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## **BANK ASSETS: THEIR ESSENCE AND THE SPECIFIC FEATURES OF EFFECTIVE ASSET MANAGEMENT**

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### **Abstract**

This article examines the nature of bank assets and the distinctive aspects of their effective management. It explores the theoretical foundations of bank asset and liability management and analyzes the practices employed by commercial banks in managing their cash assets. Based on the findings of the research, a comprehensive conclusion is drawn.

**Keywords:** Commercial banks, assets, liabilities, liquidity, interest rate, bank balance sheet, cash assets, nostro

### **Introduction**

In the context of reforming and transforming the banking system of the Republic of Uzbekistan, priority tasks have been identified, including the privatization of banks, the sale of state-owned shares in commercial banks to foreign investors, and the introduction of modern banking services. According to Presidential Decree No. DP-5992 of May 12, 2020, “On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020–2025,” major commercial banks have lagged behind in transformation processes required by modern industry standards, particularly in implementing corporate governance standards, information technology solutions, asset and liability management practices, and modern customer relationship management methods. This indicates the existence of significant challenges facing the banking sector.

Furthermore, the introduction of modern information technologies into banking operations contributes to the development of digital banking services by expanding the availability and scope of remote banking services, including contactless payment systems. In addition, the decree assigns the task of conducting an inventory of assets owned by state-participated banks, identifying



***Modern American Journal of Business,  
Economics, and Entrepreneurship***

**ISSN (E):** 3067-7203

**Volume** 2, Issue 5, May, 2026

**Website:** [usajournals.org](http://usajournals.org)

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non-core assets, and taking measures for their disposal. This necessitates the implementation of effective mechanisms for managing bank assets.

### **Literature review**

It is appropriate to review the research conducted by domestic and foreign economists on the management of bank assets in order to reveal the content of bank assets and manage them through optimization, and to increase the efficiency of bank activities.

Research on the management of assets and asset portfolios of commercial banks has been widely studied by foreign economists and is being conducted today. The famous American economist D. Sinki, in his work “Financial Management in a Commercial Bank and in the Financial Services Industry”, discussed the management of assets and liabilities of banks in three stages. In particular:

Stage 1, management of general bank assets;

Stage 2, refinement, i.e. management of bank liquidity, loan management and other asset portfolio management;

Stage 3, management of bank activity efficiency based on achieved financial results.[3]

According to the scientist, the income-generating assets of banks, excluding the “concrete and glass” (i.e., fixed assets such as bank buildings), are of great importance in ALM (Asset and Liability Management). In asset management in banks, the categories of assets, quantity, and interest rate are important as the basis for asset and liability management.[3]

In asset management, banks use various measures and methods to form a portfolio of assets resulting from active operations of a commercial bank. Asset management in banking originated in the 1960s in the United States and initially involved managing the level of risk associated with changes in interest rates.[4]

Until this period, commercial banks used certain instruments of asset and liability management or certain operations. However, today, changes in the banking system, the increasing intensity of the banking services market, and the development of information technologies have led to the need for asset management in banks to ensure a balance between high income and risk.

The well-known economist P. Rose further explains the essence of asset and liability management of banks, stating that “the essence of asset and liability management is the formulation of a strategy and implementation of measures to ensure that the composition of the bank’s balance sheet is consistent with the bank’s strategic programs.”[5] In addition, P. Rose emphasizes the need to



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ensure the goals of using bank assets and the liquidity of the bank for its existence. Banks are required not only to fulfill their obligations to customers, but also to ensure high profits and achieve important goals for bank shareholders by increasing the bank's profitability.

### **Analaysis and results**

According to the Regulation "On the Classification of Asset Quality in Commercial Banks and the Procedure for the Formation and Use of Reserves to Cover Potential Losses on Assets," approved by Resolution No. 14/5 of the Board of the Central Bank of the Republic of Uzbekistan on June 13, 2015, and registered by the Ministry of Justice of the Republic of Uzbekistan under No. 2696 on July 14, 2015, bank assets are defined as credits, microloans, overdrafts, leasing and factoring transactions, securities, investments, funds placed with other banks, accrued and/or uncollected interest-bearing and non-interest income receivables, other assets owned by the bank, assets sold on an installment basis, off-balance-sheet items (including irrevocable credit commitments, unused credit lines, letters of credit, and guarantees), as well as other assets and off-balance-sheet items exposed to credit risk.[2]

Internal regulatory documents play a crucial role in the management of assets within commercial banks. In banking practice, asset management is governed by a set of internal regulatory documents, including policies, regulations, and procedures. These documents are developed and implemented in accordance with applicable legislation and the regulatory requirements established by the Central Bank.

The following internal documents are commonly used in commercial banks for asset management purposes:

- Asset and Liability Management (ALM) Policy;
- Liquidity Management Policy;
- Credit Policy;
- Investment Policy;
- Interest Rate Policy;
- Regulation on the Asset and Liability Management Committee (ALCO).

Today, these internal regulatory documents have been developed and implemented by most commercial banks and are widely used in the management of bank assets. A brief overview of their significance in asset management is provided below.



*Modern American Journal of Business,  
Economics, and Entrepreneurship*

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The Asset and Liability Management Policy serves as a conceptual framework and represents one of the most important internal regulatory documents governing a bank's operations. It forms the basis for the development of other internal policies and procedures. Through this policy, the bank establishes a comprehensive asset and liability management system.

Asset and liability management involves implementing measures aimed at aligning the structure of a bank's assets and liabilities, together with the associated risks, with the bank's strategic objectives. It also seeks to maintain the bank's margin at an appropriate level. The primary objective of the Asset and Liability Management Policy is to ensure sustainable and growing profitability while maintaining a high level of liquidity and keeping risks within acceptable limits.

In commercial banks, asset and liability management must strike a balance among three key objectives: the safety, liquidity, and profitability of the bank's financial resources. The fundamental goal of asset and liability management is to maximize profitability while minimizing the level of risk.

The regulation also provides a detailed classification of bank assets according to the structure of a bank's balance sheet.

Commercial banks' cash assets include cash held in their vaults, funds maintained in their Nostro correspondent accounts with the Central Bank, balances in Nostro correspondent accounts with other banks, and cash in the process of collection.

Among a commercial bank's assets, cash assets rank first in terms of liquidity. However, they do not generate income. Therefore, banks must maintain an optimal level of cash assets that ensures sufficient liquidity without significantly reducing the profitability of their asset portfolio.

In our view, the main characteristics of commercial banks' cash assets are as follows:

a) Cash assets possess a very high degree of liquidity but a relatively low level of profitability.

Cash held in commercial banks' vaults is generally regarded in international banking practice as a non-earning asset. Similarly, balances maintained in commercial banks' Nostro correspondent accounts with the Central Bank do not generate income, as central banks in most countries do not pay interest on such balances.

In addition, balances in commercial banks' Nostro correspondent accounts with other banks create significant costs, since correspondent banks charge fees for



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maintaining these accounts. As for funds in the process of collection, their profitability is also very low due to the relatively small commission fees earned from collection services.

b) In countries with underdeveloped financial markets, cash assets represent the only asset group capable of ensuring the liquidity of commercial banks' balance sheets.

In many developing countries, financial markets remain weakly developed, which negatively affects banks' ability to manage liquidity. For example, the underdevelopment of securities markets limits commercial banks' opportunities to allocate a portion of their assets to highly liquid securities investments, which are commonly used as liquidity management instruments in more advanced financial systems.

c) Cash assets are highly sensitive to changes in economic conditions and developments within financial markets.

Deterioration in a country's economic environment or the emergence of an economic crisis typically leads to a sharp increase in demand for liquid assets. As a result, the share of cash assets in commercial banks' balance sheets tends to fluctuate significantly and may often become insufficient to meet liquidity needs.

Moreover, the depreciation of the national currency increases the nominal value of balances held in foreign-currency Nostro accounts while reducing the real value of balances denominated in the domestic currency. Consequently, the ability of cash assets to support the liquidity of commercial banks' balance sheets may decline.

The establishment and implementation of an effective asset and liability management system in banks makes it possible to ensure:

- an optimal asset structure that maximizes income while maintaining risk at an acceptable level;
- an optimal liability structure that minimizes the cost of attracting funding sources for bank assets;
- the maximization of the net interest margin through increased net interest income.

At the same time, the contemporary body of scientific knowledge concerning bank asset management does not yet provide comprehensive answers to a number of important issues and requires further clarification and development. In particular, there remains a need for additional research into the theoretical foundations and practical application of commercial bank asset management.



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Addressing these unresolved issues is essential for enhancing the effectiveness of asset management practices. Furthermore, improving the management of income-generating assets is a key prerequisite for increasing the overall efficiency and profitability of commercial banks.

### **Conclusion**

Based on the definitions discussed above, it can be concluded that the effective management of bank assets is the process of forming and managing the structure of a bank's balance sheet in a manner that ensures the achievement of the objectives and strategies of financial management. Bank assets constitute one of the primary resources of a commercial bank, and their effective management plays a crucial role in maintaining the bank's financial stability, operational efficiency, and profitability.

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