

## Topical Issues of Improvement of Banking System and Legislation in Uzbekistan



Prof. Dr Said Gulyamov<sup>1</sup>, Prof. Dr Islambek Rustambekov<sup>2</sup>, Dr Shokhjahan Khujayev<sup>3</sup>

<sup>1</sup>Professor of Private International Law Department at Tashkent State University of Law, Uzbekistan

<sup>2</sup>Professor of Private International Law Department at Tashkent State University of Law, Uzbekistan

<sup>3</sup>Head of Intellectual Property Law Department at Tashkent State University of Law, Uzbekistan

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**ABSTRACT:** Banks and banking systems are among the most important mechanisms in the development of a country's economy and the creation of favourable conditions for doing business. The internationalization of the banking business poses new challenges for the scientific community to find optimal solutions that reduce banking risks, strengthen national banking systems and improve banking technologies. Accordingly, today it is important to strengthen the banking system and its legal regulation in Uzbekistan. In this regard, it is important to analyse the development of the domestic banking system, including in terms of its legal support.

This article investigates the banking system, bank services and their regulation in Uzbekistan, where the role of foreign banks is not sufficiently regulated and is not attractive for foreign banks. This study identifies the problems of further improvement and liberalization of banking legislation. The focus is on the lack of banking practices and legislation, and on the introduction of new foreign banks in the domestic banking services market. However, the development of the country's economy and the involvement of foreign direct investments are impossible without a strong banking services market.

It is noted that one of the important conditions for the development of a banking system in Uzbekistan is the formation of an effective mechanism of state regulation and improvement of legislation directed at creating favourable conditions for foreign banks to enter Uzbekistan's domestic market.

The article examines the implementation of international best practices in state regulation of the banking system and banking services that will serve to modernize the system of banking services, attract foreign investment in the banking sector, and harmonize banking legislation.

**KEYWORDS:** banking system, banking legislation and regulations, foreign banks, Uzbekistan

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**JEL Classification** G20, G21, G28, K10

### INTRODUCTION

The development of international economic and trade relations generates a rapid inflow of financial funds and monetary capital. Banks have an essential role in this process, and they are the driving mechanism of a country's economy. Commercial banks are the stimulating agents of a market economy and active participants in investment projects. In this connection, the number of banks around the world is growing, while their activities are not limited by one country. According to statistics, there are currently 5,256 banks in the USA, 798 in China, 622 in the Russian Federation, 301 in the United Kingdom, and 247 in Switzerland (<https://myfin.by>). As of 2020, 30 banks are operating in Uzbekistan, of which 13 are under state ownership and 17 are private, whereas the share of state ownership in assets and equity of banks amounts to 86%.

Drastic economic and political reforms implemented in the independent Uzbekistan are directed at the construction of a new economic model, the foundation of which could include not only a multitude of ownership forms, competition, deregulation and equality, but also a modern banking system. In this context, measures to improve and strengthen the banking system are being undertaken in the Republic of Uzbekistan. The Strategy of Actions on five priority directions of development of the Republic of Uzbekistan for 2017-2021 includes such matters as "deepening of reforms and ensuring sustainability of the banking system, levels of capitalization and deposit base of banks, strengthening their financial stability and reliability, further expansion of lending to promising investment projects as well as small and medium business entities." Therefore, research is crucial in the area of banking operations, lending issues, and the role of the banking system in implementation of significant investment projects .

A particularly important element of the new economy is the market, which, combined with state regulation, will become an active instrument facilitating effective activity of all participants of social production. To make it happen, it is necessary to attract

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additional monetary funds through, among other things, development of credit institutions. These processes require due legal support.

The strong demand for loans in modern business practices, as well as a need for efficient banking mechanisms, makes the legal regulatory system of the banking sector highly relevant.

It should, however, be recognized that the national regulatory and legal framework for banking operations still does not meet those requirements posed by current economic realities. It is mainly oriented toward establishing rules for accounting and reporting rather than issues related to performing operations on provided services.

Today, there is a need to develop a single concept of legislative regulation of banks' operations in Uzbekistan and to shape priority directions for improvement of their activities.

### LITERATURE REVIEW

The idea of universal banking activity has been developing in parallel with banking specialization. That is the regular pattern of global banking community development. It is generally assumed that specialization helps banks increase the quality of client servicing and reduce costs of banking products. The idea of specialization is more common for US banks (Lavrushina, 1998).

World experience shows that banks can develop with respect to both versatility and specialization. In both cases banks can earn good profits and only clients can answer which line of development will be more advantageous.

Expanding the commercial banking network and granting licenses enabling banks to carry out settlements on export and import operations instigates a necessity not only to increase the level of banking automation, but also to develop communication networks in the Republic of Uzbekistan and a connection to global telecommunication networks. This task is being solved both independently at the regional level and by way of connection to the largest communication network in the world provided by the Society for Worldwide Interbank Financial Telecommunication (SWIFT).

This addresses the challenge of developing prompt, reliable, effective, confidential and secure telecommunication servicing for banks and standardizing forms and methods of financial information exchange.

The process of forming a wide range of services to offer banking clients has been underway in recent years. The execution of various banking operations is an essential feature of modern-day banking activity in all countries with developed banking systems. Leading commercial banks in Uzbekistan strive to carry out a broad range of operations and services for their clients in order to expand their revenue base and increase their rate of return and competitiveness. At the same time, it is important to consider that the development of banking activities assumes the provision of banking services with minimum costs for clients and the bank itself and the use of acceptable pricing for services required by clients.

Along with performing conventional banking services for the public – attracting cash deposits, providing loans and conducting cash management and payment servicing – modern banking institutions in our country are starting to carry out online services and perform marketing research at clients' request, foreign currency operations, information and inquiry advisory, operations with securities, etc.

According to Lexis V., banking services exhibit a number of common properties:

- cannot be carried out for future use;
- are of a productive nature;
- capital serves as the object of banking services;
- cover active and passive operations;
- are not provided solely by banks;
- may be classified as non-banking operations (Lexis V., 2000).

The restructuring of the economic mechanism, orientation of the national economic strategy toward market relations, and a focus on expanding the diversity of ownership forms gave rise to a need for new, modern-day banking practice financial instruments – securities in the form of shares, bonds, promissory notes, etc. – as well as an active securities market. Securities are monetary and commodity documents with a common property – they must be presented in order for the rights expressed in them to be exercised. Securities such as government and regional bonds, shares, promissory notes, savings and certificates of deposit, cash and prize lottery tickets are functioning at present in our country.

Banking operations with securities are divided into active and passive operations. In turn, active operations of banks with securities can be provisionally divided into two major groups: accounting and lending operations and investment operations. The first group comprises operations on accounting of promissory notes, providing loans against promissory notes and commodity documents, mortgage loans, and loans against securities. The second group of active operations with securities consists of arbitrage operations of banks at own cost with the aim of making a profit due to the exchange rate difference.

At present, over 200 countries are developing banking services on the basis of credit cards, and non-cash payments for goods and services in the majority of countries are reaching 90% in the structure of all monetary operations.

A plastic bank card represents a personalized medium of payment issued by a bank and verifying the account of the card holder in that bank. It gives the card holder the right to purchase goods, works, and services without cash payment.

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The following operations can be carried out using credit cards: purchase of goods, payment for services, receipt of cash funds in the form of a loan or prepayment from any member bank of the system within which this type of card operates. The majority of credit cards can also be used for cash withdrawals from ATMs (autobanks) both inside the country and abroad in establishments of banks that participate in the relevant system for using credit cards. One of the services provided by credit cards is free travel accident insurance. When paying for a trip with a credit card, its holder will be automatically insured against accidental damage, injury or death. Compensation is guaranteed to the card holder, and in the event of the card holder's death – to their spouse and dependent children.

Credit cards are used in non-cash settlements between natural persons, legal entities or private entrepreneurs on the one hand, and by legal entities or private entrepreneurs selling their products, performing work or services (hereinafter – trade or service companies) on the other, as well as for withdrawal of cash from cash dispensing offices (CDO) and ATMs.

Authorized banks can issue and service international credit cards; in doing so they are guided by the rules for conducting operations as stipulated in agreements concluded with international payment systems and the laws of the Republic of Uzbekistan.

Historically, banks are most sensitive to the development of information technologies. Changes occurring at the “bank - client” level can be characterized as follows: from bank cards (1969 – emergence of cards with a magnetic strip) to a teletext system (beginning of the 1980s) and other methods of remote management of a bank account (home banking) (Elinor Harris Solomon, 1987) to Internet/online banking and eventually Internet banks in their pure form (Security First Network Bank, Wingspan Bank, Juniper, CompuBank, etc.), which use only online channels for servicing clients (Gracheva, 2001).

The number of Internet users receiving banking services continues to grow rapidly and this growth, according to the majority of analysts, will increase even more in the future. According to a report published by the marketing company Cyber Dialogue in May of 1999, 24.4 million Internet users in the USA would be using online banking services by 2002 (their number amounted to 6.9 million at the end of 1998 - <http://www.cyberdialogue.com>).

Online banking is most commonly used in the USA (<http://www.bankir.ru>), where almost every large bank and a multitude of medium and small banks offer their clients remote account management services via the Internet. According to the marketing service Qualisteam, the distribution of Internet banks by region is as follows: Africa – 23, North America – 1395 (Canada – 32, USA – 1363), Latin America – 258, Asia – 174, Europe – 1205 (Germany – 355, France – 172, Italy – 228, other European countries – 450), and Asia-Pacific region – 32. In total, according to self-reported estimates of Qualisteam, almost 95% of Internet banks around the world are included here (3,107 websites - <http://www.qualisteam.com>).

The market for online banking applications (<http://www.idc.com>) is also developing and such applications are attractive for banks aiming to increase their profits through new clients (particularly remote clients). According to IDC, the sales volume of online banking applications in the USA amounted to \$93 million in 1998. Growth of sales of this software up to \$326 million was expected in 1999. Such strong growth of the online banking apps market can be explained by the ever increasing presence of the Internet in all life spheres. This urges banks to start competing for clients in the open-for-all environment. Thus, increasing numbers of banks are offering Internet banking services to their clients (Glinskikh A., 2000).

As noted by Glinskikh, the development of Internet banking will go through three main stages. The first stage provides for client access to bank accounts and the ability to conduct operations by telephone or online. Interactive technologies such as online bill payment and personalized reminders of the client's account status are used during the second stage. Personal finance management functions such as receiving credits, implementing secure trade transactions and formalizing insurance policies are offered at the third stage.

Solonin B. specifies that the provision of services by banks through remote management of accounts via the Internet shall be referred to as online banking – Internet banking (available at <http://www.bankir.ru/>).

Internet banking described by Petrov S. as a prototype of an online bank, i.e. a new interactive technology that allows clients to be served without their physical presence (available at <http://www.bankir.ru/>).

In fact, Internet banking is a logical extension of such forms of remote banking as PC banking (using a personal computer to access an account via a modem connection with the banking network), telephone banking (servicing of accounts via telephone) and video banking (interactive communication between client and bank personnel).

The above types of banking are combined under the term “electronic banking services”. This is the most commonly used term in the literature and it characterizes all forms of access to the relevant banking services (Birkelbach, 1998). Electronic banking services is understood as being a collection of technological procedures and contractual conditions ensuring implementation of bank operations and other transactions by electronic means (Litvinenko A., 2000).

Despite the extensive use of Internet banking and the range of offered services, the majority of authors believe that Internet banking is not a separate service, but rather a continuation of normal banking services, albeit in a different environment (Gracheva, 2001).

Speaking of the objectives of regulating relations arising in connection with the use of IT by banks when performing banking operations, the need to minimize risk by creating a consequence predictability scenario for rights and obligations of parties should be pointed out. Another objective of regulation is protection of the rights of consumers of banking services. This is equally

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important since the full-scale development of retail banking products is impossible without consumers' trust, the basis for which lies in legislation. (The first classic example of this type of protection is the US Electronic Fund Transfer Act, 1978. *ibid.*)

Understanding regulatory objectives is important for adequate consideration of mass application specifics of IT in the course of performing licensing and banking supervision functions on the part of central banks.

There are still very few examples of national approaches reflecting the views of central banks on the requirements for founders of an Internet bank, but we can speak about two main strategies through the example of the USA and Hong Kong.

The specifics of licensing an Internet bank's activities (referred to as "virtual banks") in Hong Kong are legally outlined in the document of the Hong Kong Monetary Authority as of 5 May 2000 – "Authorization of virtual banks".

A virtual bank is defined as a company providing banking services primarily, if not completely, via the Internet or other electronic channels. The following is announced as a common principle: The Monetary Authority will permit creation of virtual banks in Hong Kong under the condition that they will comply with criteria of prudential supervision and meet general criteria of licensing.

With regard to banking supervision, a separate direction is being formed in the activities of central banks and other supervisory authorities: control over the functioning of information banking systems, ensuring information security and risk management tools are used in the process of providing electronic banking services (Rud'ko-Silivanov V.V., Afanas'ev A.A., 2001).

With respect to regulation of banking relations in the Republic of Uzbekistan, it is important to underline the fact that the domestic banking system went through the way of development including in terms of its legal support. Taking into account the extraterritorial character of information technologies and the dynamics of computerization processes, it is necessary to provide an appropriate and effective legal basis in the banking sphere. It should be noted that the lawmakers undertook separate efforts of legal regulation of analysed legal matters.

It is required to mobilize the legislative process to the maximum extent in order to optimize legal support of the mentioned processes. These measures will allow significant easing of the implementation of the digital economy in the transition to open market relations and of the integration of the national economic system in the global reengineering processes of the economic relations system. Therefore, improvement of the legal regulation of the newest banking services by implementing innovations and up-to-date information and communication technologies is a high priority.

Everyone knows that one of the main factors of successful banking activity today is consistent implementation of innovations using information technologies. Scientific and technological progress is still associated with the concepts of innovation, strengthening of competition and active application of the newest information technologies, urging commercial banks to change their approach to organization and development of their activities. Implementation of technological, financial and organizational innovations offers an opportunity to remain competitive against the background of the dynamically changing reality. Banking creates a breeding ground for implementation of new information technologies. Thanks to that, at present, banks are offering quite a broad range of services under the common term "remote banking servicing". Internet banking and mobile banking are considered the most successful examples in this respect. A number of banks in Uzbekistan provide such high-demand services not only to legal entities but also to natural persons. As of the end of 2019, the number of remote banking services users exceeded seven million. Consequently, the solid functioning of this system requires construction of a legal mechanism. In our opinion, the time has come for creation of a specialized legal and regulatory document in the area of banking services. The resolution of the Cabinet of Ministers of the Republic of Uzbekistan "On approval of rules for provision of banking services in the Republic of Uzbekistan" could serve as such a document to provide specific procedures for performance of banking services, approval of the banking service register, creation of a unified interbank information system on banking services, reviewing client requests regarding banking services, and ensuring protection of the rights and legal interests of banking service consumers and other important issues.

### GENERALIZATION OF THE MAIN STATEMENTS

This study analysed banking legislation and statistical data on the development of a range of banking services.

Based on the analysis of the legal literature in the previous part of this article, we can distinguish different points of view on the concept, status, and ways to improve the activities of commercial banks, which are conventionally grouped into three categories:

#### *Corporate approach.*

This approach is the most common (S. S. Gulyamov, L. G. Efimova, S. S. Zankovsky, M. N. Ilyushina, Geoffrey Yeowart, Robin Parsons, Edward Murray, Hamish Patrick, Iris H.-Y. Chiu, Michael McKee, Anna P. Donovan, Rod Edmunds, Andreas Kokkinis, John Lowry, Marc T. Moore, Arad Reisberg) and provides for the consideration of commercial banks as a joint-stock company – a commercial legal entity. Proponents of this approach define banks as a special type of joint-stock company with specific participation of national or foreign capital. The advantage of this approach is a detailed discussion of the activities of commercial banks (especially foreign ones) as enterprises with an effective corporate governance system.

Within the framework of this approach, the authors identify the following ways to improve banking legislation:

- improved efficiency of corporate governance in commercial banks;

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- improved legislation regarding joint-stock companies;
- regulation of the relationship between banks and the Central Bank (banking supervision authority).

### *Transnational approach.*

This approach is followed by Dragomir Larisa, Joseph L. Abraham, V. I. Smagina, E. Yu. Gracheva, V. V. Yershov, N. Yu. Erpyleva, etc. According to this approach, commercial banks, in particular foreign banks, are considered transnational corporations. In accordance with the transnational approach, foreign banks are considered a complex or group of legal entities – a foreign bank and its subsidiary bank in a foreign country.

This approach provides for the following ways to improve banking legislation:

- regulation of the activities of transnational banks and banking unions;
- regulation of banks' relations with the states in which they operate;
- determination of the laws applicable to the activities of transnational banks.

### *Investment approach.*

According to this approach (B. B. Samarkhodjaev, R. Z. Yusupov, E. A. Karagulyan, S. Y. Saab, J. Vacher), banks are considered through the prism of investment legislation. The participation of foreign banks in the national banking sector should be considered a form of investment. The investment approach involves considering a commercial bank as a bank whose authorized capital is the object of investment. Commercial banks, by creating a subsidiary bank or a bank with foreign capital, act as an investment entity. Thus, a commercial bank is both an object and a subject of investment relations. This approach is very promising and can be applied in the future, as it more closely reflects the civil status of commercial banks, especially foreign banks.

In this article, emphasis was placed on analysis of the following aspects of the improvement and harmonization of banking legislation:

- problems in the interaction of the banking system subjects of the Republic of Uzbekistan;
- improvement of the legal status of foreign banks in the Republic of Uzbekistan.

This article analyses the statistical data of the banking sector of developed countries, in particular the countries of Central Europe, which in the 1990s had the same economic development results as Uzbekistan. This ensures that growth rates are acceptable for Uzbekistan.

## 3. DISCUSSION

### *Problems in the interaction of banking system subjects in the Republic of Uzbekistan*

Comprehensive research into banking legislation requires consideration of the legal situation of banking system subjects in order to identify existing problems between those subjects. After all, the rational and effective use of any system depends on the condition of its components.

For a precise definition of the circle of subjects, it should be determined what a banking system is. We understand a banking system to be a multitude of different kinds of banks and banking institutions existing in one or another country in one or another period of time.

Article 124 of the Constitution of the Republic of Uzbekistan specifies that the banking system of the Republic of Uzbekistan is governed by the Central Bank of the Republic. Therefore, the Central Bank of the Republic of Uzbekistan is a major element of the two-tier banking system, which consists of the Central Bank and commercial banks and other credit institutions, the establishment of which is not prohibited by law.

In market economy conditions, the banking system acts as a driving gear of the national economy – it provides for accumulation of free monetary funds of natural persons and legal entities and their re-distribution, and carries out in-country and international settlement relations between different economic entities (Tedeev A.A., Parygina V.A., 2006).

Banking system represents a complex legal phenomenon consisting of credit institutions united by the system of contractual and other legal relations, riddled with functions of control and oversight, backed by own reserves and possessing qualities that differ from qualities of its participants.

Relationships between participants of the banking system develop in two directions:

- between the Central Bank of the Republic of Uzbekistan and other participants (first of all, banks and credit institutions);
- between banks and credit institutions.

Therefore, problems arise from the relationship between the Central Bank of the Republic of Uzbekistan and other participants and relations between the credit institutions themselves.

Banks, by nature of their operation, are concurrently subjects of public-legal and private-legal relationships. The special status of the Central Bank lies in the fact that, being predominantly a subject of special public-legal relationships, it ensures control of private and legal relations developing between commercial banks and their clients.

The Central Bank of the Republic of Uzbekistan also has a dual nature. On the one hand, it is a specialized government authority implementing management of the monetary and credit system, and on the other hand it is a legal entity and can carry out civil-legal transactions with Uzbek and foreign credit institutions, as well as with the state, in the person of the Government of the

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Republic of Uzbekistan.

The Central Bank of the Republic of Uzbekistan shall be viewed as a special subject type, which can be provisionally defined as a legal entity under public law, and its status is unveiled through unity of such criteria as the centre of a banking system, a government authority of monetary policy and a counterparty of the state, as well as a bank.

Legal regulation of the Central Bank is mainly based on the Law of the Republic of Uzbekistan “On the Central Bank of the Republic of Uzbekistan”.

The Central Bank is a legal entity incurring its expenses at the cost of own revenues and is exclusively owned by the government.

The point of contact between the interests of the state and the banks is the independence of banks in their relations with the Central Bank. The banks’ economic independence is an important component of the legal framework. Thus, article 1 of the Civil Code of the Republic of Uzbekistan stipulates that civil legislation is based on the recognition of the equality of participants in the relations regulated by it, the inviolability of property, freedom of contract, the inadmissibility of arbitrary interference in private affairs, the need for the unhindered exercise of civil rights, ensuring the restoration of violated rights, and their judicial protection. Legal entities, including banks, acquire and exercise their civil rights by their own will and in their own interest. They are free to establish their rights and obligations on the basis of the agreement and to determine any terms of the agreement that do not contradict the law. Banking services move freely throughout the territory of the Republic of Uzbekistan. Therefore, independence is the main principle of banking activity

If the governments of the world ignore the independence of banks in this matter and apply restrictive measures to them, it can lead to the aggravation of banks’ financial difficulties. At the same time, the issue of independence requires the introduction of a judicial procedure for applying restrictive measures against commercial banks. This procedure will protect banks, including foreign banks, from the subjective mistakes of officials that can, on formal grounds, without taking into account the essence of what is happening, destroy the banking business. In any case, the process of legal proceedings provides the parties (in this case, the bank) with the most complete protection mechanism. In turn, article 10 of the Civil Code of the Republic of Uzbekistan proclaims judicial protection of civil rights. At the same time, banking is a business activity, i.e. the exercise of civil rights.

The legislative concept of a bank is defined as a legal entity, a commercial organization carrying out the opening and maintaining of bank accounts, making payments, attracting cash funds in deposits, providing loans on its own behalf; these are specified as banking activities.

Commercial banks as subjects of the banking activity possess two types of competence – general and specialized. As carriers of a specialized competence they are subject to additional state control.

Own equity and attracted funds comprise the property base for banking activities of commercial banks, whereas the term “attracted funds” assumes formation of a new legal title that simultaneously fixes the rights of different subjects with regard to the same property; thereby a bank activities are commercial and generating income from attracted funds and the client retains the right of disposal, the right for the income, the right to capital value, etc.

Banks are established, as a rule, in the form of a joint-stock company according to the Civil Code and the Law of the Republic of Uzbekistan “On banks and banking activities”. Subject to sources of authorized capital formation, banks are grouped into the following categories: a non-resident bank, a bank with participation of foreign capital, a private bank, or a subsidiary bank.

Branch offices of foreign banks cannot carry out their operations within the territory of the Republic of Uzbekistan as this provision is specified in the Civil Code of the Republic of Uzbekistan (Art. 47). Consequently, branch offices are not legal entities and obtaining a license for banking activities is legal only in accordance with the procedure established in the Republic of Uzbekistan. Two sides can be distinguished in this case: (1) protection of interests of local banks that are not able to compete with global banking giants, and (2) absence of a deep experience and receiving banking services at the world level.

Implementation of banking operations, performing banking activities, making certain banking transactions includes the receipt, storage and use of information, as a rule, with high economic and other value. Maintaining bank secrecy in the applicable legislation of the Republic of Uzbekistan is governed by provisions of three legal acts: Art. 36 of the Constitution of the Republic of Uzbekistan, Art. 786 of the Civil Code of the Republic of Uzbekistan and Art. 38 of the Law of the Republic of Uzbekistan “On bank secrecy”.

According to Art. 36 of the Constitution of the Republic of Uzbekistan, secrecy of bank deposits is guaranteed by law. As per Part 1, Art. 786 of the Civil Code of the Republic of Uzbekistan, a bank guarantees the secrecy of a bank account and deposit, account operations and client data.

For one part, bank secrecy protects clients’ interests and prohibits, as a general rule, access by third parties (including access by the government in the person of state authorities) to confidential information of a bank’s client. For the other part, governing legal relations associated with bank secrecy stipulate, at the legislative level, exceptional instances and procedures of such access in the interest of the state.

Providing information without the client’s consent and delimitation of subjects entitled to receive banking information assumes breaking the limits of banking and professional systems and granting the right to separate subjects to receive banking

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information on the state of affairs of a bank's clients without their consent. Competences of some government authorities include the right to demand information from different economic entities, including banks. However, information on a bank's activity regarding client accounts has additional protection in the form of bank secrecy that means that such data can be presented to law enforcement authorities only in cases of initiation of a criminal case, passing of a sentence or court judgment or any other judgments testifying that the case is part of judicial proceedings of a given authority.

### *Improvement of the legal status of foreign banks in the Republic of Uzbekistan*

One of the essential issues in the development of the banking sector is improvement of the legal status of foreign banks in the Republic of Uzbekistan. As of today, 30 banks are operating in the Republic of Uzbekistan, seven of which participate with foreign capital: JSCB Savdogar, JSCB Hamkorbank, JSC KDB Bank Uzbekistan, JSC Ziraat Bank Uzbekistan, a subsidiary of the bank Saderat Iran in Tashkent, Tenge Bank, and the digital bank JSCB TBC Bank. Banking legislation has a number of challenges in the regulation of activities of foreign banks.

The first of these challenges is the incomplete definition of the term "foreign banks" in the banking legislation. According to the Law of the Republic of Uzbekistan "On banks and banking activities", a foreign bank is defined as a legal entity, which is a bank based on legislation of the foreign country where it is registered. However, in subordinate legal acts this definition experiences unjustified modification. In particular, the regulation on registration and licensing of bank activities applies two terms – "subsidiary bank of a foreign bank" and "a bank with participation of foreign capital", where the latter does not fall within the legal concept of foreign banks. In turn, the regulation on the procedure for accreditation of representative offices of banks of foreign countries in the territory of the Republic of Uzbekistan defines a foreign bank as a bank registered and located in the territory of a foreign country and having a license entitling it to conduct banking operations issued by the banking supervision authority at the place of registration. As we can see, different definitions of the term "foreign banks" were used in all mentioned legal and regulatory acts. Based on the meaning and objectives of foreign banks' activities, the most reasonable option seems to be to make a provision in the banking legislation for a norm that provides for a form of participation of foreign banks in the country's banking system.

The second challenge is the complexity of the requirements for the establishment of foreign banks and accreditation of their branches. To establish a foreign bank, in addition to the general requirements it is also mandatory that the applying foreign bank has been operating in its own country for at least five years, and that it has a solid reputation and stable financial position with short-term obligations rated at least A1 (or A+) as per the classification of credit rating agencies IBCA, Moody's or Standard and Poor's. Similar requirements are set for accreditation of representative offices of foreign banks. Accreditation is given for a period of no more than three years. These strict requirements, even if they arise from the need to maintain competitiveness of local banks and stability of the national banking system, to a certain extent prevent an increase in the share of financing by foreign banks, attracting foreign investments and development of the banking sector in general. In our opinion, in the course of establishing foreign banks, accreditation time should be extended and granting preference should be provided for with respect to those banks that already have accredited representative offices in the territory of the Republic of Uzbekistan or that have participated in the authorized capital of local banks.

Extension of the accreditation time of a representative office is based on the survey results of employees working in banks of the Republic of Uzbekistan in the course of thesis work (thesis work is attached). In addition, in accordance with the Decree of the President of the Republic of Uzbekistan dd. 1<sup>st</sup> August 2018 #UP-5495 "On measures for radical improvement of the investment climate in the Republic of Uzbekistan" the procedure for accreditation and activities of representative offices of foreign commercial organizations in the territory of the Republic of Uzbekistan are improved, which included the extension of the accreditation time up to five years and reduction of fees for accreditation by three times.

To address these challenges, it is required to fundamentally revise the provisions of the banking legislation of the Republic of Uzbekistan regarding the activities of foreign banks.

The next key issue is to review the matter of *permission for foreign banks to open branch offices*. According to the Law of the Republic of Uzbekistan "On banks and banking activities", establishment of branch offices by foreign banks in the Republic of Uzbekistan is not allowed. It should be noted that a branch has broader authorities than a representative office. Thus, a bank's branch office is a separate business unit performing banking activity on behalf of the bank that established the branch. A representative office of a foreign bank is a separate business unit representing its interests but not performing banking operations.

The prohibition of the opening of branch offices by foreign banks is substantiated mainly by two reasons:

1. to maintain competitiveness of national banks and demonstration of protectionism;
2. the risk of problems with conflict-of-laws regulation (jurisdiction of the founding state).

It is hard to agree with these arguments. The establishment of branch offices does not violate the competitive environment and rather encourages better provision of banking services. Competitive positions of a bank (i.e. its ability to retain and increase its market share) are determined by a range of factors: quality of promoted bank products and services in the market, appeal of price conditions of banking operations, ability of the bank to increase its volume of operations in response to expansion of the market demand, and the degree of confidence toward a bank on the part of market participants.

It should be noted that globalization processes taking place from the beginning of the 21st century induce mobility of

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foreign bank capital and its movement to new markets, above all to the banking sector of developing countries. Namely, financial liberalization was the result of effective activities of foreign banks and increased foreign capital that allowed the opening of branches of foreign banks and provided an opportunity for transformation of resident banks into foreign banks in some countries. Statistics show that the percentage of banking assets that belong to foreign banks in certain Central European countries, e.g. Slovakia, increased from 24.10% at the end of the 1990s to 95.96% in the beginning of the 2000s, and Poland saw an increase from 17.4% to 70.9% of the total assets of commercial banks (Tulin D.V., 2006).

From an economic point of view, operations of foreign banks' branches have a number of positive aspects:

- foreign banks are the most stable in crisis situations. According to statistics for 2016-2018, assets of foreign banks in the Russian Federation such as Raiffeisenbank, Rosbank, and Citibank have increased by more than 25%, while the indicators of national banks have been increasing at lower rates (5% or 10%) (available at <http://www.banki.ru/>);

- foreign banks are the most competitive in terms of enhancing the quality of services and reduction of their costs, therefore they ensure the greatest realization of banking interests of natural persons and legal entities and improve the efficiency of the banking system. As the experience of countries such as Croatia, Slovakia, Slovenia and the Czech Republic shows, an increase in the share of foreign banks was accompanied by the growth of the banks' efficiency (including on matters of bank deposits) by one and a half times and twice in general (L.G. Efimova, 2016).

- foreign banks lower loan restrictions for users. Statistics show that loans of more than USD 1 million are provided by Sumitomo Mitsui Banking Corporation (Japan), Vneshekonombank (Russia), Aktif Bank (Turkey) and others.

- activities of foreign banks are accompanied by improved risk management systems and introduction of innovative financial instruments and corporate bank management methods.

Consequently, the economic component of the permission to open foreign banks branches represents the most favourable condition for development of the banking sector of a country.

It is also debatable that a branch office will be under the jurisdiction of the state where the bank was established. Performing activities in the territory of the Republic of Uzbekistan, foreign banks in terms of contractual relations will be mainly applying the principle of conflict of law of the place of contract (*lex loci contractus*) and will be burdened by legislative requirements regarding the quality of banking services.

## CONCLUSION

The role of banks in the modern-day stage of market transformation of Uzbekistan's economy has sharply increased. On the one hand, they are actively facilitating progress toward a market economy, and on the other hand, they help its most important sectors achieve economic progress. Despite inflation, commercial banks are beginning to finance industrial and agricultural production, trade, and small and medium businesses.

Banking activity is the most distinctive indicator of a financial system's condition, the movement of cash flows, the level of settlement operations, the level of protection of depositors' interests, and the stability of the financial market.

In a market economy, the all-encompassing increase of investment activity and rational use of its financial potential plays a crucial role.

The key role is assigned to the banking sector in developing countries, including Uzbekistan. The largest part of all financial assets is accounted for by this sector in our country. Accordingly, commercial banks are basically the only functional financial institutions on the credit and deposit markets in Uzbekistan.

Taking this into account, a practically monopolistic position in the financial sector requires enhanced guarantees from the banking system of Uzbekistan both in the sphere of immediate functioning and in the area of protection of rights and legal interests of banking service users.

At present, work is being carried out in Uzbekistan to improve the regulatory and legal base governing the financial service market, including banking activities.

Nevertheless, despite certain positive results, the system of banking settlements and payments does not fully meet the current requirements. It is fairly hard, due to bureaucracy and sometimes corruption and high interest rates, to obtain required loans, especially investment loans, from commercial banks. This can be also explained by the lack of competition in the credit market. Most regrettably, banks have not yet become real partners and assistants for companies and entrepreneurs.

Correspondingly, in our opinion, we can point out the following as the main reasons for poor development of the banking sector in Uzbekistan:

- imperfection of the applicable legislation;
- poor application of advantages of modern market instruments;
- inertness and redundant conservatism of banking organizations;
- limited influence of self-regulating institutions in this sphere;
- existence of a number of limitations on the part of state control of credit operations, represented in certain cases by unjustified government interventions in the market processes.



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In other words, the banking system of Uzbekistan as of today does not yet fully meet the requirements set by the market economy system. Taking into account the dominant position of banks and, as a result, the absence of competition in the financial and credit sector, such factors as high interest rates, banking bureaucracy and difficulties in ensuring communication inside the banking system significantly hamper the formation of a well-adjusted system of banking relations.

From our standpoint, the concept of legal regulation of the banking sector should be revised toward further liberalization that corresponds to the need for development of a market economy and fits well in the general direction of reforms aimed at liberalization of economic and political processes. It appears that the principle of diversification of forms and mechanisms of banking services such as factoring, forfeiting, clearing, mortgage lending, operations in the securities market, etc. shall be laid in the foundation of the legislative concept of pledge regulation.

As we know, banking legislation consists of multiple regulatory and legal acts, the majority of which are departmental rules and regulations (board resolutions of the Central Bank of the Republic of Uzbekistan). Over the years of independence, banking legislation has undergone many significant changes. Thus far, the Law of the Republic of Uzbekistan “On banks and banking activities” has been passed in three revisions. However, a number of issues remain unregulated. Banking legislation should be specific and effective, as the reflection of numerous issues in subordinate acts disrupts the efficiency of banking legislation provisions. It is necessary to revise the excessive rule-making activity of the Central Bank of the Republic of Uzbekistan and clearly indicate the limits of regulation in accordance with the concept of improving the law-making activity approved by the Decree of the President of the Republic of Uzbekistan dd. 8<sup>th</sup> August 2018 № DP–5055.

At the same time, the list of issues to be legally governed by the Central Bank of the Republic of Uzbekistan shall be specified in the legislation. To protect the rights and interests of commercial banks, in particular foreign banks, it is necessary to abandon the administrative procedure for revoking bank licenses and transfer the right to make a decision on revoking a license from the Central Bank of the Republic of Uzbekistan to the court.

We believe it is necessary to create effective and reliable legislative foundations for the extensive introduction of international standards in the area of banking operations; integration of the domestic banking sector in international settlement and clearing systems, e-commerce, as well as engagement of independent international credit agencies and research companies to the national market.

The analysis of the international experience reveals the necessity to form legal conditions for the application of promissory notes and checks for their full-scale participation in circulation, as well as to increase the level of requirements for capital adequacy required for continuation of credit institutions’ activities in the market of banking services.

It is necessary to activate cooperation of Uzbekistan with specialized international institutions in this area such as the International Monetary Fund (IMF), the Bank for International Settlements, CPSS, Basel Committee, Group of 30, etc.

We believe that the current state of affairs requires the Parliament to undertake a package of measures of adequate legal response that will allow optimization of the system of interbank relations and bring the Republic of Uzbekistan even closer to the designated objective of building a strong and modernized market economy.

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