

DEVELOPMENT OF INTERNATIONAL BANKING: IMPROVING PERSPECTIVES IN UZBEKISTAN

Farrukh Akhmedov

Banking and Finance Academy, Republic of Uzbekistan

farruh_15@rambler.ru

Abstract

This paper discusses the recent developments of international banking, its main tendencies and in this context, highlights the key developments of the banking system of Uzbekistan. Major players of the system such as the role of the central banks' of resident countries while granting foreign banks to establish their first offices in a foreign country is discussed within different angles. Movement and currency exchange related issues as well as establishment of strong foreign banking experiences have taken the central focus of research subject. Also, the policy and structure of banking perspectives are stated as an outcome of study. In conclusion, obtained features make analyses of banking system in Uzbekistan while showing both outcomes and shortcomings as whole.

Keywords: International banking, exchange rates, risks, money market, capital market

INTRODUCTION

For the last two decades, the main trend in the development of the world economy was the rapid development of global financial markets and the emergence of new financial instruments, which unequivocally had an immense effect on the dynamic development of the banking businesses too (Abdukarimov B.A, 2013). Currently, banking is a highly dynamic activity which is able to absorb all the latest technology applied in international financial transactions and is constantly in the spotlight of the media as a result of the functioning of the foreign exchange, money and capital markets. Share of international banks played the major role in the growth of this sector by expanding the number of services they provide (Beatty & Ritter, 1986). Without them, foreign trade companies could not have been expanded their activities with timely inflow

of money and other resources offered by international banks. Banks not only facilitate the movement of existing enterprise resource flows, but also assist and provide debt financing in local and international markets (Akimov & Dollery, 2009). In order to establish foreign banking institution in US the Federal Reserve's approval must be obtained first. Furthermore, foreign banks should acquire approval from the OCC or the state banking supervisor when establishing new branches and agencies (Berger & Humphrey, 1991). Although branches and agencies have no capital of their own, those that are federally licensed must deposit cash or eligible securities at approved depository banks to satisfy the "capital equivalency requirement" specified by the International Banking Act. Development of banking conglomerates merging wide range of services within an institution raised the interest of Holthausen and Rande (2004), whose findings suggest that current regulatory framework may fail due to different interests of participants (Abdullaev, De Fraiture, Giordano, Yakubov, & Rasulov, 2009; Akimov & Dollery, 2009).

Legislation of the Republic of Uzbekistan prohibits the opening a branch of foreign banks, it only permits the foreign banks to establish their representative offices and participate with foreign capitals in the system. The requirement for a minimum allowed capital of the bank with foreign share is set at 5 million euros or higher than the Uzbek banks' requirements. Extending on the above comparative analysis of developed countries' banking system here we aim to analyze the current state of banking of the republic and develop recommendations for its further improvement.

International banking is a system of methods and approaches used in the organization and management of banking operations, which are carried out in the international economic and legal environment. Banks that are referred to handle international operations are called subjects of this marketplace. As per Arteaga et al. (2007) banks monitor the business sectors of the economy by pricing and providing liquidity into the system (Calhoun, 2013; Ferrier & Lovell, 1990). Economists along with historians bring forward three waves of internationalization of banking activities which goes back to early 19th century when JP Morgan, Lehman Brothers and Goldman Sachs were underwriting securities. Consequently, this led to vast development of banking activities in late 80's and eventually covered entire developing countries in the new millennia.

As a comparison of dynamics, in 1960 only eight US banks had branches in other countries, and their total assets amounted to less than \$ 4 billion. In early 2000 more than 80 US banks had foreign branches, while their total assets exceed \$ 700 billion (Haupt, 1999). The rise of European and Japanese economies and the gradual loss of the leading positions of the USA on the world stage, as well as a return to convertibility of the leading industrialized

countries' currencies, international banking business have acquired a new development. Although it is worth noting that post crisis period allowed the expansion of new credit institutions in this market (Worthington and Welch, 2011). At the beginning of sixties in England large network of branches of foreign banks were operating, with main objectives which were meeting the needs of branches of foreign corporate clients of their country, taking part in operations in the foreign exchange market and participating in operations in the sterling market (Beatty & Ritter, 1986; Boot, 2000). The improvement of the external economic environment, namely, growth of international trade served as the main catalyst for the development of institutions with activities such as currency conversion, taking deposits and granting loans in foreign currency, international payments and wiring etc.

Galema et al. (2013) develops interesting framework by looking at marginal costs of setting up lending operations through foreign affiliates of banks in the example of German banks.

BANKING LEGISLATION SYSTEMS IN UZBEKISTAN

At the beginning of the new millennium, the process of globalization of financial markets, which is to strengthen their role in the movement of financial resources between countries, accompanied by the growth of the international network of financial institutions and the emergence of qualitative changes in their governance structure and management philosophy. For instance, in September 9, 2002 world global system of interbank payments was introduced in the currency market. The central role in this latest system is given to specially created New York City bank's "continuously linked settlement", with co-founders of 36 leading banks in the world. The new center settlement areas linked seven central banks, the US Federal Reserve, European Central Bank, Bank of Tokyo and Bank of England. Such a system reduced time for payments for transactions of purchase and sale of currency of up to five hours. It also changed the traditional currency trading scheme in the world market, for which all payment transaction agreements with other countries currency required almost two days for the mediation of the correspondent bank. Under this prism, the studies of Wood (2014) are noteworthy to consider where he delves into legal development of banking sector in the future. Other side of the coin - providing secure online banking services (Moscato et al. 2012) with the development of technology, nowadays becomes major concern in a competitive environment while developing "security policy" within banks.

From aforementioned we may say that development strategy of international banks highlights the trend similarity with development of national banks. The main difference of the banking strategy clearly expressed in financial transactions. Thus, international banks

contributed to the rapid financial and economic development of developing countries through efficient allocation of resources and the transfer of modern banking technology and expertise. These changes are becoming significantly noticeable in the banking sector of Uzbekistan, which we will discuss in the following paragraphs.

According to estimates of national experts (this assessment is based on the ratio of the volume of assets of banks and other financial institutions), the share of the banking market in the financial market is not less than 90 per cent, which shows its high importance for the economy of the country. Here we will look at the national banking legislation in terms of the modes of supply of financial services from foreign banking institutions.

One of the leaders of foreign operations among commercial banks in the country is the National Bank for Foreign Economic Activity of Uzbekistan (NBU Uzbekistan.). It became one of the largest channels of financing of the economy with private sector projects due to foreign loans attracted. Within the credit lines of the EBRD, ADB, the KWF, the IFC, and others export credit agencies; looking at figures from year 2015, the National Bank has financed 141 investment projects in the sphere of small business in the total amount of \$442.9 million. While noting the positive aspects of this trend, it must be emphasized though, that foreign credit lines are crafted by intergovernmental agreements, and the merit of the other Uzbek banks in this endeavor is small.

The next most influential institution for the banking system of Uzbekistan is the ADB. Within the framework of the established benchmarks to attract ADB investments in the financial and banking sector, the Open Joint Stock Innovation Commercial Bank "IpakYuli" achieved significant results for the implementation of ADB projects aimed at the expansion of capital base of commercial banks of Uzbekistan. On August 7, 2012 The Investment Committee, ADB approved the proposed investment in the authorized capital of the Bank "IpakYuli". As a result of this transaction, it is expected that the ADB will become one of the major shareholders of the Bank IpakYoli.

With regards to foreign currency operations Law "On Currency Regulation" opening of legal and individual residents' accounts abroad is allowed for the period of their stay or work in foreign countries, after which an account is required to be closed and the balances shall be transferred to authorized banks. Moving foreign currency in cash outside the country by non-residents are allowed within the amount of bringing in or legally authorized sources of its acquisition in Uzbekistan, for residents without restrictions up to 5000 dollars, if funds exceed the specified amount, letter of permission by Central Bank and from authorized banks is required to move foreign currency abroad. Moving the currency by payment cards, circulating in foreign countries is not limited.

Preference is given to non-resident banks, short-term classification of which are A1 (or A +) rated on the classification of IBCA, Moody's or Standard & Poor. The authorized capital of non-resident bank, wants to open subsidiary bank or participate in the capital of a bank within the territory of Uzbekistan must not be less than \$30mln. Banks operating in the Republic are required to obtain prior authorization from the Central Bank to increase their authorized capital by contributions from non-residents, as well as the sale of shares of the bank and the bank's pre-emptive right to acquire the shares in favor of non-residents. It is forbidden to participate in the bank's capital with legal entities registered in offshore zones.

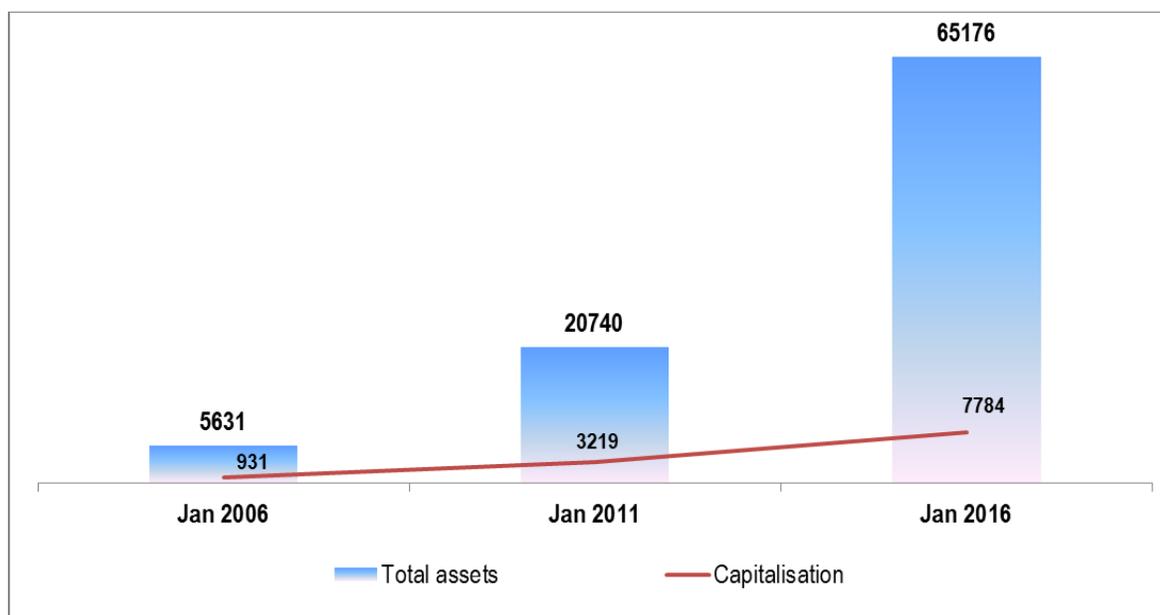
DEVELOPMENT OF INTERNATIONAL BANKING: IMPROVING PERSPECTIVES IN UZBEKISTAN

During last several years of reforms, with aim of achieving the objectives on integration of commercial banks of Uzbekistan in the international financial markets following measures were carried out among which creating a legal base for moving out and functioning of commercial banks of Uzbekistan in the international financial markets. According to the article 17 of the Law "On Banks and Banking Activity" from April 25, 1996 commercial banks of Uzbekistan are allowed to establish foreign banking structures is worth noting. Also, most commercial banks of Uzbekistan are currently equipped with necessary IT platforms, means of communication and modern systems of mutual settlements, allowing for international transactions in the global financial markets. Almost all commercial banks of Uzbekistan now have correspondent relations with leading European banks. In conditions of good equipment of domestic banks the necessary communications equipment, the main task for them is to mobilize the large available funds in foreign currency for transactions in the Forex market. The ability to generate income in the currency market is based on the fact that exchange rates do not stand still, and every day they create large swings in price movements. Since the main purpose of the operations in this market is speculation on the course change, for big profit should trade at a fairly large amount. On the other hand, Forex market dynamic enough and the formation of exchange rates affect many factors which predict, is virtually impossible. In this regard, the presence of highly skilled professionals and analysts with knowledge of the trends and patterns of the international currency market as well as greater freedom for the Bank in the currency markets is a necessary condition for entry and the start of Uzbek banks in this market.

During 2006-2016, banking system of Uzbekistan has achieved significant positive growth with the aggregate bank capital increasing by 8 times, and the asset growth showing 11 fold increases (see Chart 1). Also, important steps were taken in achieving the recognition of

international rating agencies. Twenty-six commercial banks of the country have positive "stable" ratings of the rating agencies Moody's, S & P and Fitch Ratings.

Chart 1. Total assets and capitalization growth of commercial banks of the Republic of Uzbekistan (in billion soums)



Source: <http://www.cbu.uz/uzc/monetarnaya-politika/doklad-o-monetarnoy-politike/>

These results will undoubtedly contribute to the safe integration of banks in the international banking system and the positive impact on improving the competitiveness of domestic producers on world markets. However, there are some issues preventing them attaining these goals with efficiency which could help to yield the highest positive impact:

1. The absence of the sovereign rating. In most cases, the assessment will also improve if the country has a sovereign rating. In addition, the sovereign rating will facilitate the effective integration of the domestic financial market to other countries, obtaining and placing debt instruments involve a more comfortable environment in foreign currency borrowing, expansion of investment opportunities.
2. Limitation of banks to establish correspondent relations. One of the necessary conditions for the Bank of currency transactions is the existence of wide correspondence relations with foreign banks. Also, include operations conducted on these accounts for almost 60% are banking, i.e. operation on trade finance, in particular for the opening of a documentary letters of credit.
3. Lack of liquidity in the domestic foreign exchange market. At the same time in the regulations governing this question is registered only period for consideration of applications in the

authorized banks (3 days), but there is no deadline to meet applications filed at the currency exchange, in connection with which an application may be granted both in 1 day, and through year or longer.

4. Low level of development of international currency transactions. To ensure the successful integration of the banking system in the world banking system and access to international financial markets require liquid foreign exchange market.

CONCLUSION

To strengthen the processes of international integration of banks and increase their role in ensuring the competitiveness of the country, we conclude and offer following measures. First of all, expansion of correspondent relations. What's more, policy measures on the expansion of correspondence relations which should include a strategic marketing study to determine the cost-effectiveness of the accounting operations. Moreover, releasing the foreign currency deposits from mandatory reserve. The experience of countries with developed banking system shows that deposits in foreign currency are not valid order of reservation. These measures are aimed to integrate into the international financial market and creating Eurocurrency markets. Besides, expansion of urgent exchange transactions. In the current economic conditions, commercial banks of the republic should actively develop and offer customers those banking products, which are widely used throughout the world. Furthermore, it is necessary to remove the role controlling function from the banks. It is known that banks play a key role in the economy, which is growing more and more in the period of economic reforms. Since banks serve as an account for economic entities, they hold important information about the execution of payments and transactions carried out by companies, which is considered confidential.

REFERENCES

Abdukarimov B.A. (2013). Trade economics.

Abdullaev, I., De Fraiture, C., Giordano, M., Yakubov, M., & Rasulov, A. (2009). Agricultural water use and trade in Uzbekistan: situation and potential impacts of market liberalization. *Water Resources Development*, 25(1), 47–63.

Akimov, A., & Dollery, B. (2009). Financial development policies in Uzbekistan: an analysis of achievements and failures. *Economic Change and Restructuring*, 42(4), 293–318.

Beatty, R. P., & Ritter, J. R. (1986). Investment banking, reputation, and the underpricing of initial public offerings. *Journal of Financial Economics*, 15(1), 213–232.

Berger, A. N., & Humphrey, D. B. (1991). The dominance of inefficiencies over scale and product mix economies in banking. *Journal of Monetary Economics*, 28(1), 117–148.

Boot, A. W. (2000). Relationship banking: What do we know? *Journal of Financial Intermediation*, 9(1), 7–25.

Calhoun, C. (2013). Human Rights Society of Uzbekistan. Globalization. Retrieved from <http://en.hrsu.org/archives/1819>

Ferrier, G. D., & Lovell, C. K. (1990). Measuring cost efficiency in banking: econometric and linear programming evidence. *Journal of Econometrics*, 46(1), 229–245.

Arteaga-Ortiz J., Arbelaez H. and Jeffus W. (2007) “Cross-Border Investment in the Latin American Banking Sector”, *Value Creation in Multinational Enterprise International Finance Review*, No.7, pp.419-438.

Galema R., Koetter M., Liesegang C. (2013) “Cost leadership and bank internationalization”, *Deutsche Bundesbank discussion paper*, No.57, pp.12-15.

Holthausen C. and Rande R. (2004) “Cooperation in International banking supervision”, *ECB Working paper series*, No.316, pp.34.

Haupt James V. (1999) “International activities of US banks and in US banking markets”, *Federal Reserve bulletin*, September, pp.599-614.

Moscato D. and Altschuller S. (2012) “International perceptions of online banking Security concerns”, *Journal of Communications of the IIMA*, vol.12 (3), pp. 51-64.

Wood P. (2014) “The future of international banking and financial law and lawyers”, *Singapore Journal of legal studies*, pp.355-376.

Worthington S. and Welch P. (2011) “Banking without the banks”, *International Journal of Bank Marketing*, 29(2), pp.190-201.