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RISK-BASED SUPERVISION IN IMPROVING THE RISK MANAGEMENT SYSTEM OF COMMERCIAL BANKS: THE EXPERIENCE OF EUROPEAN COUNTRIES

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Abstract. This paper analyses risk-based supervision (RBS) — one of the most effective directions for improving the risk management system of commercial banks — drawing on the experience of European countries. It examines the Supervisory Review and Evaluation Process (SREP) applied by the Single Supervisory Mechanism (SSM) and the European Banking Authority (EBA), the principle of proportionality, the risk-profile matrix, and the CRR3/CRD6 package implementing the Basel III standards. Using the Risk-Based Supervision Manual (RBS Manual) introduced by the Central Bank of Uzbekistan as a case study, the paper assesses national practice and proposes ways to align it with international standards. The findings provide a scientific and practical basis for ensuring the financial stability of commercial banks and for improving the supervisory system.

Keywords: risk-based supervision, prudential supervision, risk management, SREP, EBA, Basel III, CRR3/CRD6, risk profile, proportionality, capital adequacy, early supervisory intervention, financial stability.

Introduction.

Commercial banks are one of the financial pillars of the economy, and their stable functioning determines the reliability of the entire financial system. In recent years, volatility in global financial markets, the rise of credit and liquidity risks, and digitalisation processes have placed new demands on banks’ risk management systems and on the supervisory approach of regulators. Traditional methods — supervising all banks with the same intensity — are proving unsustainable under conditions of limited supervisory resources.

For this reason, in European countries **risk-based supervision** (RBS) has become the modern paradigm of banking supervision. Its essence is to allocate supervisory resources in line with a bank’s risk profile and systemic relevance — that is, to direct greater supervisory attention to banks with higher risk and greater systemic importance. Following the recommendations of the IMF and World Bank FSAP programme, the Central Bank of the Republic of Uzbekistan is also gradually transitioning to risk-based supervision and has developed a manual (RBS Manual) governing this approach.

This paper analyses the core elements of risk-based supervision based on the experience of European countries and considers ways to apply them to improving the risk management system of commercial banks in Uzbekistan.

The essence of the risk-based supervisory approach.

Risk-based supervision is a systematic approach aimed at identifying, assessing and mitigating risks under conditions of limited supervisory resources. On this basis, the supervisor builds a **risk profile** for each bank: the bank’s inherent risks, the quality of its risk management, corporate governance, capital, earnings and liquidity are continuously assessed. The results are recorded in the form of a **risk matrix** and a narrative, which together produce the bank’s overall rating.

The second key pillar of the approach is the principle of **proportionality**: supervisory practices and intensity are commensurate with a bank’s systemic relevance and risk profile, operationalised through the Supervisory Engagement Model (SEM). However, proportionality does not mean relaxing

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prudential standards for small banks; rather, it means balancing the costs and benefits of supervisory activities — financial stability must not be compromised under any circumstances.

The experience of European countries.

In the European Union, banking supervision is carried out within the Single Supervisory Mechanism (SSM) by the European Central Bank together with national supervisory authorities. The central instrument is the **Supervisory Review and Evaluation Process** (SREP), which, based on EBA guidelines, assesses banks' business models, corporate governance, capital and liquidity risks using a single methodology.

Within SREP, a **Pillar 2 Requirement** (P2R) is set for each bank — a bank-specific capital requirement applied in addition to the uniform Pillar 1 requirements. Banks, in turn, must independently assess their risks through the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). In 2025 the ECB simplified its P2R methodology, linking it directly to each risk driver, while the EBA's revised SREP guidelines will apply from 1 January 2027.

European supervision rests on the Basel III standards. The **CRR3 Regulation and the CRD6 Directive**, which implement Basel III in the European Union, were published in the Official Journal on 19 June 2024. The CRR3 requirements began to apply from 1 January 2025, while CRD6 must be transposed into national law by Member States by 10 January 2026. This package strengthens the "output floor" in capital calculation, updated approaches to credit, market and operational risk, and early supervisory intervention tools.

As shown in Figure 1, risk-based supervision forms a continuous cycle of five interconnected elements: risk-profile assessment, the proportional supervisory model, the SREP review, capital and liquidity requirements, and the early supervisory intervention mechanism. Each of these elements has been tested in European banking supervision and is also reflected in Uzbekistan's RBS Manual.

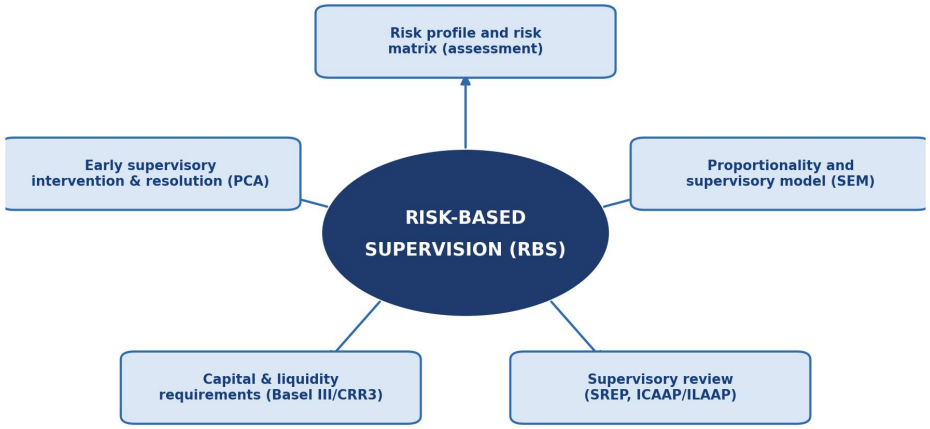


Figure 1. Core elements of the risk-based supervision (RBS) approach

Source: compiled by the author based on EBA and the RBS Manual.

Uzbekistan's practice and analysis.

The Central Bank of Uzbekistan is introducing a Risk-Based Supervision Manual (RBS Manual) developed in line with European practice. The manual establishes a single methodology for assessing a bank's risk profile, determining systemic relevance, the supervisory model (SEM), early supervisory intervention, and credit, market, operational, interest-rate (IRRBB) and liquidity risks, as well as

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corporate governance. This is an important step in bringing the national supervisory system closer to international standards.

Practical indicators also show a positive trend. According to Central Bank data, during 2025 the share of non-performing loans (NPL) in the banking system fell from 4.0% to 3.0%, while the credit portfolio grew by 13.3% to 604 trillion soums. The NPL share fell from 3.9% to 3.2% in state banks and from 4.1% to 2.6% in private banks. Nevertheless, Fitch Ratings warns that the share of loans overdue by more than 90 days in state banks could rise to 9–10% in 2026 — underlining once again the importance of early risk identification and proactive supervision.

The analysis shows that the following problems exist in improving the risk management and supervisory system of commercial banks in Uzbekistan:

➢ the risk-profile matrix and the principle of proportionality are not yet fully implemented in supervisory practice, with assessment still relying largely on formal prudential norms;

➢ banks' ICAAP/ILAAP processes are only beginning to take shape, and the culture of internal capital and liquidity assessment is insufficiently developed;

➢ early supervisory intervention (Prompt Corrective Action) and resolution mechanisms are not fully developed in regulatory terms;

➢ the high share of state banks and portfolio concentration increase systemic risks;

➢ there is a shortage of digital tools and qualified staff for supervision and risk assessment.

To address these problems, drawing on European experience, the following are proposed: the gradual introduction of a single, risk-based assessment methodology similar to SREP; making ICAAP/ILAAP processes a mandatory requirement for banks; applying a proportional supervisory model (SEM) based on the risk profile; strengthening early warning systems (EWS) and early supervisory intervention mechanisms; and upgrading the qualifications of supervisory staff in Basel III, CRR3/CRD6 and EBA standards.

Conclusion.

Risk-based supervision has proven itself in European countries as the most effective institutional instrument for improving the risk management system of commercial banks. SREP, the principle of proportionality, the risk-profile matrix and the Basel III (CRR3/CRD6) standards make it possible to direct supervisory resources to the highest risks and to safeguard banks' financial stability in advance. Uzbekistan's introduction of the RBS Manual and the improvement of NPL indicators are steps in the right direction. Adapting European experience to national conditions — strengthening the SREP methodology, ICAAP/ILAAP, proportional supervision and early intervention mechanisms — is an important factor ensuring the stable development not only of individual banks but of the entire national financial system.

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