

## WAYS TO DIVERSIFY AND IMPROVE THE SECURITIES PORTFOLIO OF COMMERCIAL BANKS.

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**Abstract.** *This article provides information on ways to diversify the securities portfolio of commercial banks and improve it.*

**Keywords:** *stock market, financial market, issuer, investor, investment organization.*

In the conditions of the current global economic crisis, the banking system of Uzbekistan is improving the banking services provided and actively working on restructuring of assets allocated to various district banking operations related to the support of enterprises of the real sector of the economy. At present, commercial banks pay special attention to the issue of minimizing risks while obtaining stable high income from asset operations. The existence of the country's stock market is one of the priorities of modern financial market development. The reason for banks' active participation in the stock market is the existence of a number of favorable conditions for their activities in the securities market.

For example, the laws and regulations governing banks' activities do not contain any restrictions on performing any functions in the securities market. Thus, banks can operate as an issuer, investor and investment organization. Stable financial condition of banks and high level of profitability of banking operations allow banks to allocate large volumes of resources to securities operations. Decreasing profitability of traditional banking operations makes banks to work more actively on other alternative sources of income. Banks, possessing extensive information on financial and economic activities of their clients, are not only large issuers, but also large investors. Banks actively use their potential as a direct participant of the securities market and at the same time as an important auxiliary institution of the stock market infrastructure, which creates favorable conditions for the development of securities trading in general. The need for banks to attract additional resources to





their authorized and circulating capital by issuing their own securities is one of the most important factors of banks' activation in the securities market.<sup>25</sup>

Diversifying the securities portfolio of commercial banks is essential for managing risk, maximizing returns, and ensuring financial stability. However, several challenges may hinder the effective diversification of these portfolios: **Limited Availability of Diverse Securities:** In some markets, there may be a limited range of securities available for investment, particularly in emerging or less developed markets. Commercial banks may struggle to find a variety of high-quality securities to include in their portfolios, limiting their ability to diversify effectively.


**Liquidity Concerns:** Certain securities, especially those with longer maturities or limited trading activity, may lack liquidity. Illiquid securities can be challenging to buy or sell in the secondary market, making it difficult for banks to adjust their portfolios quickly in response to changing market conditions. **Credit Quality and Default Risk:** Diversifying into lower-rated or riskier securities can increase a bank's exposure to credit risk and the potential for default. Assessing the credit quality of various securities and managing default risk requires sophisticated risk management capabilities and may deter banks from diversifying into certain asset classes.

**Regulatory Constraints:** Regulatory requirements may impose limits or restrictions on the types of securities commercial banks can hold in their portfolios. Banks must comply with regulatory guidelines governing capital adequacy, liquidity, and risk management, which can constrain their ability to diversify into certain securities. **Market Volatility and Correlation:** In times of market volatility, correlations between different securities may increase, reducing the effectiveness of diversification. Events such as economic downturns or financial crises can lead to widespread market disruptions, causing correlations to converge and undermining the benefits of diversification. **Complexity and Monitoring Challenges:** Managing a diversified securities portfolio requires ongoing monitoring, analysis, and rebalancing to ensure alignment with investment objectives and risk tolerance. The complexity of managing diverse securities, combined with the need for continuous oversight, can strain banks' resources and expertise. **Yield Considerations:** Securities with higher yields may offer attractive returns but may also come with elevated risks. Balancing the pursuit of higher yields with the need to manage risk effectively poses a challenge for banks seeking to diversify their portfolios while maintaining profitability.

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<sup>25</sup> <https://www.nbu.uz/uz/corporate-business/securities/>





**Market Access and Infrastructure:** Access to diverse securities markets and infrastructure, including trading platforms, clearing and settlement systems, and custody services, can vary across regions and jurisdictions. Banks operating in markets with limited infrastructure may face obstacles in diversifying their portfolios internationally. Addressing these challenges requires a comprehensive approach to risk management, investment strategy, and regulatory compliance. Commercial banks must carefully assess the trade-offs between risk and return when diversifying their securities portfolios and develop robust processes for monitoring and adjusting their investments over time. Collaboration with regulators, industry partners, and investment professionals can also help banks navigate the complexities of diversification effectively.

Diversifying and enhancing the securities portfolio of commercial banks is essential for managing risk, optimizing returns, and ensuring long-term financial stability. Here are several strategies banks can employ to achieve these objectives:

**Asset Allocation:** Develop a well-thought-out asset allocation strategy that aligns with the bank's risk tolerance, investment objectives, and regulatory requirements. Allocate investments across different asset classes such as equities, fixed income securities, real estate, and alternative investments based on their risk-return profiles.


**Diversification Across Asset Classes:** Spread investments across a diverse range of asset classes to reduce concentration risk and enhance portfolio resilience. By diversifying across asset classes, banks can mitigate the impact of adverse market movements in any single asset class on the overall portfolio performance.

**Geographic Diversification:** Invest in securities from various geographic regions to mitigate country-specific risks and capitalize on global growth opportunities. Geographic diversification enables banks to benefit from economic cycles in different regions and reduces exposure to localized political and economic events.

**Sectoral Diversification:** Allocate investments across multiple industry sectors to reduce sector-specific risks and capture opportunities for growth in different segments of the economy. Sectoral diversification helps banks avoid overexposure to industries that may underperform and enhances the resilience of the portfolio.

**Credit Quality and Maturity Diversification:** Diversify the fixed income portion of the portfolio by investing in securities with varying credit qualities and maturities. Spread investments across a range of credit ratings to minimize credit risk, and diversify maturities to manage interest rate risk effectively.





**Active Portfolio Management:** Implement an active portfolio management approach to regularly review and rebalance the portfolio based on changing market conditions, economic outlook, and investment objectives. Monitor the performance of individual securities and asset classes closely and make adjustments as needed to optimize portfolio returns. **Risk Management Strategies:** Employ risk management strategies such as hedging, derivatives, and other risk mitigation techniques to protect the portfolio against adverse market movements and unforeseen events. Implement robust risk management frameworks to identify, assess, and manage various types of risks effectively.

**Research and Due Diligence:** Conduct thorough research and due diligence on potential investment opportunities to identify high-quality securities that align with the bank's investment criteria and objectives. Evaluate factors such as financial performance, valuation, growth prospects, and regulatory compliance before making investment decisions.

**Collaboration and Partnerships:** Collaborate with external asset managers, investment advisors, and research providers to access specialized expertise, insights, and investment opportunities. Partnering with reputable financial institutions and investment professionals can help banks enhance their investment capabilities and broaden their access to diverse investment opportunities. By implementing these strategies thoughtfully and consistently, commercial banks can diversify and enhance their securities portfolios, optimize returns, and mitigate risks effectively.

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