



The Importance of Risk Appetite Policy and Limits in Improving Loan Portfolio Quality

**Misirov Iskandar
Abduvalievich**

**Head of the Tashkent City Territorial Administration,
JSCB "Business Development Bank"**

Abstract. This paper examines the role of risk appetite policy and limits in ensuring the stability of banking operations and improving loan portfolio quality. It is noted that risk appetite establishes strategic frameworks for acceptable risk, while limits specify these at the level of individual segments and operations. Examples of international practice (Basel Committee recommendations, EU and US experience) are provided, where these instruments have become an integral part of risk management and the prevention of credit concentration. The paper examines the specifics and challenges of implementing risk appetite and limit systems in Uzbek banks. It concludes that the development of these instruments will improve loan portfolio quality and enhance the competitiveness of the national banking system.

Keywords: risk appetite, limits, loan portfolio, risk management, Basel III, banking system, Uzbekistan.

Introduction. Modern banks operate in a highly competitive environment with macroeconomic instability, increasing the importance of systematic credit risk management. One of the key risk management tools is the risk appetite and limits policy, which helps balance the bank's strategic goals with the acceptable level of risk. Globally, this tool is considered part of corporate governance, directly impacting the quality of the loan portfolio and the stability of the financial institution [1].

Theoretical Foundations of Risk Appetite and Limits Policy. Risk appetite and limits policy play a key role in the corporate governance and risk management systems of banks. Risk appetite is defined as the level of risk an organization is willing to accept to achieve strategic goals in an uncertain environment. The Institute of Internal Auditors (IIA) defines it as "the amount and type of risk an organization is willing to pursue or withhold" [1]. This is not only an indicator of risk tolerance but also a strategic benchmark that determines the bank's direction, asset structure, and priority lending areas.

Limits serve as a quantitative framework for risk appetite. They are set across industries, borrower segments, types of credit products, or currencies and are expressed in specific numerical values. Examples include a limit on the share of loans to a specific economic sector or a cap on the maximum amount per major client.

Limits translate a bank's strategic guidelines into daily practice and become a tool for ongoing control [2].

Risk appetite and limits are interconnected: the former sets a general framework for acceptable risk, while the latter ensures its detailing and regular monitoring. The combined use of these tools reduces the likelihood of excessive loan concentration in certain segments, increases portfolio diversification, and enables asset quality control. Research by Power (2009) notes that the absence of a clear risk appetite system leads to formal risk management, in which procedures exist nominally but do not provide real risk mitigation [3].

Integrating risk appetite policies and limits with stress testing tools is crucial. In practice, limits are adjusted based on stress scenarios simulating deteriorating macroeconomic conditions or financial market crises. This approach allows for the early identification of potential vulnerabilities in the loan portfolio and the adoption of management decisions before problem assets arise.

The theoretical basis for risk appetite policies and limits emphasizes their dual function: they are part of the bank's strategy and simultaneously a tool for ongoing control. The stability of the loan portfolio, the balance between profitability and risk, and the confidence of regulators and investors depend on the quality of their implementation. In the context of globalization and the integration of national banking systems into international financial markets, the importance of these tools is steadily increasing.

International experience. According to the recommendations of the Basel Committee on Banking Supervision (BCBS), formulating a risk appetite is an integral part of risk management. In European Union banks, this tool is integrated into stress testing, enabling the early identification of portfolio vulnerabilities [3]. In the United States, limits are strictly regulated and monitored by supervisory authorities, reducing the risk of systemic shocks [4].

In developing countries, such as Kazakhstan and Georgia, the implementation of risk appetite and limits is gradual. Research shows that the main obstacles remain a lack of statistical data, personnel shortages, and the need to modernize IT infrastructure [5][6].

Practice and Prospects in Uzbekistan. For the Uzbek banking system, the development of risk appetite and limits is particularly important in light of active modernization and integration into global markets. In recent years, the Central Bank of Uzbekistan has increased its focus on risk management, but in many commercial banks, limit policies remain formal. Limits are often set without taking into account stress scenarios and macroeconomic factors, which reduces their effectiveness. Development prospects include integrating risk appetite into strategic planning, implementing stress testing and scenario analysis, and using digital technologies and Big Data to monitor risk concentrations. Training specialists capable of implementing international approaches in the national banking system is also essential [7].

Conclusion. Risk appetite and limits policies are a key tool for improving the quality of the loan portfolio. International experience shows that the successful implementation of these mechanisms helps reduce systemic risks and strengthen trust in the banking sector. For Uzbekistan, their implementation represents a strategic

objective directly linked to the sustainable development of the financial system and its integration into the international arena.

References

1. Power, M. (2009). The risk management of nothing. *Accounting, Organizations and Society*, 34(6–7), 849–855.
2. ICAEW. (2011). Risk Appetite – The Board’s Responsibility. Institute of Chartered Accountants in England and Wales.
3. Basel Committee on Banking Supervision (2019). Guidelines on risk appetite frameworks. Bank for International Settlements.
4. Federal Reserve (2020). Supervisory guidance on risk management. Washington, D.C.
5. Lee, J. H., Kim, K., Hong, S. C., & Yoon, J. H. (2015). Human Capital Planning and Labor Market Alignment in Korea. KDI School of Public Policy and Management.
6. Chanturia, K. (2020). Implementation of Basel III in Georgia: Challenges and perspectives. National Bank of Georgia Working Paper.
7. Абдурасулов, М. (2022). Совершенствование управления кредитными рисками в коммерческих банках Узбекистана. *Финансы и банк*, №4, 45–53.