



**Management of
Troubled Loans of Banks Operating in Palestine**

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بِسْمِ اللّٰهِ الرَّحْمٰنِ الرَّحِیْمِ

الإهداء

إلى من يعود لهم الفضل بعد الله في وجودي، أبي الذي غرس في نفسي حب العلم والفضيلة، ورباها على الأخلاق والبذل في سبيل الخيرات، وأمي التي سهرت وكدت وتعبت في رعايتي، وحممتني بحنانها وحبها، أقدم هذا العمل، وأدعو الله- أن يوزعني ان أكون قرة عين لهما، وان يعينني على ادائهما بعض حقهما علي...
الى زوجتي الغالية، التي آزرنتني وأخذت بيدي رغم الصعوبات، ودعمتني وشجعتني على خوض التجربة، وزرعت الامل والعزم في نفسي نحو النجاح...
الى احبتي وقررة عيني، رؤى وابراهيم ويوسف، الذين أثقلت عليهم، وتحملوا معي عناء التجربة، وضحوا بأوقات عزيزة على طفولتهم، عسى الله ان يعينني على إيصالهم بر الأمان ...
الى اخي واخواتي، مهبط فؤادي ومحط فخري واعتزازي ...
الى كل من لهم فضل علي، الى أساتذتي الذين دعموني واخذوا بيدي نحو العلم والمعرفة، وأعمالوني على خوض غمار هذه التجربة، وتجسيدها الى حيز الوجود ...
الى جامعة بيرزيت، التي خطت في وجداني اسطرا جميلة في قصة الحياة....

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Abstract

Palestinian Banking Sector has its own unique peculiarities due to the natures of hardships and intricacies it is facing. It has to maneuver unlimited numbers of barriers .The turbulent political circumstances , the immature legal infrastructure, and the questionable administrative approaches operating in Palestine have burdened all aspects of our domestic life including the banking sector. After being enchanted by the illusive progress in the peace process in the mid nineties of the last century, banks began to ease their conditions and to extend their financing to different sectors in the society . No sooner had the political march been retreated than the troubled credits began to surge in uncontrolled way. Troubled credits issue is an endemic disease for which the society has paid an exorbitant price. It has its subjective and objective causes .The regulatory authorities prefer to handle the issue with high confidential approach away from the public media despite its overwhelming and pervasive impacts .

This thesis is trying to shed some light on this issue and to call for better management and more courageous confrontation especially since transparency and the right to know are both missing values .

The research was performed in accordance with the scientific research methodology applicable in similar circumstances and included literature review, structured and unstructured interviews so as to raise appropriate issues related to

the problem. The process ended with deductions to diagnose the dimensions of the crisis and to suggest certain steps necessary and relevant in the situation .

The thesis shows that a lot of works have to be performed in terms of enhancing the employees' quality of experience and knowledge ,addressing and ingraining professional policies and procedures to define the way of conduct and handling the employee has to follow , and in the way PMA is dealing with the crisis .

Chapter One

Introduction:

Banking sector is one of the leading sectors that play a key role in any economy. The ratio of banks' total credits to gross domestic products (GDP) reveals the volume of participation the banking sector contributes to the economy. Healthy dynamic and efficient banking sector provides adequate investment funds to investors. As a key ingredient of production and a medium of exchange, credit plays an essential part in the economy; it makes capital more productive, speed up the movement of goods from producer to customer, and increase the volume of goods produced and sold. Banks initially were established to serve as an intermediary between deficit units or those who want to spend more than they earn ,and surplus units or those who earn more than what they want to spend. By establishing banks, information became less costly and the degree of efficiency in the whole economy had been enhanced. Commercial banks are major ingredient of financial system which extends credits out of funds that they own, borrow, or create. Profound financial system according to Abdulkarim & Thaher (1996) has three major roles:

1. To insure stability in the money and capital markets including stability in exchange rates and inflation.
2. To intermediate efficiently between providers of and users of funds.
3. To foster the soundness of the contracts and to facilitate settling obligations.

The banking sector is more than the aggregate of banking institutions. The structure of the banking sector encompasses the forces of law and traditions that form the active framework within which banking institutions provide services to the community.

One of banks' exceptional characteristic is that the ratio of credits to deposits is usually high while the ratio of capital to total assets is low; this means that the bank is

using the resources of the depositors as a main source for its operations ,and this may cause what is called Agency Problems since those who possess the resources are different from those who manage them . In addition, and as Halm (1956) said, the most characteristic feature of commercial banks ,which distinguishes them from other private credit institutions, is their ability to create money. According to the definition of money supply(M1), money equals currency in circulation plus demand deposits which may be divided into two categories: Primary deposits or the ordinary deposits the bank gathers from public or private sectors, and derived deposits or those deposits created by banks through the process of money creation. These accounts are payable on demand and subject to transfer by check. Since they create deposit money, the commercial banks are used by central bank as tools to implement its monetary policy and as instruments to adjust the money supply and the interest rates .

The main ingredients that constitute banks' balance sheet or their financial position are the loans and investments in securities in the assets' side, and the deposits in the liabilities' side. All ingredients of the bank's balance sheet are vulnerable to fluctuation in their values as the market modifies its evaluation according to the circumstances it goes through. The amounts of assets, liabilities and capital are valued according to their economic values-the price they would be sold in a free market. So, we are dealing with economic balance sheet, not a traditional (accounting) balance sheet. If there is any risk that precludes bank from meeting the depositor's claims in full and on time, the economic value of such claims will be less than it would be if there was no such a risk. Moreover, any unpredictable changes in the borrower's financial ability may deteriorate the amount of his loan, and as a result, the market value of the loan will decrease.

Among many risks that the banking sector is vulnerable to is credit risk which arises from the potential that a borrower or a counterparty is unable or unwilling to perform on an obligation, resulting in an economic loss to the bank. Credit risk is considered as

the main ingredient of banking risks model ,it was the only risk ingredient that Basel I saliently took into consideration when it initially decided the minimum capital requirement of 8 % in the year 1988. High credit risk leads the banking sector to minimize its role in the economical development or to increase its price in terms of interest rates imposed to additional credits , this means that the whole economy will pay an exorbitant price for such an infliction .

The Palestinian Banking Sector is composed of the Palestine Monetary Authority (PMA) as a regulatory body which was established in January 1995, with a mandate to regulate the banking sector, and other member banks. Instability and future ambiguity are chronic diseases that characterize the banking sector in Palestine; the bad circumstances Palestine is going through preclude local banks from being up- to-date with the technical and operational advancements international banking industry is experiencing, exposing them to what is considered to be the ugliest and most prominent problem a banking sector may ever encounter, which is troubled credit crisis.

Loans can be perceived as formal documented credits, loans and credits usually have similar concept in practice, and they are used interchangeably in this thesis.

1.1. The Objectives and Main Questions of the Thesis:

Credits are the main source of earnings in the banking sector. Having a profound credit policy within an environment of credibility and legal integrity will be of a mutual benefit for both the banks and the society as a whole .

The main objective of this research is to explore the banking sector operating in Palestine and the main problems it is encountering .More specifically; this thesis will attempt to find out answers to the following four key questions regarding the troubled loans crisis:

1. To what extent does the issue of troubled loans affect the performance of the Palestinian Banking Sector ,and what steps does the sector take in order to manage these effects?
2. What are the main causes for aggravating the troubled loans dilemma?
3. What are the most appropriate techniques that can be taken by the Palestinian Banking Sector to mitigate the negative consequences of troubled loans taking into consideration the experiences other countries have?
4. Do the PMA and other influencing authorities in the economy play a supportive role with regard to troubled loans crisis?

1.2. The Importance of the Study:

As it is well known, the Palestinian fledgling banking sector was proliferated within a turbulent atmosphere and is facing many problems that have severely affected its chances and development. The importance of this study stems from the following:

1. Since we are living in a primitive undirected economy, it is very hard to have adequate comprehensive knowledge about any indicator or factor that may have effects upon the troubled credits. Furthermore, hardly can anybody find an article or a research that discusses in depth the real dimensions of the crisis because the Palestinian Financial Sector considers it as a confidential issue that is exclusively dealt with within very narrow channels through the inflicted banks. Lack of transparency led to a situation where every bank lonely dealt with the problem despite the fact that the problem is of a collective dimension. Disseminating sufficient well-thought-of information will lead to many productive goals ,one of which is that banks will adopt more thorough approaches in order to have a profound credit portfolio as they know that the public will have adequate disclosure about their positions and decisions. This thesis is calling for more courageous transparent confrontation by diagnosing the true factors and by taking decisive decisions.

2. This thesis is calling for integrating the efforts of the operating banks and the regulatory authorities so as to have a profound prudential and practical approaches to assist any bank in its ordeal to minimize the bad consequences of this crisis.

The thesis put forward a presumption that troubled credits crisis is not the problem of the banking sector only, virtually the whole economy is paying an exorbitant price for it .So, all playing parties including banks and the PMA must integrate their efforts and must not betray each other. The chronic problem of troubled loans ,also big and painful, needs a synergy and consolidated efforts by the banking sector as a whole .To have a well established bilateral relationship between banks and the economy ,each side must obviate what is required from the opposite side. Without this mutual understanding, both side will loose .

3. This study is aiming to shed some light on the extent of the issue and to find out an appropriate way to manage the problem and to mitigate its bad consequences taking into consideration the limitations inherent to the Palestinian economy.
4. The thesis is calling the PMA to modify its practices and to reconsider some of its decisions regarding the issue .

1.3. Limitations:

In an economy where ambiguity prevails ,it is hard for any body to have sufficient information that may facilitate his endeavor to shape a comprehensive perspective about any pivotal issue he is discussing. A lot of obstacles encountered the efforts of achieving the thesis; among other difficulties were the following:

1. **Lack of sufficient illustrative resources** :As the first step of writing a thesis is gathering information from literature reviews , it was laborious to have contemporary books about banking industry in general and about troubled credits in specific in the university or other academic centers in the area. Moreover ,the banking conduct in Palestine is based on a routine and traditional practices , academic dimension and research and development are at their minimum levels .

2. **Lack of Transparency:** Banks and PMA are merely ready to provide general and accumulated information that are not sufficient to shape a true comprehensive picture about the issue , it was difficult to find any stipulated data from any accredited party. Banks operating in Palestine usually generalize secrecy to include all aspects of their operations. In certain circumstances while convening unstructured or structured interviews, some officers were reluctant to answer certain question about their banks.
3. **The commuting difficulty** confined the sample within managements and branches in Ramalla and Al Bireh area and Nablus city. For sure ,the limited number of respondents who were chosen as a sample could only lead to a limited representative sample since many other credit officers in different places and circumstances who may have different points of view were not included . Moreover, the limited number of the applicants makes the analysis more vulnerable to discrepancies that may emerge from misunderstanding the content of any question or even from handling any question leniently.
4. **The conflict of interest** between PMA and other banks regarding the acceptable ways for dealing with troubled credits and provisions puts question marks on the accuracy of the amounts of the related accounts. Since calculating precisely the provisions for troubled credits is in a paradoxical trend with the general goal of any bank that aims to exaggerate its profits, it is not expected that data shown in the promulgated financial statements of any bank will depict the actual and true size of the troubled credits.
5. It is also well known that the computer systems used in the banks are limited with regard to their capabilities in dealing with problem loans' issues, manual follow up and other banks' criteria and discretion have a great influence on the way any bank may categorize or handle the default loans

Chapter Two

Literature Review and Historical Data

2.1. Credit Framework:

2.1.1. Credit Definitions:

Thus far, credit has become one of the key social inventions, in addition to money, that plays a major role in enhancing the ability of the economical sectors. Nearly every writer on the topic has initiated his own definition of credit. Golieb (1962) said that in his Political Economy, John Stuart Mill defined credit as the permission to use another's capital. Joseph F. Johnson, in Money and Currency, defined it as the power to obtain goods or services by giving a promise to pay at a specific date in the future.

2.1.1.1. Credit is a Medium of Exchange of Limited Acceptance :

One of the most widely quoted definition holds that credit is a present right to future payment. The word credit was derived from the Latin word, creditum, which means trust. Basing his definition on the premise of its function, Cole (1976) defined credit as a medium of exchange of limited acceptance. The widespread acceptability of credit as a medium of exchange has led many people to consider that credit in itself is wealth, but virtually the extension of credit does not result in the creation of capital; it simply transfers the means of production from one person to another, so time and risk are inherent in all credits.

Credit is not a replacement of money, but rather it can be perceived as an integration that adds more abilities to money to fulfill its main task as a medium of exchange. But the main characteristic that distinguishes it against money is that although it is issued at the time of transaction, it does not close the transaction, and there is a promise that at certain time in the future, step will be taken to redeem it by a process called payment. So the foundation of credit entails creating rights and privileges ,and the

process stream includes giving credit (instead of money) by the buyer to the seller in exchange of his good or service. And it is only after seller's acceptance of the credit, the good will be transferred to the buyer.

2.1.2. The Benefits of Credits:

There are many advantages that can be attributed to credit, one of which is that it facilitates the passage of goods or services from the seller to the buyer just as money does. Initially according to Cole (1976), the use of coin money as an alternative to a cumbersome barter system was seen as a big stride. The invention of paper money was a further improvement of the medium of exchange. The breakthrough that followed these inventions was badly influenced by some inadequacies. It was and still hazardous to carry a large amount of money while trying to buy goods or services. Moreover, each unit must allocate its consumption through time, recognizing that with given current and expected future incomes, the more we consume in one period the less can we consume in other, and there will be always men who want to consume in excess of their current incomes in order to meet their needs and wants. Other groups may be in the reverse position, their present needs may be small relative to those expected in the future while their present income may be higher. Golfeild & Chandler (1981) said that in the absence of debit or credit, exchange of present consumption against future consumption are likely to be inefficient and so limited to the extent that large potential increase in utility will fail to be utilized. Cross & Hempel (1973) said that by supplying credits to different sectors, commercial bank bridges the time lag between production and consumption and thus helps to bring the financial affairs of the economy into balance.

2.1.3. Credits categories in Local Banks:

Credits in our local banks are usually divided into two main categories:

2.1.3.1. Direct credits which include all kinds of direct facilities such as: overdraft, overdrawn, revolving credits, commercial loans, and bills discounted. Their main

accounts are included in the assets side of balance sheet. PMA pay a lot of concern to safeguard the credit portfolio in all phases , quarterly over the years, banks are required to modify the allowance for troubled credits according to the maturities of installments due.

2.1.3.1(i). Loan's Definition:

A term loan according to Shamaa'(2001) is a formal, legal commitment to lend a specific amount of money, for a particular purpose, for a stated period of time according to a predetermined schedule.

The advantages to the customer as opposed to other forms of financing include the following:

1. Unlike other forms of financing, term loans represent a legal commitment of funds and assure the firm of a credit source as long as the terms of the agreement are met.
2. Term loans can be negotiated faster ,more confidentially and at less expense than a public issue of bonds.Bonds issuance entails registration cost, issuance costs, and other costs that the public tries to avoid. The company can deal confidentially with the bank without being forced to reveal certain information to the public.
3. Loans can be tailor-made to meet the borrower's needs and are more flexible financing vehicle .If the firm's requirements change ,the term and conditions of the loan may be revised. It is more convenient to deal with a sole lender or a small group of lenders than to deal with a diverse group of public .Moreover, publicly issued bonds usually require the approval of two third of the stockholders .
4. Loans are suitable financing vehicle to meet short or medium term needs. The borrower is not constrained into long-term financing at high interest rates.

There are various types of repayment schedules according to Shamaa' (2001), these can be classified according to the following:

1. Conventional payment: payback is in equal installments over the life of the loan.
2. Moratorium: no payments are scheduled for a certain period of time – grace period- with payback in equal installments thereafter.
3. Unequal payback according to the expected cash flow of the borrower's project.
4. Balloon payback through which payments are made in small equal payments over the life of the loan with a large lump-sum payment at maturity.
5. Bullet payback or repayment in full at maturity.

2.1.3.2. Indirect credits which include contingent liabilities (obligations) against the customers such as letters of credits, letters of guarantees, and marginal accounts. Indirect credits are listed as off- balance sheet accounts in disclosures attached to the balance sheet and are not included in the balance sheet itself as a component of its credit portfolio since their likelihood of occurrence is reasonably possible and are linked with other prerequisites in the future .

2.1.4. Credit department's functions:

According to Chapin & Hassett (1960), it was until the nineties of eighteenth century that the bank credit department came into existence. The vast extinction of information and knowledge pertinent to credit process made it necessary to organize a specialized department able to implement professionally the following three tasks:

1. **Investigation and assembling** essential information from different sources internally and externally.
2. **Analysis or arrangement and interpretation** of the credit information including horizontal and vertical ratio analysis of the data from the audited financial statements .
3. **Filing or orderly putting away** of information for preservation and reference, and confining the availability of these information to insure an exclusive and

credible access for utterly authorized persons. The promissory note and the loan agreement document the terms under which the bank is granting the loan . The loan agreement is normally prepared by the bank's attorney or by the legal counselor .The terms of the loan agreement according to Chapin& Hassett (1960) are tailored to the specific situation, and they usually contain provisions under each of the following headings:

- Preamble for documenting the agreement between the parties' contract.
- Amount and terms of the loan including interest rate and installments' maturities.
- Representation and warranties provided by the borrower testifying that the financial statements on which the credit decision was made are correct and truly reflect his financial position and condition.
- Conditions of lending that articulate the situation that must be exist, the representations that must be made ,and the documents that must be delivered to the bank before providing the loan.
- Description of the collateral and how it is to be handled.
- Covenants of the loan that correlate the financial strength of the borrower and the quality of his management .If the borrower is strong, covenants will be less.
- Affirmative covenants and other obligations imposed on management, for example, that the bank will be furnished with financial statements periodically.
- Events of default :all term loans have provisions to make the entire loan immediately due and payable under certain conditions.
- Miscellaneous.

They should allow prompt and effective actions to be taken place by the bank under the event of default. Performance covenants, such as interest-coverage requirements is

critical for providing lenders with an early warning system to uncover potential problems regarding the credit. Other covenants may address particular situational concerns that the bank may have. Loan documentation also contains collateral and guarantees of legal scope. Any erroneous or mishandling may threaten the position of the bank or weaken its ability to prosecute the defaulted borrower or even to liquidate the collateral. In addition, all documents should be stored in a safe and protected place so as to prevent the possibility of alteration or robbery. As it is known, collaterals are more valuable when given, but worth substantially less when repossessed. It is a priority for any credit officer to get sure that no action that may severely affect the value of the collateral has ever happened.

In Brief, the most important function of the credit department is to properly analyze and evaluate all key factors in order to safeguard the assets and deposits of the bank and to reduce probability of default loss. It is obvious according to Chapin & Hassett(1960) that even performing conservative policies will not enable credit officer to reach the level of zero bad loans. Moreover, implementing rational criteria in collecting and analyzing information pertinent to loans' granting will lead the bank's officer to accept some of those which prove to be bad and reject some risks which are good. There is an imaginary line between the good and bad risks ,which, like the division between the true and false, is no wider than a hair. The task of credit manager is to follow this line of division which will result in maximum profit with minimum risks.

Another role through which credit department can assist in making profits is by establishing a close and friendly relationship with the borrowers through the promotion of a spirit of good will. The credit department said by Chapin & Hassett(1960) must be a business getter, it must preserve the very sensitive balance between marketing and promoting its services on one side, and protecting the interests and broad objectives of the bank on the other side ,it must not adopt the aggressive

manners that the sales department follows, but rather it must be a close friend and a credible consultant for the borrower as there is a mutual interest for both the bank and the borrower to make the project proceed successfully. To bind more closely the customers to the bank may be said to be the chief functions of credit department.

Many executives agree that the best performance can be achieved if credit departments are not subject to influences from any direction outside the frame of policies and procedures adapted by the bank to run the credit department effectively and efficiently. In addition, Chapin & Hassett (1960) added that credit manager must make some delicate decisions which embody his experience and trained mind as a qualified specialist for the position which he holds. As he is a front officer according to the borrower, he has to have some degree of empowerment so as to be persuasive. His judgment based on information and knowledge is superior and critical. In certain situations, credit manager has the authority –confined with certain limits- to make a final decision. So he will hold responsible for any problem linked with his decision.

Effective internal credit review is vital to good portfolio management, Chapin & Hassett (1960) said that internal review consists of three elements:

1. Review the credit administration and loan servicing within the entire bank.
2. Assignment of risk rating; and,
3. Periodic review of individual loans.

The internal credit review team should report to senior management and to the board of the bank. It will serve as the monitor of the quality of the institution's portfolio on an on-going basis.

2.1.5. Qualifications of credit executive:

Credit executive has to have certain attributes to be able to face the pressure and myriad challenges he is vulnerable to. It is not true that success in this field is just a chance, but rather, the credit officer has to go through a continuous and directive approach in order to acquire the ever necessary information related to the practice,

market and persons. The credit officer according to Chapin & Hassett (1960) has to improve certain qualifications that are essential in his vocation:

1. A profound **background** acquired through liberal education and experience. Background has many components, one of which is experience, which should be continuously developed.
2. A credit man has to possess **an analytical mind**. He must develop his abilities in disseminating problems into their parts and recognizing their essential elements. He must be energetic in looking for information and in adapting judicial temperament to evaluate the events. As he is the person who has the necessary information and who perform the process of follow up, his judgments have to be final and decisive.
3. A third major quality is **thoroughness**, his hunger to further information should never have an end. Thoroughness consists of going into just sufficient details to cover the task in hand with completeness and efficiency.
4. **Alertness** is his fourth quality as a credit man should never bypass any information, what so ever it is. His analytical mind has to link the ties between events in a way that will lead to the right conclusions and the right decision.
5. **Firmness**, having come to the right decision or conclusion, he will adhere to it and perform his abilities to persuade the top management about the steps to be taken.
6. The final attribute is **honesty**. The Latin word *honesta* expresses the quality desired. He must have honor, high moral attributes, and a nobleness of character so as to be credible and trusted for both the borrower and the bank that he represents.

It is the loan officer's responsibility to stay close enough to the borrower to uncover problems before deterioration and default. This includes intermittent visit to the borrower's premises and continuously checking the borrower's audited financial statements. The main purpose for such a follow up is to get sure that the project is doing well according to the proposed plan and that the financial position of the

borrower is not eroded but rather preferably going on the right track. Any deterioration in the debtor's position will be reflected in its financial statements.

2.2. Monetary Policies and Credits:

When central bank decides to adopt an expansion or contraction policies, or in other word, when it tries to control the amount of credits or money supply, it has three main monetary instruments:

1) **Raising or lowering reserve requirements of member banks.** Each member bank is required to maintain as reserve a percentage of its deposits. The reserve requirement lower the amount of money the member bank can lend since the loans can only be extended by merely using the excess reserves. If the credits are expanding too rapidly, and a boom seems to be out of control, the central bank can raise the reserve requirement and restrain member banks from making additional loans to borrowers. On the opposite side, in case of recession, the bank can decrease the percentage of required reserve and as a result, additional amount of excess reserve can be used to enhance the credit lending process.

2) **Open market operation:** Credit can be limited or expanded by buying and selling government securities on the open market. Selling government securities by the central bank will shrink the excess reserve and as a result will decrease the amount the member bank can lend, while buying government securities will expand the amount of excess money that can be lent to borrowers.

3) **Rediscounting:** One of the powers of the central bank's system is the authority to advance money to member banks on notes that they have accepted from their customers. By discounting a note, a member bank makes available the face amount of the note less interest. Central bank advances money to the member bank on notes that was discounted for its customer, the member bank endorses the note and is liable for its payment. The central bank deducts interest in advance. This process of advancing

money to a bank on note that is discounted is called rediscounting. By increasing the rediscounting rates, central bank reduces the excess reserve available for lending .

2.3. Risks at Banks:

According to Gittman (2002), the financial manager must learn how to assess two key determinants: risk and return. The price of the credit should include a unique combination of these characteristics. Risk as a term includes uncertainty and the variability of return associated with the credit.

In the banking sector , the broader definition of risk is that it is the fluctuation in the market price of the assets.

Traditionally and according to Basel II ,risks in banks can be categorized into four main kinds:

- a) Country Risks including political and economical instability and natural disasters.
- b) Financial Risks which include credit risks, liquidity risks ,currency risks and interest rate risks.
- c) Operational Risks or the risk of losses resulting from inadequate or fail internal processes, people and systems, or external events.
- d) Other events' risks including crisis in banks and other external risks.

According to Basel I with respect to measurements of risk exposure, risks run by banks fall into two broad categories: credit risk (particularly from loans in the banking book); and market risk; with the assumption that other risks are implicitly covered. In 1996 and after they perceived an escalation in the amount of risks and diversification of their types, Basel committee performed a substantial amendment on capital adequacy ratio of 8% which was addressed on the 1988 accord to cover the credit risks, the committee inferred to the importance to retain additional rate of capital adequacy in order to absorb the other types of risks such as market risks and other risks. The main cause for such amendment was the situation under which banks

became more vulnerable to such kind of risks due to Globalization and Liberalization of the financial and banking policies. Risk management should be minimized and supervised carefully since risk is linked to any decision that may affect the market price of the bank.

2.3.1. Basel committee on Banking Supervision and Credit Risk Management :

In June 1999, The Basel Committee on Banking Supervision (the Committee) has decided to introduce a new capital adequacy framework to replace the 1988 Accord.

The committee proposed the recognition of external ratings and asked for suggestions on how to evolve to reflect improved risk measurement and management techniques. The greater risk-sensitivity is the hallmark of Basel II which aligns the minimum regulatory capital held against credit risk with the formal risk assessment of individual counter-parties and specifically assigns capital against operational risk for the first time. (ESCWA issue No.2(2005))

This new capital framework consists of three pillars:

1. Minimum capital requirements,
2. A supervisory review process, and
3. Effective use of market discipline(Disclosure Rules).

The 1988 Accord gave recognition, for capital purposes, to certain techniques banks use to reduce credit risk on a loan or other exposure, namely taking collateral or obtaining a third party guarantee. The Accord's current approach to recognizing **credit risk mitigation techniques** reflects largely the state of the art in credit risk management when the Accord(Basel II) was endorsed.

2.3.1.1. Credit Risk Mitigation Techniques:

The following directive recommendations, said by Hashad(2005) were published as supportive documents to elaborate risk mitigation techniques:

- 1) The Board of Director has the absolute authority and responsibility to approve the strategy of risk management and to revise credit policies adopted, at least once a year.

- 2) Top management is responsible to apply the approved policies and to comply adherently with the strategy of risk management. Meanwhile, top management is authorized to develop policies and applicable procedures designed to allocate ,control and evaluate credit risks.
- 3) Banks have to specify and run credit risks inherent to banking operations and services before being activated and approved by the board of directors or other specialized party.
- 4) Banks have to address effective credit criteria including their vision and preferences with respect to the targeted industries and markets , the kind of debtors they are willing to deal with ,the purposes of the credits ,and means of payments.
- 5) Banks have to figure comprehensive credit boundaries or limits relevant and acceptable for individuals and other related parties.
- 6) Banks have to promulgate bases and conditions for credit approval, credit amendments, and credit restructuring.
- 7) Extending the terms or time of credit must be taken in conformity with independent basis. With respect to extending credits for companies or related parties beyond their limits, these credits should be based on an exceptional basis. Further steps to control and minimize the inherent risks must be taken.
- 8) Banks should establish a system to manage different portfolios which may generate additional risks.
- 9) Banks have to activate an effective system to control the conditions of individual credit including assigning adequate provisions.
- 10) Banks are encouraged to develop and adopt an internal credit rating system . The credit rating system must be relevant and in harmony with the nature ,volume, and complexity of the bank's activities.

- 11) Banks should have effective information systems and other technology necessary to help management to evaluate the credit risks attached with its activities .
- 12) Banks have to employ suitable and comprehensive systems to monitor the composition and quality of the investment portfolio.
- 13) Banks have to take into consideration the potential of unpredicted changes in the economical situation when evaluating individual credits and other portfolios.
- 14) Banks have to establish an independent and continuous evaluation system to manage credit risks and to dispatch the results to BOD and top management.
- 15) Banks have to get sure that the lending process is run and controlled properly and that the inherent risks are within the acceptable levels .Banks have to encourage and establish effective independent internal controls and other practices to get sure about the applicability of the adopted policies.
- 16) Banks have to establish an early detection system to implement precautionary steps when needed.
- 17) External as well as internal controllers are asked to encourage banks to initiate a practical system to specify measure, monitor and restrain credit policies as a part of risk management. In addition, they are asked to perform an independent evaluation of the strategy and other policies and procedures regarding credit and portfolio management.

The Committee acknowledges the benefits that can accrue from the use of credit risk mitigation techniques and the key role they can play in prudent risk management .So, the Committee believes it is important that the capital framework should provide a better recognition of mitigation techniques.

2.3.1.2. Other Broad Techniques for Mitigating Risks :

Maisel (1981) put forward major techniques that can be taken in order to reduce risks according to the following:

1. The most important step is diversification of assets and liabilities so as the impact of undesirable or unpredictable events may not be overwhelming. Banks usually underestimate the effect of interest fluctuation. Increases in interest rates cause heavy losses in the value of portfolio that contains loans and securities with long maturities. In addition; concentrating on certain economical sector or particular location may put the bank in hazardous situation since the absence of adequate diversification will endanger the position of the bank if the selected sector or geographical territory faces bad conditions.
2. The risk from non-diversification or from unforeseen events can be measured by estimating the probability distribution of possible outcomes around those that are predicted . The larger deviation, the greater the danger .Knowledge of such perils can be used by an institution to reduce the total level of its risks of losses to an acceptable level.
3. Increasing the adequacy of capital so that the bank will be able to absorb any losses likely to occur.
4. An other approach to minimize risks is by insurance policy that covers such risks by a third party. In this case, the insurer will charge a fixed premium per each unit value of the currency deposited. An insured depositor has in this case two claims :one against the bank and another against the insurer .

2.4. Fund Management:

2.4.1. Asset Management:

Asset management according to Reed, Cotter ,Gill,& Smith (1976) is a term used to describe the allocation of funds among investment alternatives. The term refers to the distribution of funds among cash, security investments, loans, and other assets.

Specialized areas of asset management include liquidity, portfolio ,and loan management. The greatest portion of commercial bank liabilities is payable on demand .The first priority of any bank management is to maintain its ability to meet the claims of the depositors. The second priority is to keep the sufficient funds to satisfy the reserve requirement articulated by the central bank or any other regulatory side. The third priority is to satisfy the credit needs since credit is the principal profit-making activity of the commercial banks.By making available for lenders to have access to use the funds of the banks, banks can show their public responsibility. The public must never be skeptic about the banks solvency, liquidity, or integrity.

The allocation of bank funds is constrained by regulation and law ,by the need to maintain a high degree of liquidity ,and by the need to earn sufficient income. There are different approaches to asset management bankers usually exploit in an attempt to resolve the liquidity-profitability conflict. No one of the approaches can be considered a fool proof method because problems and deficiencies are associated with each. Two of thesis approaches are presented below:

2.4.1.1.The Pool-of –Fund Approach :

The basic idea of this approach is that all funds should be pooled together. Funds then should be allocated from the pool to whatever asset investment (cash ,securities, loans, etc.) is appropriate. The source from which funds were derived to make an investment is immaterial as long as the investment will assist in achieving the banks' objectives.

2.4.1.2.The Asset-Allocation Approach (Conversion-of-Funds Approach) :

It has been contended that the Pool-of Fund approach places too much emphasis on liquidity and fails to distinguish among the different liquidity requirements of demand deposits, time deposits, and capital funds. This deficiency as many felt causes erosion to the profitability of the commercial banks.

This approach recognizes that the amount of liquidity needed by a bank is related to the sources from which its funds are obtained. The model attempts to distinguish between different sources of funds according to the legal reserve requirements and velocity, or turnover, of the resources. Central banks in many countries impose a higher legal reserve requirement on demand deposits than on saving and time deposits; moreover, demand deposits have higher velocity or turnover rate than do the other types of deposits. A greater portion of each demand deposit dollar, therefore, should be allocated to primary and secondary reserves and smaller portion to investments. The model establishes several liquidity-profitability centers within the bank for allocating funds obtained from different resources. Once the liquidity-profitability center has been identified, management must formulate a policy regarding the allocation of funds generated within each center. The demand deposit center would allocate a higher portion of funds to a primary reserve, and the bulk of uncommitted funds would go to secondary reserves for investment in short-term government securities. Relatively small amount would be committed to loans, mostly in the form of short-term commercial loans. The saving deposits and time deposits centers would require relatively less liquidity and hence larger amount would be prorated to loans and other investment accounts. Capital funds require little liquidity and would be used to finance land and buildings, with the balance committed to long-term loans and less liquid investments to enhance the income. The principal advantage of asset-allocation approach is that it reduces bank holdings of liquid assets by allocating additional amounts to the loans and investment accounts and thus tends to increase profitability.

2.4.2. Liquidity Management:

In their manual, Board of Governors of Federal Reserve(1994) said that fund management represents the core of sound bank planning and financial management. Fund management is the process of managing the spread between interest earned and

interest paid while ensuring adequate liquidity. Therefore, funds management has two components: liquidity and interest rate risk management. A sound basis for evaluating management requires understanding the bank ,its customer mix ,the nature of its assets and liabilities ,and its economic and competitive environment. No single theory can be applied universally to all banks.

Liquidity represents the ability to accommodate decreases in liabilities and to fund increases in assets. Liquidity is essential to compensate for expected or unexpected balance sheet fluctuation and to provide funds for growth. The price of liquidity is a function of market conditions and market perception of the risks, both interest rate risk and credit risk ,reflected in the bank's balance sheet and off-balance sheet activities. If liquidity needs are not met through liquid asset holdings , a bank may be forced to restructure or acquire additional liabilities under adverse market conditions.

Determination of the adequacy of a bank's liquidity position according to Board of Governors (1994) depends upon an analysis of the following components:

1. Historical funding requirements.
2. Current liquidity position and anticipated future funding needs.
3. Source of funds.
4. Present and anticipated assets quality.
5. Present and anticipated earnings capacity.
6. Present and planned capital position.

To meet funding needs, a bank must perform one or a combination of the following:

1. Dispose of liquid assets.
2. Increase short-term borrowing (and/or issue short-term deposit liabilities).
3. Decrease holdings of less liquid assets.
4. Increase liabilities in a term nature.
5. Increase capital funds.

Governors (1994) added that information that management should consider in liquidity planning includes:

1. Internal cost of funds.
2. Maturity and replacing mismatching in the balance sheet.
3. Anticipated funding needs.
4. Economic and market forecasts.

2.5. The Unified Evaluating System (CAMELS) :

In 1979, the United States adopted a unified evaluation system for banks and other financial institutions. This system was named CAMELS. CAMELS is an acronym or an abbreviation of the ingredients that synthesize the concept. These ingredients are:

- | | |
|----------------------|-------------------------------|
| 1) Capital Adequacy. | 2) Asset Quality. |
| 3) Management. | 4) Earnings. |
| Liquidity. | 6) Sensitivity to Market Risk |

Credits are the main ingredient of the assets side, the thesis quoted the following information about how CAMELS system handles assets.

2.5.1. Quality of Assets:

Since it is the engine that leads the bank to generate profits, it is of a paramount goal to establish high quality asset, through which the bank can manage to achieve the following goals:

- a) Substantial increase in profits.
- b) Better capital adequacy.
- c) Lower allowances for bad debts.
- d) Commitment and punctual receipt of installment and due interests.
- e) Better confiscation of the management's professionalism.

The spread (difference) between the interests received from credits and other profitable assets and interests paid for deposits constitutes the major portion of the gross and net income of commercial banks; Maisel (1973) said that at any time,

interest earnings reflect the categories of assets and liabilities and the interest rate maturities in each category selected by a bank. As was said before, the portfolio should be classified so that all activities whose values are likely to react in similar manner are grouped together. Bank should exploit their knowledge about the future tendencies of interest rate to constitute the structure of its assets and liabilities in a way that will enhance its capital adequacy and raise interest earned. When it expects a raise in interest rates, it may lean toward signing short- run credit agreements with floating interest rates while collecting long –term deposits that will be less flexible to the increasing tendency of interest rates.

Banks' management usually involves running sources of funds and uses of funds in a way that will combine three key components: safety, liquidity and profit for the best benefit of the stockholders and other stakeholders. The bank should embark a comprehensive process of analyzing the different alternatives for building a safe and profitable composition of assets and liabilities based on the theories of portfolio risk. Halm (1956) said that the basic problem that encounters any bank is the conflict between profitability and liquidity. There is a direct relationship between safety and liquidity but an inverse one between liquidity (safety) and profit. Money is barren, perfectly liquid asset do not earn income. The highest profitable assets are usually those with less liquidity. Liquidity means the ability to convert a sufficient amount of the earning assets into cash without much loss or delay. The management of the commercial bank has to make a rational compromise. With more objective evaluations and better understandings of potential trade-offs, unnecessary risks can be avoided, other inevitable risks can be minimized or managed efficiently, and the bank capital will not fade away. Asset-liability risk is a leveraged form of risk. The capital base of banks is small relative to their assets and liabilities, so small percentage changes in assets or liabilities can lead to a big percentage change in capital or even to insolvency.

2.6. Capital Adequacy and Solvency:

2.6.1. Solvency:

Solvency depends on the relation of the value of a bank's assets to the contractual value of its liabilities. The balance sheet of the commercial banks has three major components: assets, liabilities and capital funds (Net worth or Stockholders' equity). Net Worth represents a minimal amount by which the total assets exceed the contractual value of the liabilities. Capital funds are derived from subscription by stockholders and the accumulation of the retained earnings. Capital account, as the smallest ingredient of the balance sheet, is not the main source of operation in banks. Skilled risk management enables the bank to absorb the shock of unexpected events that may cause insolvency. Management shall do its best so as to avoid circumstances under which there will be a sharp decline in the bank's assets side- mainly by the deterioration of the loans and other credits- through which the net worth will be vanished (bankrupted) ,in order to keep the bank aloof from insolvency. According to Maisel (1981), insolvency will depend on the amount of capital, and the composition of assets and liabilities, as well as on dividend policy. The risk of insolvency is a function of the current economic value of the bank's capital, that is, the present value of the expected cash flows from the bank's portfolio –and the probabilities that either the expected cash flow or the discounted rate at which the flow is valued will alter. The bank will be insolvent if events cause its income to be negative by an amount in excess of its net worth adequacy.

Capital accounts according to Maisel (1981) consist of equity capital, paid-in-capital, retained earnings, reserves for contingencies and other capital reserves .In addition, reserves for bad debt losses and other reserves on loans and securities are available to offset losses. They offset assets and require no cash outflow. Changes in net worth depend on net earnings and on a bank's dividends and other capital policies, since risk depends on the ratio of capital to liabilities, the growth of liabilities must be carefully

estimated. Moreover, the higher the percentage of capital compared with assets or liabilities, the lower the risk of insolvency. The soundness of the bank is a function of its management, ownership, and operating procedures; its liquidity or ability to meet future demand for cash; and, above all, its capital adequacy.

2.6.2. The Roles of Capital Adequacy:

Determining the adequacy of a bank's capital is important as a gesture not only to the extent of loss that a certain bank can hold and endure, but also to the soundness of the entire banking system. Bank's capital as Maisel (1981) added has several roles to play:

1. Assuring public confidence in the stability of the bank and the banking system.
2. Supporting the volume, type, and character of the business conducts.
3. Assuring that the risks in banking sector are distributed appropriately between the private sector and banking sector since higher capital leads to lower risks.
4. Permitting the bank to continue to meet the credit requirements of their community.

A comprehensive evaluation of capital adequacy according to BASEL II includes a wide range of quantitative and qualitative measures; quantitative measures are commonly shown as ratios while qualitative measures discuss other things such as the bank's liquidity position, management quality, asset quality, and earning capacity.

2.6.2.1. Quantitative factors:

The related guidelines establish a minimum capital ratio, under these guidelines, capital is divided into two tiers: Core Capital (Tier 1) is defined as the sum of core capital components, less goodwill and other non-qualifying intangibles. Supplementary (Tier 2) capital includes all cumulative perpetual and limited-life preferred stocks, hybrid capital instruments, and all reserve for loan and lease losses.

The 8% risk-based capital ratio is a minimum, and most banks will be expected to maintain risk-based capital level that exceeds this ratio because although this ratio focuses primarily on credit risks, a bank's capital base must also be available to

absorb other types of losses. The bank's risk-based ratio is calculated by dividing the capital base by risk-weighted assets which include both balance sheet assets and off-balance sheet items in proportion to their relative credit risk.

The risk-based guidelines according to CAMELS evaluating system represent a significant step in measuring capital adequacy for several reasons:

1. The guidelines support the quality of capital by emphasizing on owned funds and by restricting the amount of troubled credits loss provisions .
2. Banks are required to hold capital against their off-balance sheet activities in a systematic manner.
5. The guidelines will help in making the definition of capital and the minimum standards uniform internationally.

2.6.2.2. Qualitative factors:

In addition to the importance of quantitative factors, other elements of qualitative factors are taken into consideration:

1. Quality of management which includes experience, hierarchy of authority and the sophistication of banks' activities. It also includes implementing policies and procedures, internal control, and audit coverage.
2. Fund management which includes the supervisory and management of liquidity and interest rate sensitivity. Lack of liquidity will force the bank to sell assets under pressure and this may lead to losses. Mismatching assets maturities and their source funds maturities will inevitably lead to interest rate risk.
3. Asset Quality ,because lower quality assets are vulnerable to more hazardous fluctuation and have a great potential for loss.
4. Risk diversification: a great degree of defined asset and liability concentration increases the need for capital.

5. Ownership : the objectives and financial status of a bank's ownership are important consideration since they can significantly affect the condition and the direction of a bank.
6. Strategic and dynamic Planning processes are essential components in competition within the intense financial sector.

The aforementioned titles about capital adequacy and fund management show that the bank's credit policy is directly affected by its net worth of the bank for mainly two reasons:

- There is a correlation between the net worth and the volume of credits that can be given to a person. According to the promulgated regulations in Palestine, it is illegal to give a debtor credits above 10% of the bank's net worth except if there is a specific permission by the PMA. According to PMA circular 21-D4/97.
- Capital adequacy is the cushion that is used to absorb the risks, mainly credit risk , and other losses, and so, to guarantee a strong position for the bank and its continuity.

2.7. Credit Policy Ingredients:

The framework of credit policy should take into account certain key factors ,these factors will serve as a guideline for performing and implementing these credit policies. Some of these factors according to Shamaa'(2001) are:

2.7.1.The region to serve:

- Traditionally, banks inaugurate branches in main cities where they can easily direct their services to the industrial and commercial sectors in the surrounding area. The far areas and rural areas will have less competitive advantages in receiving such services .

- It is true that the need for banks will be greater in these areas so as to enhance their commercial and industrial activities, and it is also true that the greatest bulk of cash gained will be concentrated in these cities.

2.7.2. Maturities:

According to their maturities ,credits can be classified into three categories:

1. Short term credits with maturity below one year.

- Offering Basic Short-Term Notes.
- Lines of Credit

2. Medium credits from one to three years.

3. Long run credits more than three years.

This categorization has a great effect on both the liquidity and credit risk. The shorter the period of the credit, the more liquid and less risky it will be. Loans funds from short-term credits are generally used for short-term purposes, and repayment of such loans comes from cash flow of operations. But there are other criteria that may lead to the downward sloping in short run financing or lending. The possibility for restructuring the credit will be great as the borrower may find himself unable to meet his obligation due to the fact that this kind of lending will pressure the cash flow of the borrower. So, the main point in this regard is that the credit has to meet the true needs of the borrower and to pave the way for him to achieve his objectives without being forced to restructure or even modify the condition of the credit. One of the basic questions the credit officer has to ask is about the borrower's cash flow ,by projecting the information, he has to match the maturity dates of the installments with the date of cash inflow so there will be no time lag between these two correlated factors. By doing so, the bank can guarantee to a great extent the commitment of the borrower to pay his installments on schedule.

The maturity of the credit is also linked with the level of economical activities and the monetary policy adopted by the central bank. This implies that at peak period, when the demand for credit is at its highest levels, banks will lean toward lending short run credit.

2.7.3.Credit risks:

According to Basle Accord-II, while financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the fiduciary position of a bank's counterparties. Credit risk is simply defined as the potential that a bank borrower will fail to meet his obligations in accordance with predetermined terms. The real risk from credit is the discrepancy of portfolio performance from its expected value.

The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the inherent credit risks on the entire portfolio level and on the individual credit level . Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization. The sound practices set out in Basle accord specifically address the following areas:

- a) Establishing an appropriate credit risk environment;
- b) Operating under a sound credit-granting process;
- c) Maintaining an appropriate credit administration, measurement and monitoring process; and
- d) Ensuring adequate controls over credit risk.

A comprehensive credit risk management programs will address these four areas.

2.7.4. Credit worthiness:

Credit worthiness entails certain preferable or minimum conditions that the borrower should afford in order to be entitled to apply for a credit. Many banks while discussing the experience and credibility of the company discuss the historical financial data and other inquiries regarding the time interval the company is in the business. Factors that are of a prime importance to the bank are collectively known as 5 Cs.

2.7.5. Interest Rates and other fees:

The result of deep analysis of the borrower's worthiness and the compatibility of the credit's goal should be reflected by the interest rate of the credit. Credit policy should be highly concerned on how to address these rates since they are considered as the major source of generating profit. Interest determination is a complex process since it is based on a combination of many internal and external factors that the bank must understand and use in its interest's formula .Some of these factors are :

- 1) The cost of deposits or other sources of funds .
- 2) Other required reserves which regulatory central banks use not only as an insurance of the deposit, but also as a tool to adjust banks' ability to lend money.
- 3) Other risks the bank is vulnerable to.
- 4) Operational and administrative costs which compromise the major part of expenses any bank incur.
- 5) The nature of the collateral obtained.
- 6) Competition between banks and other financial institutions.

All banks should have written policies and procedures authorized and ratified by the highest level of management, these policies and procedures should stipulate the following:

- The type of loans bank will and will not make.

- How loan application will be processed and analyzed.
- The loan approval process .
- Documentation required .
- Post-distribution monitoring.
- Other policies to regulate the sequence of handling of the loan application.

2.7.6. Guidelines and regulation of the central banks (PMA) and other related legal implications applicable to the situation.

2.8 .The definition of troubled Loans :

Loans are considered good when one or two of the following conditions exists:

1. On time payment of due installments.
2. Totally covered by accepted collateral including cash, governmental unconditional guarantees, bank guarantees, personal guarantees, real estates or any other collateral.

Troubled loan is the loan that lacks the presence of the aforementioned conditions. Troubled loans according to Shamaa'(2001) means the position under which the loan's agreement is faced by conditions that may jeopardize the possibility of the debtor's commitment to pay the due installment on time and according the schedule. As a result, the financial position of the bank may be affected severely since the bank will not be able to redeem the principal loan and as the interests that should have been added to the net income had been suspended. The adjacent risk that may emerge by lending additional loan underlines the importance of preemptive steps banks should perform in order to mitigate the bad consequences of troubled loans. The possibility of failure usually appears at the initial stage of any credit. The future performance of any debtor with regard to meeting his obligation toward the bank depends mainly on two factors: the willingness of the debtor to pay his obligation (will the borrower pay?) and his ability to meet commitments (can the borrower pay?). It is impossible for the

bank to predict the amount of troubled credits it is going to have in the future, but if the percentage of this kind of credit exceeded the average of the industry, this means that the credit policy or the ability of the credit management should be under question. The study of the worthiness of the debtor is of a significant importance in any lending process, it is a comprehensive process which takes into account every aspect that constitutes the debtor's personality as well as his financial and economical abilities.

2.8.1. Eligibility of the Applicant:

The components that constitutes the debtor's worthiness according to Abu Rub(1997) include what is usually called the Five Cs' factors :

2.8.1.1. Character:

In general usage, character connotes the inner nature of an individual. With regard to credits, character has to deal with a comprehensive moral perspective-absolute honesty and integrity, the debtor's reputation and his sense of responsibility. This means that the role of credit officer is not confined within the borders of the economical dimensions, but rather he should use his means to gather additional information beyond the financial framework and explore the borrower's integrity and credibility ,his experience and operational conduct, his way of life and whether he is living within his financial abilities. The applicant's personal and business reputation, particularly with respect to truthfulness and integrity must be carefully e

2.8.1.2. Capital adequacy or the Financial Position of the Firm:

Capital and Capacity answer the question: Can he pay ?Capital is important when relatively large loans are requested. Capital in business is the investment available to produce profits. This is something related to the financial condition of the capital, not merely to his net worth in the balance sheet. If capital is tied up in inventories or accounts receivable, the salability of the inventory or the ability of the account of being collected is of a great interest to the credit manager. If the assets consist broadly

of property and equipment, their availability as security for the bank is of a primary consideration. In evaluating risk, capital should be limited to the money available to creditors through the process of law.

a) Partnership contract is a mutual agency. Each partner is a principal and agent for each other and has the power to bind the partnership to the extent of such partner's experience, implied and apparent authority. Partners are tied by vicarious liability including liability for partnership contracts and loans.

b) Limited Partnerships must have at least one general partner and one limited partner. The general partner has unlimited liability, while the limited partner has a limited liability to the extent of capital contributed in the project.

c) Corporations are legal entities created by statute, unlike a partnership, limited or unlimited partnerships, a corporation has no owners until shares are issued. Shareholders have limited liability, they are not liable for corporation liabilities merely because they are shareholders. They can only lose what they have invested.

2.8.1.3. Capacity:

Capacity denotes to the debtor's ability to pay his financial obligation orderly and without hindrance. This factor deals with the borrower's ability to generate cash flow. On the premise of the credible financial statements, a cash flow statement based on audited financial statements should be prepared to measure the main sources of payment and other streams of cash inflows so as to reach the net cash flow.

Credit is a powerful tool in personal and business finance, handling it properly will lead to win-win relationship that links between the bank and the debtor, while mismanaging it will lead to detrimental results for both. According to Ettinger & Golieb (1962), education, training, experience, and the ability to apply all three to their maximum advantage in earning livelihood are important standards for measuring individual capacity to pay. Age, health, and personal responsibilities are secondary but

important considerations. Stability and individual's promotion will reveal important facts about his capacity. If the applicant asked for long period loan while he is hired for an employer who has a record of successive lay offs, his application should be rejected unless additional sufficient collaterals were provided.

valuated.

2.8.1.4. Conditions:

This factor deals with the evaluation and prediction of the macro economics and other social and political circumstances that may have a great influence on the future performance of the borrower as well as other internal conditions. Both capacity and capital must be considered from the standpoint of probable unfavorable conditions .While no foolproof method of predicting the business future has been developed, there are signs that can call attention.

2.8.1.5. Collateral:

Collateral is something of value, easily convertible into money, deposited as a pledge with the creditor to guarantee the payment of an obligation. If the debtor fails to redeem the principal and/or the interest due, the bank is free to sell the collateral and take its principal .Collateral includes claims to personal and real property-mortgages, stocks and bonds, life insurance and other instruments or documents of title evidencing ownership of commodities or manufactured goods. Banks differ in their ways of dealing with the collaterals and usually base their decisions with regard to this issue on the nature of the lender and on many other factors including the competition and political and legal environment that have a direct influence on the degree of risk now and in the future. In case of bankruptcy, when business ceases to exist, corporations and partnerships are dissolved, individuals are discharged. Usually there are some assets exempted from being collected by creditors such as homestead, household goods and clothing, and alimony. The asset side ignores Book Value and

use realizable value of assets .Non-exempted property is distributed according to the following sequence:

- Fully secured assets (collateral) go to secured parties including banks.
- Prior and perfect claims have first priority on unsecured assets, and include: administration costs, wages, employee benefits, advanced customer deposits per customer-if not insured, child support and taxes.
- Unsecured creditors.

The preceding sequence shows why it is important for the bank to deal properly and with high alert with the collateral offered by the borrower in order to guarantee its priority in collecting the due amounts before other creditors. After all, the bank has to differentiate between the source of payment and the collateral of the loan, because banks use the collateral as a final resort in case of default .According to Camp(2004), banks usually refrain using collaterals as a mean for payment mainly for at least three reasons:

- The value of collaterals will decrease substantially when liquidated relative to their cost when secured at the advent of the loan.
- The process is time consuming and will entail administrative and legal costs.
- People disdain banks when they sell the collaterals.

Any adverse effect on one or more of the preceding factors will enforce the bank to take one or all of the following steps:

1. To increase the cost of the debt or the interest rate,
2. To enhance the conditions and collateral so as to bind the borrower more rigorously , or
3. To decrease or abstain lending so as to minimize or avoid risks.

The preceding section means that a comprehensive process of investigation is launched by the bank once the debtor applies for loans to investigate his merits.

2.8.2. The Credit Officer's Legal Duties:

Credit manager according to BackerConvisor CPA(2000) as an agent of the bank is authorized to represent the principal bank with respect to the borrower and other third parties. His duties as an agent include the following:

- Fiduciary duty.
- Duty of obedience including the duty not to appoint subagent or improperly delegate.
- Duty of diligence: the duty to act with orderly care.
- Duty of candor: the duty to notify the principal of all matters relevant to the principal interests; and
- Duty to account including not to commingle the agent's property with the principal property.

The conduct of credit manager at the analyzing stage will have a considerable influence upon the flow of credit in the future, indulgent credit officer or aggressive credit policy will automatically lead to a delinquent borrower, in other world, this means that the proliferation of troubled credits appears at the outset of credit process. There are circumstances under which certain factors arise and lead to sharp increases of troubled loans. A recent World Bank study as mentioned by Camp(2004) showed that 93 countries experienced systemic financial crisis in its banking sector during the 1980-1990's. A systemic financial crisis is a situation in which an economy encounters a large-scale financial and corporate distress within a short period. Examples include the US and the Nordic countries in the late 1980's and early 1990's, the transition economies (Central and Eastern Europe and the New Independent States) in the early and mid 1990's, East Asia in 1997-1999 and Argentina in 2001-2002. Palestine has gone through very exhaustive economical situation especially as the second Intifada

blasted off. The systematic long-term brutal approach adopted by Israeli occupation has culminated and reached unprecedented levels. One statistical data presented in the PMA web site shows that GDP declined 30 % from \$4.5 billion in 1999 to \$3.1 billion in 2002. As a result, a substantial increase in bad credit has been recorded followed by a contraction in credit and a considerable increase in the lending cost as means to reduce the skyrocketing risks in the Palestinian market. Total credits in Palestinian territories were decreased 34.3 % to \$990 million on September 2003 compared with \$1,507 million on September 2000. The banks' total assets had declined 3.5 % from \$4,817 million on September 2000 to \$4,651 on September 2003 despite the fact that banks' total assets had increased approximately 13 % per annum in the three years that preceded the Intifada. The amount of troubled credits was increased by \$95 million or 105.5% from \$90 million on September 2000 to \$185 million on September 2003.

2.8.3. Factors that Contribute to the Troubled Credits:

Troubled credit is inevitable and undetectable part of the banking practices in any country. In the Arab world, there is no precise study to characterize the reasons for troubled loans, but experience and other banking historical records according to Shamaa(2001) have showed that the following reasons may have a direct influence on the proliferation and even the increment of this problem:

1. Small entities that loose professional management are usually more vulnerable to troubled loans than big companies run by professional management practices. Financial management can facilitate the mission of controlling the inflows and the outflows of resources and the performance of the entities.

2. Troubled loans decrease as the geographic distance between the bank and the borrower decreases, this implies that the facts about the borrower and his activities as well as the follow up process will be enhanced, and any deviation on the internal or external environment pertinent to the bank or the debtor can be handled quickly.

3. Economical conditions: slack periods or depression will lead to accumulation of inventories and finished goods and a sharp decrease in cash flow. When the debtor initially applies for a debt, he usually will offer an exaggerated financial data in order to eliminate the mistrust and doubtfulness of the bank toward him. To avoid such a misleading, banks usually ask for audited financial statements and feasibility studies prepared by certified companies before they accept the application .Certainly there will be a discrepancy between the actual circumstances and the situation depicted on paper, if the bank did not take into consideration the emerge of such an excursion, its position will be vulnerable to a higher risk. For example, currency fluctuations can swiftly decrease the purchasing power and the financial position of the borrower.

4. Political instability and civil disorder will have a severe influence upon investment and profitability. As it is known, there is an inverse relationship between investment and political unrest; moreover, the room of uncertainty, or the degree of risk will be substantially increased in circumstances where there is big probability for government intervention or probability of emerging new regulations.

5. Extraordinary technological developments: the global economy is in the midst of fierce competition based on invention .These days, life cycles of many products are curtailed as galloping technology stride out in the market. Companies must allocate adequate portion of their budges for the purpose of research and development if they like to persist in the market.

6. It is widely perceived that the big percentage of troubled loans stems from the inability to pay rather than the unwillingness to meet borrowers' obligations. No one can predict the future, but by good planning and sufficient gathering of information about the borrower, the credit officer can minimize the probability of troubled credits. Using financial ratios, although they show historical performance, can be of a great help to forecast the borrower's performance in the future taking into account the fact

that in the absence of extraordinary events, it is more likely that the history will repeat itself ,at least financially .

7. Well prepared and highly professional credit officers have a considerable influence on decreasing the percentage of troubled credits. Inability to analyze the factors that have precise role in the borrower's ability to meet his obligation, or the lack of necessary experience in dealing with the laws and regulations in relation with documenting the collaterals may expose the bank's position to hazard .

8. Knowledge is power , strong management information system is essential for high performance with regard to lending process. Computer system has a key impact on the punctual follow up of any credit agreement; experience has shown that weak banking software will lead the bank to confusion.

9. Weak and ambiguous legal environment will enlarge the span of troubled credits. In Palestine, as it is in the emerging phase, the absence of decisive regulations combined with the nature of the social structure put the economy in a dilemma because there will be no enforcement on collaterals at the event of failure on one hand, and as there will always be social and political barriers that preclude creditors from litigating defaulted debtors on the other hand.

After granting the credit, it must be closely monitored so as to get sure about the right conduct of the borrower which will guarantee his ability to pay. Camp(2004) added that there should be periodical revision to the promulgated financial statements as well as intermittent visits to the borrower's premises in order to keep up- to- date with any circumstances that may affect his financial ability. Important information can be gathered by observation of the debtor's conduct and other changes in the surrounding area.

Identifying troubled credits early, or early detection, is of a key importance for mitigating the influence of any loss that the bank may face in the future. The earlier a problem is identified, the more diversified options the bank can have in dealing with

the problem. This means that the bank should never count merely on the payment status of the installment, but it should concentrate on a comprehensive operation that the borrower use in generating his profits since default is an accumulated process that takes time to be completed and usually emerges in all phases of operations. Financial crises are phenomena that are created as a result of bad performance or mismanagement. That is why credit officer is highly asked to be acquainted of the industry to which the borrower belongs and to be alert to any development that may prevent the borrower from achieving his goals. When credit defaults, the borrower is no longer a friend of the bank, and credit officer shall do his best not to save the borrower but rather to safeguard the position of the bank which he represents.

2.8.4. A sound Infrastructure for Effective Lending Process :

Records show that the accumulation of due installments is a gesture of new circumstances that lead the borrower or force him to act negatively. The structure of effective lending process shall be based on the following ingredients:

1. A profound credit policy based on information and professional criteria.
2. Well trained credit officers who feel the support of top management and the sufficient support to be independent.
3. A well developed computer system than can provide the bank and other related parties with punctual and precise information.
4. Cross functional teams who work integrally and responsibly to reach acceptable conclusions. Experience has shown that the big mission of lending should never be confined on the credit department, but rather should be the task of the whole employees working in the bank.

2.8.5. Troubled Credit Escalation Process :

There are two types of problems that may lead the company to perform badly:

- External conditions or circumstances beyond the company's ability to influence, such as political and macroeconomic circumstances.
- Internal conditions due to management misconduct.

When the problem starts, the first diagnosis will appear in the form of cash shortages. The company will lose the sufficient cash to meet day-to-day requirements. As a result, the company may take extreme steps to cover its shortage by trying to liquidate certain assets including the collaterals as the need of liquidity raises, the price of the assets will decline substantially and as a result, the position of the company and the bank will descent as well.

The stage of cash crisis according to Camp(2004) generally follow a progressive pattern:

1. As the company experiences cash shortages, it may lower its conditions and take critical steps to influence its liquidity management such as easing its policy of credit sales, or devaluating its assets in order to be able to liquidate them.
2. The company may start to lay-off employees since it is the easiest way to decrease expenditures.
3. It may delay its due payments or try to restructure its obligations.
4. Banks' statement will show over draft accounts .

2.8.5.1. Warning Signs :

In his book, Camp(2004) wrote about early warning signs that include certain symptoms that encompass the whole activities of the company :

Financial Statements:

- Failure to provide financial statements when due.
- Decline in the company's major ratios.

- Successive changes in the external auditors may also reveal a big problem .
- Continuous qualification of the audited financial statements.
- Declining in sales ,declining gross margin and operating losses.
- Rapidly increasing sales.
- Presence of “due from” or “due to” loans to owners or shareholders.

Management Warning Signals:

- Change in attitude, including reluctance to meet or communicate with banks.
- Poor financial reporting and control.
- Inability to perform planning .
- Failure to make changes when problem occurs.
- Failure to prepare budgets.

Operational Warning Signals:

- Poor maintenance of plant and equipment.
- Stale inventory.
- Excess staffing or underutilized employees.
- Loss of major customers or suppliers.

Banking Warning Signals

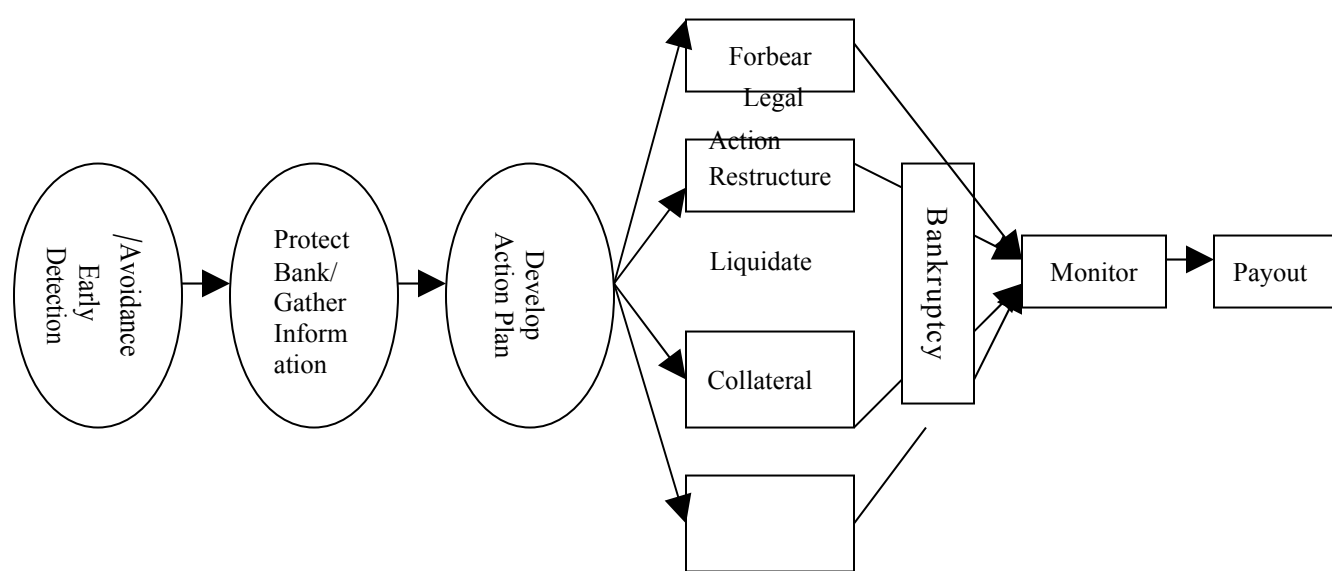
- Unanticipated requests for renewals of notes.
- Request for information on the borrower from suppliers or other banks.
- Unanticipated or repeated overdrafts.

As can be inferred from the title, none of these symptoms can be by itself a conclusive and decisive factor that can lead to a default in credit .But credit officer should be alert when such signals emerge; moreover, additional investigation should be embarked to know the exact extent these signals have on the borrower’s ability to meet his obligation toward the bank .

2.9. Troubled Loans’ Management:

Troubled loans according to Camps(2004) is a chronic and inevitable phenomenon in any banking sector. Banks in Palestine face unique challenges arising from the surge in loans defaults as a result of the second Intifada and other factors including the mass punishment policy adopted by the Israeli occupation. As earlier mentioned, the basic rule for any credit officer is to protect the bank’s position and to recover as much of the bank’s money as possible. The process of managing troubled loans must be comprehensive and integral. Of course, there is no one loophole identical to every case, every loan has its own unique circumstances and peculiarities. From the lender’s perspective, the following flowchart depicts the steps necessary to perform an effective and practical troubled loans management.

Figure 2.1 : Effective Troubled Credit Strategies’ Flowchart



As a matter of fact, the ultimate responsibility of any bank’s management is toward its shareholder who will watch the financial data including profit generation process ,mainly from credit facilities .

Under certain circumstances ,the debtor may face serious difficulties that may hinder him from achieving planned objectives , there always will be certain symptoms which may denote that the debtor is under a crisis . A professional credit officer will be the

first who will discover the situation , being under pressure will preclude the debtor from getting prudential steps to circumscribe the deterioration .It is of a paramount act for the credit officer to suggest certain remedial steps that may put the blundering debtor on the right track.

2.9.1. Corrective Steps :

The bulk of troubled loan is a parameter of the management's quality and its policy's efficiency . Having a big bulk of bad credits can be perceived as a deficiency in the adopted credit policies or deterioration in its implementation. Symptoms of such a deterioration according to Shamaa (2001)can be seen through:

- a. Trying to achieve a planned goal on the account of quality.
- b. Performing credits beyond the available skills or experiences.
- c. Lack of geographic or industrial diversification.
- d. Politicizing credit decision by basing it on an unprofessional or personal stands.

According to Shamaa (2001),the necessary remedial steps the defaulted debtor must be anxious to achieve with the assistance of his bank include:

1. Reaching the cash flow equality as soon as possible in order to stop the drain.
2. Controlling receivables and inventory.
3. Minimizing overhead expenses.
4. Exposition of excess unnecessary fixed assets.
5. Slow down the rapid growth or even, at certain circumstances , contraction .
6. Resuming the past profitability levels.

2.9.2 Effective Troubled Credit Management Program and Strategies :

An effective troubled credit management program according to Camp(2004) can have the following mechanisms:

1. Diagnosing the existence of troubled credits at early stages (early detection) and trying to find out common factors that lead to its proliferation.

2. Trying to explore the real causes for their existence.
3. Gathering additional information about the debtor and its business.
4. Planning for the early steps in dealing with the borrower including:
 - a. In depth study about the condition and the position of the defaulted borrower.
 - b. Holding well prepared meeting to negotiate about the new condition.
 - c. Constituting a strategy for dealing with the borrower and follow up.
 - d. Proposing the feasible alternatives in managing the defaulted credit.
 - e. Implementing the chosen strategy while trying not to add additional financial or administrative responsibilities to the borrower.

The bank should not underestimate the exorbitant prices it has to pay in the event of having troubled credits which include:

- a. High provisions that entail heavy burdens, financially and administratively.
- b. Suspending interest earned instead of directing them to the income statement as revenues.
- c. Opportunity cost of not using the due loans effectively.
- d. Adversely affecting the financial position of the bank which will lead to deterioration in its reputation and shrinkage in its share in the market.
- e. High cost of follow up and other legal costs.

So, effective troubled credit management includes effective continuous follow up, early detection, and even encouraging the borrower to shift the credit to other banks and taking other necessary remedial steps .

There are other major strategies a bank can undertake to confront and manage troubled credits' crisis :

2.9.2.1. Avoidance and early detection:

2.9.2.1(i). Avoidance:

The best strategy for restraining the bad effects of troubled loans as said by Camps(2004)is to avoid them, that means establishing a strong credit culture and

effective policies and procedures , and getting rid of poor applicants before loans are made.

Credit policies and procedures should be documented and clear so there will be no room for guessing or construing.

- **Credit analysis** should be based on stipulated sound studies to examine the borrower's ability to service the debt or to pay the due amount from at least two sources of payment. First and foremost ,repayment will come from the cash flow of the borrower, generated mainly by its core operation. Secondly ,the collateral which may be perceived as the final resort in case of borrower's default. The higher the liquidity of the collateral, the better it will be for the purpose of securing the credit .
- **Credit approval** should be done either through a credit committee of senior credit officers and bank management or by a gradual signature approval process through which authority is allocated among the levels of management according to certain criteria. This will increase the likelihood that the credit analysis will be rigorous, and that the experience of senior credit officers will be exploited effectively.
- **Credit monitoring** : Once it is booked, credit must be closely monitored until it is repaid. Bank should commit a comprehensive periodic review of the relationship with the debtor ,this includes following up financial statements signed by authorized public auditor as well as periodic or intermittent visits to the borrower's foundation.
- **Mechanism to resolve disputes and conflicts**: Effective resolution of creditor/debtor disputes depends upon clear enforceable credit rights; timely, impartial and predictable process whereby the related parties can seek a mutually accepted agreement; and a reliable ,time-bound process for adjudicating and enforcing credit claims and debtor rights in the events that agreement can not be reached.

2.9.2.1(ii). Early Detection:

Identifying loan problem early is likely to minimize loss. Deterioration in debtor's position is an accumulation process that is gradually deepened as the debtor goes on in his job declining trend. Banks that merely look at payment status put themselves at a great disadvantage. By the time a borrower has missed a payment, the company has more than likely reached a cash crisis, and may have done things that have harmed the bank's position. A properly structured loan agreement and a well-trained loan officer should provide the bank with an early warning that the borrower is beginning to have problems well before the actual payment default occurs. A condition for an early discovery of a problem loans is an environment of openness and candor. Without this open candor ,loan officer will not be able to scrutinize the conduct of the borrower at a relevant stage. Documents should be current; moreover, guarantees if existed ,should be current and binding. Unfortunately, early detection of troubled loans in Palestine according to Camp(2004) is a difficult for several reasons:

1. Banks rarely ask for updated financial data or concurrent information about the borrower's industry.
2. Lack of relevant information about the indicators that are related with the sector the borrower is affiliated to and other economical indicators.
3. Unreliable audited financial statements.
4. There is no credit bureau (a centralized point for credit information).

2.9.2.2. Protect Bank/Gather Information:

The first step that follows detection is to review the credit file and all documentation to: (i) establish the bank's position; and,(ii) take remedial action to fill any gap or deficiencies in the bank's loan documentation. All documents presented through the borrower's application should be checked to review the terms and conditions ,and to ensure that they are duly signed and notarized, Camps(2004) . The review should concentrate on the problems the borrower is experiencing, the remedial steps conducted, and whether these steps were taken at the expense of the bank . The bank

must also watch any possibility for fraudulent conveyance of properties in order to defraud the bank ,or to perfect(benefit) other creditors at the bank's expense.

As he knows the situation better, credit officer usually handles the process of managing the credit. He must get sure that the money lent are expensed for the purpose approved by the bank's management, that the sequence and phases of the project is compatible with the schedule offered by the debtor , and the debtor will be able to generate cash inflow on time so the credit service will be met appropriately. Credit officer has to inform his management promptly once he detects any problem that may hinder the debtor from meeting his obligation. There should be gradual escalating handlings by the bank adherent with the phase of the problems the borrower is experiencing. For example, if the bank feels it is in a weak position with regard to collaterals, it may choose to adopt a soft, non-aggressive approach. If financial difficulties' symptoms appear but there is no payment default, the bank should try to gather more information to predict the extent of these problems, but if the customer is experiencing large losses that hinder him from paying installment when due , additional decisive steps must be taken by the bank in order to protect its right and money. During the initial period when the bank has detected a problem but does not know how severely its effect will be ,the bank must keep in mind two concerns: formal notice to the borrower and the risk of lender liability.

2.9.2.2(i).Formal notice of Default to the Borrower:

Loans documents always contain events of default provisions. These provisions allow the bank to demand full payment of the loan. The bank is required to notify the borrower of the event of default ,thereby setting in motion a cure period through which the borrower can fix the problem and reconcile the conflict with his bank .

2.9.2.2(ii).Lender's Liability:

As troubled credit surfaces ,there will be a bilateral mistrust between the bank and the borrower, the bank will perceive this situation as an indication of poor management,

and as a result ,the credit officer may interfere to guide the borrower so as to help him get rid of the bad circumstances. The officer must obviate his role and that he is merely making suggestion, because misunderstanding by the borrower to the officer's directions may lead to what is known as lender's liability in case of further deterioration. The borrower may claim that the bank wrongfully forced him to do things that caused his position to worsen. A prudent credit officer can evade this conflict by asking appropriate questions instead of giving concrete suggestions. At the inception of problems with the debtor, the bank may arrange a formal or informal meeting with the borrower ,the implicit message to be conveyed is that the borrower has to be aware that the bank is concerned and that it will be on alert.

2.9.2.3. Developing the Action Plan :

Following the first meeting ,the credit officer together with other top management begin to evaluate the degree of crisis the borrower is going through, the steps to be taken are usually linked with this assessment.

There are four ways in which the bank can respond:

2.9.2.3(i). Forbearance:

Take no immediate action with the borrower, but carefully monitor the situation and gather more information. Implicitly, it is an agreement by the bank not to act against the borrower for a period of time in order to get a better picture of the problem and to give a chance for the borrower to make remedial actions, and to allow the borrower to deliver additional information or collaterals, in other world, the objective of the bank at this stage is to foster its position and to amend any shortage in the credit agreement. The bank will notify the borrower that it is aware of his position but that it is forbearing on taking action at this time. The bank must fix any error or omission in the documents or collateral before escalating its confrontation with the borrower.

Meanwhile, the bank may encourage the borrower to move to an other bank as at this early stage of default, other bank will miss the early warning and will not be able to

discover it. To encourage the defaulted borrower to dispatch the loan to other bank, certain incentives may be given such as a grace period or discounting the amount due.

2.9.2.3(ii). Move to begin restructuring:

If the bank decides to restructure the loan to accommodate the provisions with the new circumstances the debtor is going through, it will begin to provide the borrower with a formal notification of the event of default. The notification will include the following:

- A statement that the loan is past due and/or in performance default, and that the borrower has breached the contract.
 - A statement of the remedies available to the bank under the credit agreement; and,
 - A statement of action the borrower is required to perform.

The Borrower's Restructuring Plan:

If the bank decides to restructure the loan, as said by Camp(2004),it will require the debtor to prepare a new repayment plan. The plan will include the following:

- i) Updated financial statements.
- ii) Financial projections (pro-forma statements) realistically showing the resources that will be allocated to repay the loan.
- iii) An action plan that describe the steps to be taken by the borrower in order to achieve the financial projection.
- iv) A fresh valuation of the company's assets including the bank's collaterals. In certain circumstances,the bank may use an authorized appraiser to do this step.
- v) Additional collateral or guarantees if possible.
- vi) Any other source of cash to pay the loan.
- vii) A statement of total indebtedness including maturities, payment status, and any security interest on the borrower's assets.

The bank is encouraged to inform the borrower that the cooperative relationship with him will be a function of the quality of the information the bank will receive from him.

2.9.2.3(iii).Move to liquidate the collateral and to perform other necessary steps:

Once the bank reaches a conclusion that the borrower will not be able to repay the debt ,or is not willing to do so, it must be swift to use (liquidate) the last resort, that is ,the collateral since its value is likely to erode substantially either voluntarily or involuntarily. A clever credit officer knows that the first priority is to reach a mutually satisfactory agreement with the borrower because any solution imposed on the borrower unilaterally will be more costly and time consuming. Moreover ,courts usually are reluctant to ease the mission of seizing and selling the collateral.

It is important to mention that the guarantor is considered responsible and in the same legal position as the borrower, so the bank must inform him about the situation and the steps taken . If any term was altered, the guarantor must ratify the change by signing on the alteration .

2.9.2.3(iv).Legal Action:

The ultimate and the least preferred option the bank can have is legal litigation. The bank is inclined to litigate against the debtor when on of the following situation exists :

- a) The borrower is uncooperative or dishonest.
- b) Collateral is insufficient.
- c) The value of the borrower's business is rapidly declining.

2.9.2.4. Implementing the Plan:

The next step is to and forcefully implement the plan because any lag in implementing the plan will enable the borrower to defend or take what ever steps to protect himself.

2.9.2.4(i). Forbearance :

There are two objectives for the bank as it decides to choose this option:

1. To maintain control of the borrower ; the officer has to let the borrower know that refraining from taking decisive steps does not mean that the bank is apathy toward him . The bank may convey a perception that by not acting swiftly was merely an additional opportunity for the borrower to amend his position and to adjust his business conduct. In certain circumstances, this step is linked with certain conditions such as the borrower's compliance with some requirements for the bank.
2. To maintain all rights and remedies, and to improve its position :Credit agreements should contain a non-waiver clause connoting that the bank's decision not to exercise its rights does not constitute a waiver of those rights. Documenting the forbearance through a letter to the borrower acknowledging the event of default and stating that the bank is not waiving any of its rights will be an important step at this stage.

2.9.2.4(ii). Restructuring :

The debtor Camp(2004) added ,should be notified that the bank is willing to negotiate a restructuring agreement .Loan officers are reluctant to forgive principal as the loan should be paid back in full .But it is important to keep the following in mind:

- A key objective of loan restructuring is to return the loan to accrual status. Non performing loans are costly to maintain and require high loan loss provisions .Charging off a portion of the loan as an opportunity cost to save the rest of it will certainly lead to an advantageous agreement.
- It is important for the bank to let the borrower perceive restructuring as a beneficial process to his interest ,and charging off a portion of the due loan will be an incentive for the borrower to proceed in the process.

Properly structured ,a partial charge- off can work to the bank's advantage as they can be perceived as incentives for the debtor to perform positively. Restructuring is an endeavor of both sides to regain mutual trust by readjusting the credit conditions according to the new situation the debtor is experiencing.

2.9.2.4(iii). Collateral Liquidation:

At this escalated phase, and as the bank decides to go ahead with liquidation, the whole documents related to the credit will be transferred to the legal department. The borrower at this stage usually will do his best including fraudulence conveyances, in order to hinder the bank from taking action in order to save his asset and to protect his position. Collateral may be categorized into Immovable or Real Property (land, and buildings) and Movable or Personal Property. Personal property can further be categorized into tangible (car, furniture, and tools) and intangible (patent, copyright, promissory note and capital stocks). Banks usually prefer Real Property as the process of perfection will protect them against most other parties and no other creditor can supersede their claim. Subordinate creditors are entitled to surplus from the disposal of the collateral after loans and expenses have been paid.

Cash is considered to be the best personal property. Most loan agreements contains a provision that allows the bank to use any available balance in the borrower's account as a mean of payment.

2.9.2.4(iv).Legal Action:

If forbearance, restructure, or voluntary liquidation are not possible, the final option for the bank according to Camp(2004) will be to pursue legal action against debtor. There are three key legal actions against the debtor: foreclosure which is the act of barring or extinguishing the debtor's right to redeem the collateral; seeking judgment against the debtor which means a binding determination by the court of the fact and the amount of the liability; and petitioning for involuntary liquidation.

Virtually, bankruptcy regime is perceived as a forum for a debtor and all creditors to collectively adjust their financial relationship under the court supervision. Bankruptcy is beneficial for the borrower for the following reasons:

1. It provides a troubled firm with temporary relief from its creditors.

2. It provides a structural bargaining arrangement in which the company can attempt an orderly restructure of its finance or develop a plan for orderly liquidation under the protection of the court.

Bankruptcy is also beneficial for the bank as well since it impose a timeframe and a process for resolution of the defaulted credit. The bank will be guaranteed that the firm is supervised in a way that will protect its position.

2.10. Z Score:

The concept of a Z score has been developed by Professor Edward Altman. It is a figure which can be calculated from a small number of financial ratios.

Professor Altman(1968) analyzed 22 accounting and non-accounting variables for a selected failed and non-failed firms. Five key indicators emerged. According to Shamaa(2001),the five indicators were used to derive Z score. Firms with Z score of 3 or more, most likely have safe based on financial data. Firms with 2.7 to 3 are probably safe to predict survival, but this is a portion of gray area and dramatic action may be required to affect survival. When firm is 1.8 to 2.7, bankruptcy is likely to happen within two years. Below 1.8 ,firm will be susceptible to high probability of bankruptcy.

The Altman Z score model emerged as :

$$Z = 0.012 X_1 + 0.014 X_2 + 0.033 X_3 + 0.006 X_4 + 0.0099 X_5$$

Where:

X1 =working capital /total assets ratio.

X2 =retained earning/total assets ratio.

X3 =earning before interest and tax/total assets ratio.

X4 =market value of equity/book value of total debt ratio.

X5 =sales/total assets

Altman's sample size was small and related to US firms. Subsequent research based on similar principle of identifying a Z score predictor has produced different

models ,using a variety of financial ratios and different Z score values as predictors of failure.

The Case of Palestinian Banking Sector

2.11. Events and Developments :

Palestinian Banking Sector has never had any better destiny than any other aspect in the Palestinian life. The historical development of the banking sector in Palestine was initially marked by weakness and deformity in its structure and activities due to the political circumstances that Palestine went through. Since Palestinian people has never had the opportunity to run their own affairs independently, the whole economy including the banking sector had to depend on the economies of the ruling states since the room of maneuver was very narrow. The Palestinian experience in the field of banking was culminated as an ordinary Palestinian business man inaugurated the renowned Arab Bank, the giant leading bank that dominates the banking competition in the Arab world, which played a key role in the economic life of the Arab Nations. Before 1948 and during the British mandate, there were many other regional banks that opened branches in Palestine. The period that covered the years from 1948 to the 1967, during which the Jordanian monarchy ruled the West Bank and Egyptian administrated Gaza strip, six Jordanian banks and two foreign banks with 32 branches

operated in the West Bank and one national bank, Bank of Palestine, and two other Egyptian banks operated in Gaza strip.

After the year 1967 and at the advent of Israeli occupation, a systematic process of destroying every aspect of the Palestinian life was carried out; the main purpose was to create a dependent economy without any ties with the surrounding Arab countries or with other countries of the world. Banking sector was on the front line of the battle. As a result, there was a complete collapse to the banking sector as the banks served in the preceding era closed up their doors and left the area, and instead, six Israeli banks with 26 branches replaced them. The occupying authorities' acted to enforce the use of Israeli currency in the area. According to Jaber (1993), it was found that several economic disadvantages of using these banks were enumerated by Palestinian businessmen. These banks conducted business in Hebrew, so language difficulties created misunderstanding in the interpretation of the account. To deposit any Israeli currency, it had to be arranged in special and time consuming way. They kept transfers with them for a long time before remitting to the beneficiary. Opening letters of credit required full cash collateral coverage. It took a long time to have an approval to get a loan by the general managements in Israel and by the military authorities. At these days, the role that these banks played in the process of economical development was very marginal, these Israeli banks did not play the role of financial intermediaries and they were totally inadequate as suppliers of credits. According to Abdulkarim (2004), the loans offered to the Palestinian economy by the Israeli banks did not exceed 1% of the local GDP during the whole era. The eighties of the last century showed a turning point when the Israeli occupation authorities, the sole legislative authority at that time, allowed Bank of Palestine in 1981 and Cairo-Amman Banks in 1986 to reopen their doors and serve the community. Apparently, there was an immense need for building a strong banking system able to meet the economical and financial requirements in Palestine.

Palestinian national authority realized this need, the very first threshold for establishing the new state included passing resolution number 184 on 1/12/1994 that stipulated the establishment of the Palestine Monetary Authority(PMA). Since then, PMA has made reasonable efforts to restructure the banking sector in Palestine according to modern international standards. After signing Paris protocol on Economic Relation between Palestine National Authority (PNA) and Israel,many political and economical changes took place. In 1994, the number of regional and foreign banks that reopen or open branches was eight banks with 34 branches. The development in the banking sector was enhanced in the year 1996 as national banks went up to 8 constituting 40 % of the total banks and 27% of the operating branches. In the year 2005,there was 10 national banks with 63 branches and 12 foreign banks with 74 branches.

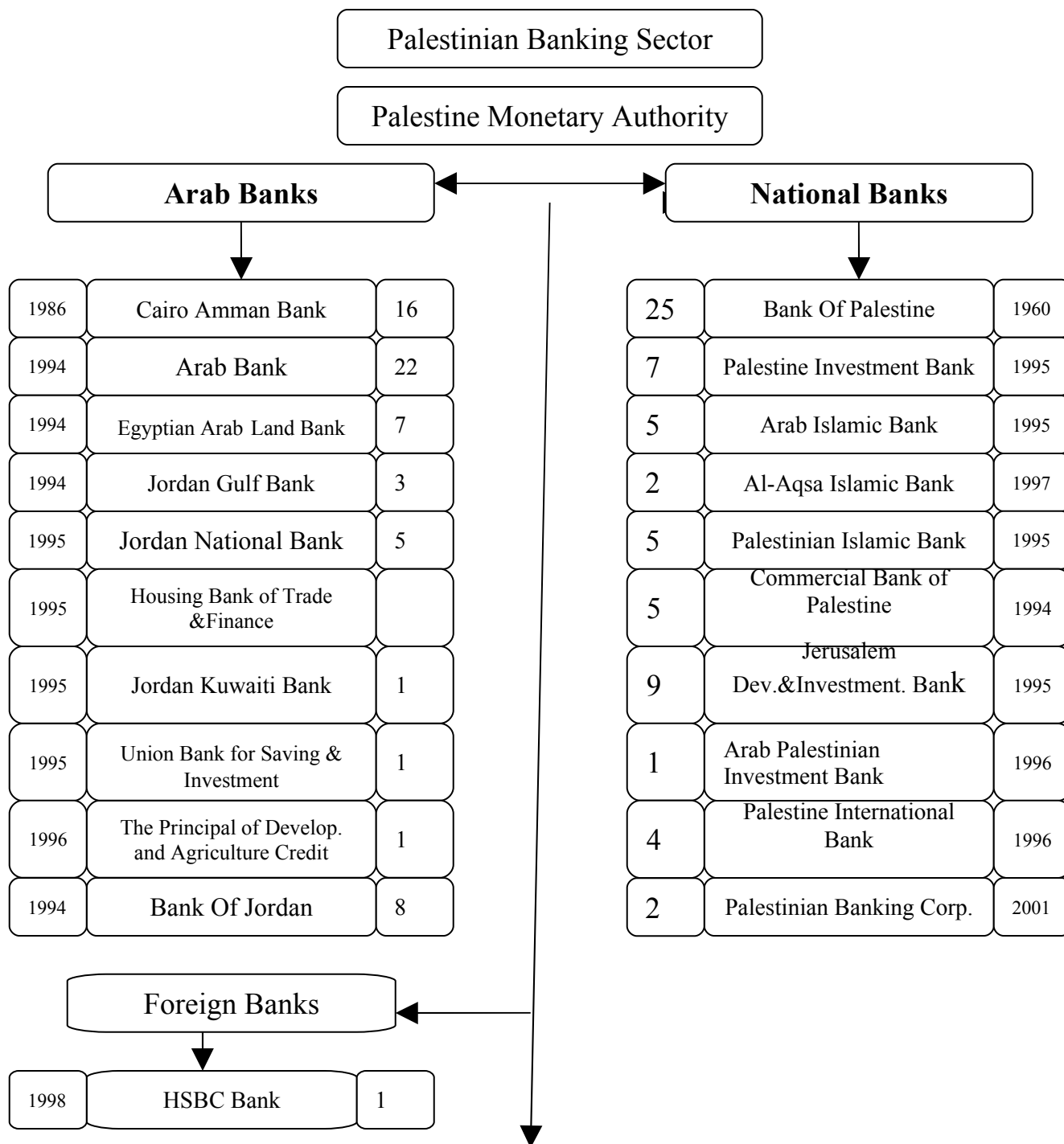


Figure 2.2 :PMA ,Statistical Bulletin ,Issue (90).December ,2005.

2.11.1. Data about Palestinian Banking Sector:

The following consolidated Balance Sheet shows the financial position of the banks operating in Palestine at the end of years 2002, 2003, 2004 and for eleven months of the year 2005 (in million USD):

Table 2.1: Consolidated Balance Sheet of Banks Operating in Palestine

Asset	2002	2003	2004	2005	Changes in eleven months
Cash in Vaults	162.47	224.70	222.48	247.59	25.11
Balances at PMA	357.22	482.75	541.52	558.56	17.04
Inter banks Deposits(Palestinian banks)	174.66	360.36	203.34	133.54	-69.8
Inter banks Deposits(External banks)	2322.24	2267.38	2329.24	2337.48	8.24
Portfolio Investment(Foreign)	3.50	14.50	21.62	11.57	-10.05
Investments (Internal)	99.50	101.81	121.97	249.92	127.95
Claims on Private Sector(Non-Residents)	20.77	31.12	45.28	67.53	22.25
Credit Facilities(Residents)	936.76	1041.18	1383.80	1726.6	342.80
Other Assets	191.64	205.20	244.33	268.63	24.30
Total Assets	4268.76	4729.00	5113.58	5601.42	487.84
Liabilities and Net Worth					
Customers' Deposits	3275.50	3558.87	3869.52	4105.57	236.05
PMA Deposits	104.74	112.04	146.49	172.16	25.67
Inter Banks Deposits	186.08	357.80	200.89	141.26	-59.63
Foreign Liabilities	221.83	117.36	132.82	193.50	6068
Other Liabilities	287.91	359.42	456.49	416.29	-40.20
Total Liabilities	4076.06	4505.49	4806.21	5028.78	222.57
Capital	192.70	223.51	307.37	572.64	265.27
Total Liabilities& Capital Worth	4268.76	4729.00	5113.58	5601.42	487.84
Capital Worth/ Total Assets	4.5%	4.7%	6.0%	10.2%	0.042
Credits/ Deposits (Private Sector)	29.2%	30.1%	36.9%	43.7%	0.068
Capital Worth/ Customers' Deposits	5.9%	6.3%	7.9%	13.9%	.06
Credits/ GDP	87.5%	90.8%	118.5 %	N/A	
Total Liabilities/Total Assets	95.5%	95.3%	93.9%	89.8%	-4.1 %

PMA, Research & Monetary Policies Department, 2005. Issue (90).

The following table shows Capital adequacy including provisions in certain years:

Table 2.2. Consolidated Capital Adequacy for Banks Operating in Palestine

	2000	2001	2002	2003	2004
Capital Worth	244	209	192	222	307
Provision for loans' losses	13	12	10	11	14
Provision for troubled credits	66	84	103	145	147
Other Provisions	32	76	88	100	115
Total	342	369	383	467	569

Tenth Annual Report Management of research and monetary policies,2005.

2.11.2. Time Span From Oslo to The Intifada Outset :

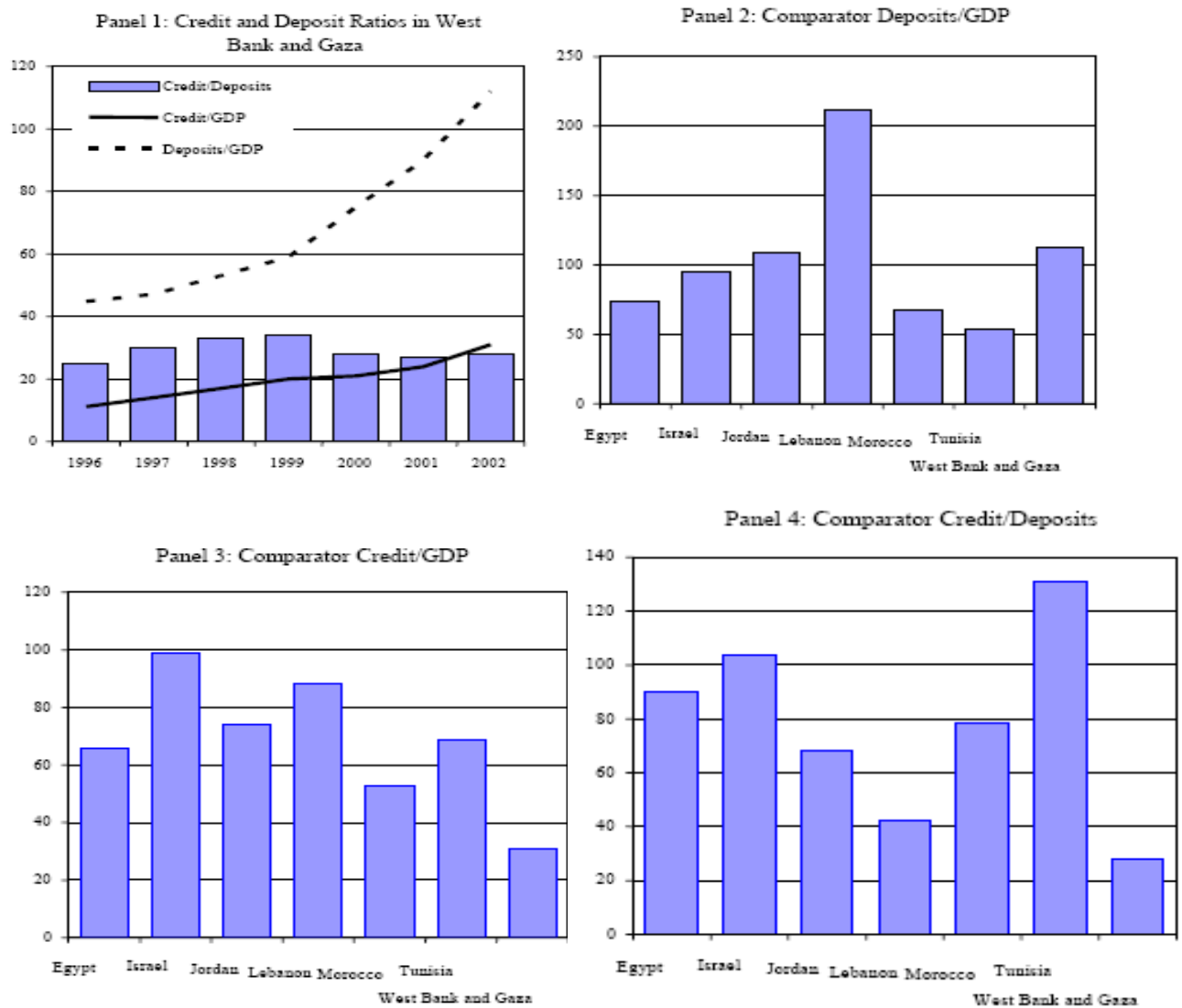
The years that followed the signing of Oslo accord has showed a remarkable upward trend in Deposits at banks . Between 1994 and 1999, the economy grew every year and by a robust average of 8.3 percent per annum according to IMF 2003 Report . This growth was mirrored by an even more rapid expansion of the balance sheet of banks operating in the Palestinian National Authority. By September 2000, on the eve of the Intifada, the consolidated balance sheet of commercial and other banks in Palestine was more than double the level of end-1996 . During this same period, the stock of outstanding domestic bank loans trebled.

An increase in deposits on this scale could not have resulted from the multiplier effect of the increase in bank lending alone. Instead, it emerged from a large scale transfer of deposits held abroad to bank accounts in Palestine, reflecting the new found confidence that followed the Oslo accord and the willingness of businessmen to repatriate monies to help finance their growing businesses. In addition, with growing confidence in the banking system, households may also have repatriated family money from abroad and banked cash holdings previously held in safes or at homes. Another factor used in explaining the strength of smaller deposits in Palestine may have been the increase in the perceived risk of cash holdings in circumstances of frequent house to house desecration and incursions by the Israeli occupying forces.

At best, only one third of the deposits' bulk was deployed as credits in the developing economy. The rest were re-deposited overseas by the banks. By September 2000, the Palestine was, at least on the deposit side, well-banked: the ratio of private

bank deposits to GDP in 1999 was 58 %, one of the prominent ratios in the region . The speed with which this had occurred was remarkable. In 1996, the ratio of deposits to GDP was only 41 % and in 1994, one year after the process started, it was only 17 %. But this high ratio of deposits to GDP in 1999 greatly overstated the role of the banking system in the economy at the time; bank credits to GDP in 1999 was only 20 %.

Figure 2.3: Key Accounts and Ratios of the Palestinian Banking Sector. IMF 2003



Why was banks' lending so low? Despite the improvement in confidence and the robust growth rates recorded during 1996–99, commercial lending in Palestine was

still a highly risky proposition. Future horizon was still hazy and businesses were still feeling their way around the new commercial opportunities post-Oslo. The legal and institutional environment was also very unsatisfactory: with limited land and real estate registration, there was little available for collateral and the court system for supporting commercial claims was shaky at best. With these circumstances, it was not surprising, and indeed creditable, that banks applied a fairly cautious lending policy.

2.11.3. The Intifada and the recession:

At the onset of the Intifada, GDP went into a steep decline. As the closure and curfews combined with a systematic demolishing to Palestinian infrastructure by Israeli invaders went into effect, many businesses found their markets cut off, their labor unable to reach their jobs, and their supplies inaccessible. In such circumstances, it is not surprising that businesses in debt to banks found it difficult to service their loans. The proportion of nonperforming loans in the banks' total loan portfolio rose from some 8 percent just prior to the onset of the Intifada to 11 percent by the end of 2000. By the end of 2001, the ratio had climbed to 14 percent, and by the end of 2002, it had reached 29 percent. With bank loans (and overdrafts) comprising only 31 percent of their balance sheet in September 2000 according to IMF report (2003), an increase in nonperforming loans to as high as 29 percent would have represented the proportion of nonperforming assets as a whole to equal 9 percent which is a considerable ratio and scaled up the accumulated ratio of capital adequacy for the banking sector at that time which was less than 6 %.

The following table shows total direct credits of deferent banks operating in Palestine for the two successive years 2000 and 2001:

Table 2.3: Credits and Provisions of Listed Banks

Bank	Ccy	Direct Credits (2000)	Direct Credits (2001)	Difference	Dif . %aga	Provisions (2000)	Provisions (2001)	Dif.	% age Of Dif.
Jordan Ntnl Bank	JOD	32726449	28251412	(4475037)	(13.67%)	765083	1784971	1019888	133.3%
Bank of Jordan	JOD	63762936	62864466	(898470)	(1.41%)	509417	483245	(71172)	(13.97%)
Al-Quds Bank	\$	29799040	38831153	9032113	30.31%	498960	939080	440120	88.20%
Arab Bank	JOD	452858000	339295000	(11356300)	(25.07%)	1494000	1674000	180000	12.04%
Grendliz Bank	\$	23549001	13280748	(10268253)	(43.6%)	1358278	723309	(634969)	(46.74%)

Unpublished Data,PMA

The data shows that except Al-Quds Bank ,all banks listed in the table had decreased their credit portfolio as a reaction to the proliferation of the second Intifada.In addition, the data shows that the provision for troubled credits was increased substantially as a result of debtors' default.

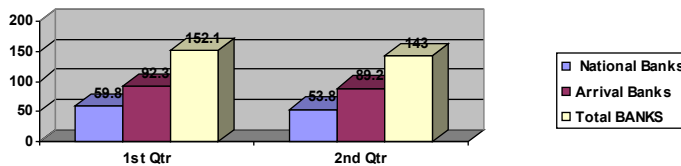
Additional unpublished data of PMA reveals that irregular facilities recorded \$143 ml in the second quarter of 2005 compared with \$ 152.1 ml for the first quarter .National banks' portion was 37.6 % of the total amount:

Table 2.4: Irregular Facilities in Banks Operating in Palestine

	National Banks(million)	Arrival Banks(million)	Total
First Quarter,2005	59.8	92.3	152.1
Second Quarter,2005	53.8	89.2	143

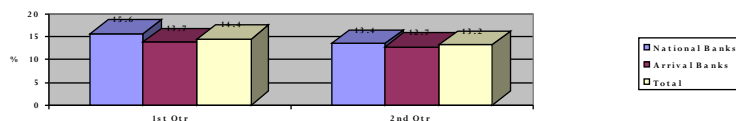
Unpublished Data,PMA

Figure 2.4: Irregular Facilities of National and Arrival Banks during the First and Second Quarters of the Year2005



The percentage of troubled credits to total private credits also decreased to 13.2 % in the second quarter of 2005 compared with 14.4 % in the first quarter according to the following chart:

Figure 2.5 :Percentage of Troubled Credits to total Private Credits of the First and Second Quarters of the Year 2005.

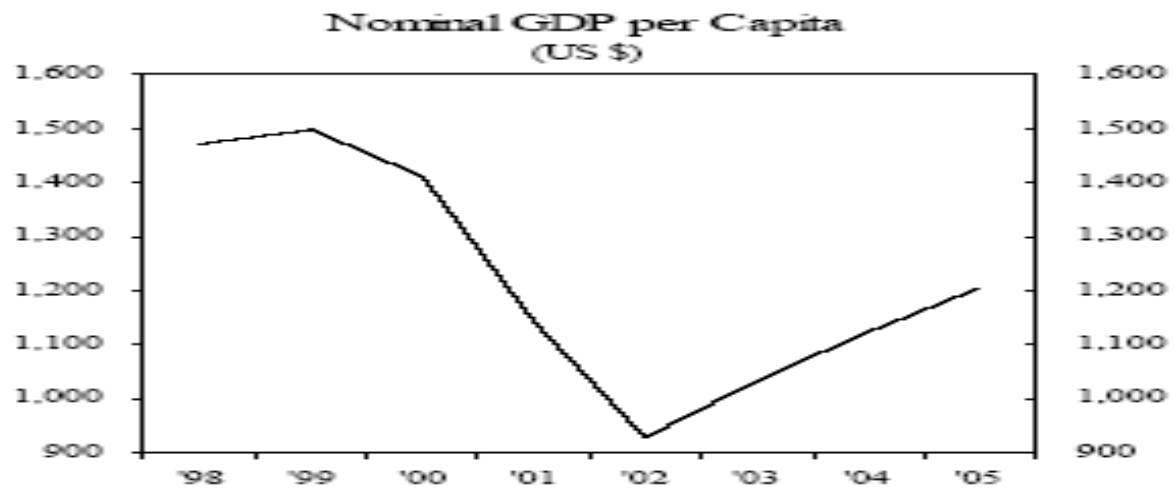


According to PMA, capital worth contributed in 6% of the fund resources in 2004 compared with 5% in the preceding year ,after it was increased by \$ 85 million .The decision adopted by PMA to increase the required minimum capital of the arrival banks from \$ 5 million to \$ 20 million (circular 57 dated 21/4/2003) banks during 2004,specifically those with deposits of more than USD 30 million , may justify a big portion of the aforementioned increment.

The annual report published by the PMA shows that the year 2003 was a breakthrough because it witnessed an easing of movement and trading restrictions, combined with other measures including the resuming of tax revenue transfers collected by the Israeli occupation on behalf of the PNA according to Paris Accord. These developments were followed by additional initiatives by the private sector.As a result, there was an upward curve in main economical indicators such as the GDP which was increased by approximately 12% from \$ 3779.7 million in the year 2002 to \$ 4221.7 million in the year 2003. In addition, GNI (current price)also showed an increase of 14 % from \$ 4160.7 million in the year 2002 to \$ 4760 million in 2003.Meanwhile,unemployment rates showed a downward sloping beginning from 31.3 % in the year 2002 to 25.6% in the year 2003 taking into consideration that the labor force had increased by 11 % to reach 786 thousands .

Financial and economical data for the year 2004 showed a continuous trend of recovery albeit not sufficient to touch the records of the year 2000. The economy showed a growth increase in the GDP equal to 5.7 % which reached the level of \$ 4462.4 million. Per Capita Income raised the individual income to reach \$ 1206.1 compared to \$1180.5 in 2003. The labor force in 2004 increased by 4% to reach 790,000; of which 528,000 worked within the Palestinian territories, 50,000 worked in Israeli labor market and the rest 212,000 were jobless.

Figure 2.6 :IMF 2005



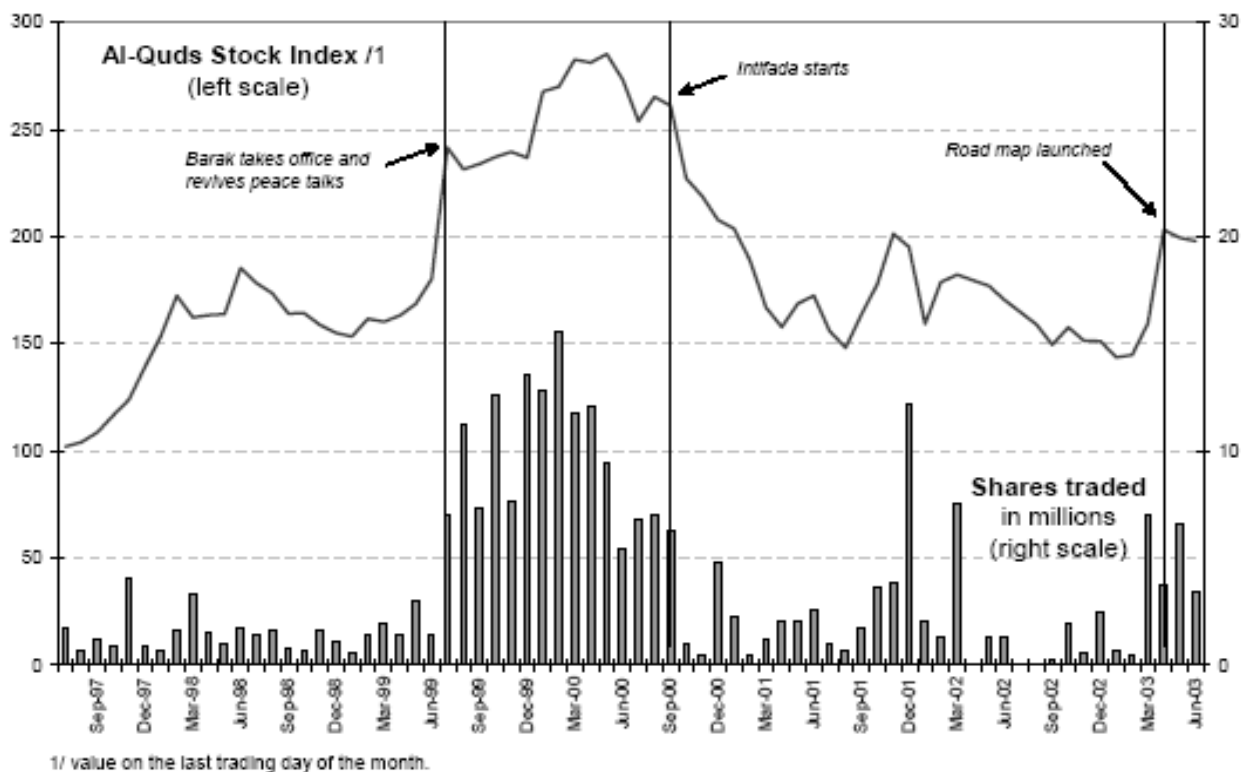
Assets of the PMA increased by 31 % to reach \$ 520 million in 2003. In 2004, the assets of banks operating in Palestine increased by 8% to reach a value of \$5113.6 million in comparison to the preceding year (\$4729.00 ml). The consolidated balance sheet for the two successive years 2003 and 2004 showed a stable trend in the troubled loans allowances from \$147 ml at the end of 2003 to \$ 148 ml at the end of 2004. On the other hand, the credit side of the balance sheet showed an increase of \$356 ml or 33.3 % in 2004 compared with 2003. The ratio of troubled credits provisions to total credits was 13.4 % in 2003 and 10.27 % in 2004 which are above the acceptable ration of 4- 7 % in the banking sector . The year 2004 was a boom with regard to the performance of Palestinian Stock Exchange market in terms of number of dealing

sessions, the amount, and the value of shares. The stock parameter Al Quds hit 278 points compared to 180 points in 2003. The public started to explore an alternative approach to the banking system with sufficient portion of security and rewarding amount of profitability.

Table 2.5: Data about Palestine Security Exchange .PMA Resources

	2000	2001	2002	2003	2004
Number of sessions	211	161	100	223	244
Number of shares	93351075	33456535	18666938	40350788	103642845
Amount of Shares	188982443	74528351	45084654	58326445	200556709
Daily average of the shares value	895651	462909	450847	261553	821954
Daily average of Shares	442422	207805	186669	180945	424766
AlQuds Parameter	208	195	151	180	278

Figure 2.7: Al-Quds Stock Index.(IMF 2003).



2.11.4. Data About Deposits and Credits in Palestine:

Table 2.6 :Geographic Distribution of Deposits by Type (in millions)

	Northern Governorates			Total	Southern Governorates			Total	Grand Total
	Time Deposits	Saving Deposits	Current Account		Time Deposits	Saving Deposits	Current Account		
1999	122.85	310.36	582.70	2121.91	491.54	67.45	194.23	753.23	2875.14
2000	1484.55	396.82	625.45	2506.83	677.91	68.19	253.97	1000.07	3506.89
2001	1547.47	414.01	622.87	2584.35	536.88	83.93	193.65	814.46	3398.81
2002	1554.10	442.64	681.35	2678.09	449.95	94.75	207.40	752.01	3430.10
2003	1420.45	500.65	890.28	2811.37	422.38	116.26	274.42	813.07	3624.43
2004	1329.02	609.23	1043.2	2981.45	455.69	149.88	370.76	976.33	3957.78
11/05	1311.36	644.89	1182.51	3139.76	500.54	155.65	409.21	1065.40	4205.16

Table 2.7. Prorating Credit Facilities by Type and Currency (in millions)

		2002	2003	2004	11/2005
Loans	JOD	82.19	98.05	125.57	159.57
	NIS	17.11	17.58	29.89	44.35
	USD	313.28	355.42	460.10	926.74
	Other	4.26	3.75	3.64	2.39
	Total	416.85	474.80	619.20	1133.05
Over Draft	JOD	54.21	45.49	46.75	70.08
	NIS	149.30	224.58	367.30	323.50
	USD	314.74	305.86	372.36	253.40
	Other	2.76	5.15	9.05	7.88
	Total	521.02	581.08	795.46	654.86
Leasing	JOD	0.00	0.00	0.00	0.78
	NIS	0.00	0.00	0.00	0.00
	USD	6.86	6.30	7.26	8.75
	Other	0.00	0.00	0.00	0.00
	Total	6.86	6.30	7.26	9.53
Bankers Acceptances & Bills Discounted	JOD	2.58	3.15	1.82	2.23
	NIS	0.53	0.20	0.18	0.09
	USD	9.29	6.20	3.67	1.68
	Other	0.00	0.00	0.00	0.00
	Total	12.40	9.82	5.67	4.00
Total Facilities		957.12	1072.00	1427.59	1801.44

PMA, Research & Monetary Policies Department ,2005 .Statistical Bulletin.edt.90

Distribution of Credit Facilities According to the Economic Sectors :

Table 2.8 : Credit Facilities According to the Economic Sector

Economic Sector	2002		2003		2004		9/2005	
	Value	Ratio	Value	Ratio	Value	Ratio	Value	Ratio
Agriculture	16.07	1.68	15.38	1.53	18.08	1.27	20.32	1.13

Industry & Mining	101.05	10.56	92.63	8.64	98.34	6.89	104.67	5.82
Construction	116.43	12.16	133.68	12.47	152.48	10.68	168.68	9.38
Internal Trade	179.87	18.79	178.89	16.69	198.49	13.90	213.76	11.89
Export	9.85	1.03	12.71	1.19	14.94	1.05	13.60	0.76
Import	73.36	7.66	63.74	5.95	85.83	6.01	95.03	5.28
Transportation Service	39.09	4.08	33.45	3.12	43.79	3.07	45.81	2.55
Tourism,Hotels&Restaurants	23.02	2.41	21.67	2.02	22.76	1.59	23.72	1.32
General Service	127.80	13.35	123.37	11.51	144.94	10.15	143.62	7.99
Financial Services	46.44	4.85	68.02	6.35	51.19	3.59	92.33	5.13
Purchase of Securities	2.42	0.25	0.42	0.04	1.21	0.08	3.24	0.18
Miscellaneous	221.76	23.17	318.19	29.68	595.62	41.72	873.63	48.58
Total	957.12	100%	1072.01	100%	1427.66	100%	1798.41	100%

PMA, Research & Monetary Policies Department ,2005 .Statistical Bulletin.edt.90

The preceding table connotes explicitly the absence of a directive economical policy as the Miscellaneous component constitutes the biggest portion of the credits during the periods covered by the data. Banks usually do not document precisely the real purpose of the loan , and since our local economy is lacking real opportunities for investments, a great portion of credit facilities were given for personal uses and luxuries .

Banks in their way to minimize the credit risks have to diversify their credits among wider range of economical sectors, but as there is no strategy for development ,no coordination between the banking sector and the government, and no clear vision by the decision makers , sectors such as agriculture and industry constitute a minimal portion of the total credits performed by banks.

Chapter Three

Research Methodology

Introduction.

The Palestinian Banking Sector is facing an endemic crisis, this crisis is culminated by the existence of two paradoxical ratios :the fragile ratio of capital adequacy on one hand and the ratio of troubled credits to total credits on the other hand. As early

mentioned, the purpose of the thesis is to shed some light on the nature and size of the troubled credits crisis faced by banks in Palestine ,and to propose procedures to manage the issue. The research was performed in accordance with the scientific research methodology applicable in the situation including its well known hallmarks. The methodology's sequence started with observation of the phenomenon as portrayed in the promulgated audited financial statements and other specialized data; the process proceeded to a literature review, which is a documentation of a comprehensive review from secondary sources of data; primary data were gathered from unstructured and structured interviews including answering a questionnaire that linked between the dependent factor (troubled loans) and other independent factors. The process ended with deductions to diagnose the dimensions of the problem and to suggest certain steps necessary in the situation to mitigate its consequences .

3.1. Developed Hypothesis :

Through primary investigation and data gatherings from literature review, it was possible to confine the factors that have the most substantial impact on the troubled credits issue .On the premise of the main dependent and the selected four independent factors : officers' experiences and empowerments, the second Intifada and political unrest ; the role of the PMA ;and the existence of adopted credit policy and procedures , the following hypotheses will be of the pivotal interest in the discussion :

- 1. High experienced credit officers combined with justified empowerment from top management will positively add to the quality of the credit portfolio and negatively to the amount of troubled credits.**
- 2. The second Intifada and political instability has a severe direct influence upon troubled loans amount.**
- 3. The role of PMA is not vital in minimizing the amount of troubled credits in banks operated in Palestine.**

4. **There is a direct relationship between lax of credit standards and the amount of troubled credits.**

3.2. The Population of the Study:

As the prime goal for this descriptive study is to elaborate how banks operating in Palestine manage troubled credits issue and mitigate its effects, the population is the banks operating in Palestine, the unit of analysis is the credit officer and manager in general and regional managements and other credit divisions in their branches. The researcher looked at the data gathered from each of the aforementioned departments or divisions as an individual data source. Data collected was categorized in a way that described the nature of the relationship between the troubled credit issue and the independent variables embodied through the questions addressed.

3.3. Sampling Process:

Selecting a representative samples sufficient to describe the relationship between the dependent and independent factors is a main task that occupied a wide range of efforts and time. The *disproportionate stratified random sampling* approach was used for choosing the sample because it is simpler , less time consuming and relevant to the situation under Israeli siege :

- a) The community was initially categorized into national and arrival banks .
- b) Secondly, the branches were categorized into those which are working in Ramallah and Al Bireh area and those serving Nablus city and its province . These two areas represent two different working environments, the former region is characterized by being located in the provisional Palestinian capital with less susceptibility to closure and other Israeli suppressing procedures. The communication between credit officers and their top management is deemed to be at its best level .It is believed that these officers and managers will be more satisfied and better equipped with experience and empowerment.Nablus city is in the opposite direction where the measures of Israeli oppression are at their highest level , this area was chosen to represent other branches

in risky regions distanced from top management . It is believed that officers in Nablus city are working under stress and pressure to reconcile between the very prompting needs of their society and the fearful and skeptical attitudes of their top management toward the high risky region. The comparison will concentrate solely on attitudinal and social environmental issues presented in the first section of the questionnaire.

3.4. **Illustrations about the Reliability and Validity :**

The reliability of a measure according to Sekaran(2003) indicates the extent to which it is without bias and hence ensures consistent measurement across time and across the various items in the instrument. On the other hand, validity handles the issue of the authenticity of the cause-and-effect relationship (internal validity) and their generalizability to the external environment (external validity).

The process of preparing the questionnaire had gone through systematic steps that deemed to afford a sufficient level of reliability and validity for the tests:

1) A revision of some resembling questionnaires about the same subject of different theses or researches was made to incorporate their main ideas in the questionnaire.

2) After preparing the basic form of the questionnaire, the content and the structure were presented to different credit specialists of different levels who are involved in related activities in several banks who directed some modifications to enhance the quality and measurability of the questionnaire.

3) After concluding the aforementioned adjustments, three samples of the questionnaire experimentally delivered to different credit officers in different banks so as to have some feed back about any difficulty, misperception or inquiry applicant may face while answering the questionnaire. Their questions and suggestions were taken into consideration in concluding the final structure.

The structure of the questionnaire was established to embody the basic hypotheses that constitute the core of the thesis.

- **The first section** concentrates on the trends that shed some light about the bank's attitudes toward learning policies and other social environments that shape the working life of the employees. This includes concepts such as empowerment, interpersonal relationship , equity ,and fostering employees' working experiences .
- **The second section** deals with the issue of how the bank professionalizes its credit practices and procedures. The questions about this fields tried to deepen our vision about issues like internal control, documentation, and policies and procedures that enable the credit stuff to have unified steps while handling the whole issue of credit.
- **The third section** discusses the role PMA has as a regulatory authority while dealing with credits in general and the dilemma of troubled credits in specific. Palestinian banking sector is an enfant- industry that exceptionally needs certain degrees of protection. PMA should shield this emerging sector by adopting necessary steps to enhance its ability to compete. According to Daniels ,Radebaugh & Sullivan (2004),many developing countries use this argument to justify their protectionist policies. Therefore,the host government needs to protect an infant industry long enough for its new companies(banks in our case) to gain economies of scale(larger market share)and for their employees to translate experience into higher productivity.

The sample contains twenty eight answered questionnaires that covered 15 banks out of 21 national and arrival banks.

Chapter Four:

Empirical Analysis

A study of the Questionnaire's Elements

4.1. Biographical Data and Empirical Findings:

4.1.1 Biographical Data :

The questionnaire has five biographical questions and thirteen questions that deal with social and psychological impacts the working outlet influences its employees.

The data below shows some biographic information about the tested credit officers .

Table 4.1 :Age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	22-30	3	10.7	10.7	10.7
	31-35	13	46.4	46.4	57.1
	36-45	8	28.6	28.6	85.7
	>45	4	14.3	14.3	100.0
	Total	28	100.0	100.0	

Table 4.2 :Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Female	2	7.1	7.1	7.1
	Male	26	92.9	92.9	100.0
	Total	28	100.0	100.0	

Table 4.3: Job Title

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Officer	3	10.7	10.7	10.7
	Deputy head of division	4	14.3	14.3	25.0
	Head of division	10	35.7	35.7	60.7
	Controller	3	10.7	10.7	71.4
	Head of department	8	28.6	28.6	100.0
	Total	28	100.0	100.0	

Table 4.4 :Academic Certificate

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Bachelor	20	71.4	71.4	71.4

	Master	8	28.6	28.6	100.0
	Total	28	100.0	100.0	

Table 4.5 :Years of Experience

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	< 5years	2	7.1	7.1	7.1
	5-10 years	16	57.1	57.1	64.3
	>10 years	10	35.7	35.7	100.0
	Total	28	100.0	100.0	

- The data depicts that credit is traditionally a masculine job as the majority of those who handle up its process are men. Credit officer has to have certain attributes in order to perform his duties properly. Analytical abilities, readiness to confrontation ,follow up debtors ,wide range of social activities , and taking swift and decisive actions that may in certain circumstances contradict employee’s conscious and beliefs are examples of the requirements that must be afforded by the officer.
- The data of **academic record** reveals a clear tendency among credit specialists toward upgrading their knowledge and aptitude to have better status in their institutions. As was mentioned in several locations in this thesis, the credit activities are considered as the most important service the bank can offer to its customers, so it is of high priority to pave the way toward a healthy employment environment for those who are involved in such activities. It is a correct practice to let the position that needs the important knowledge and responsibility to be preferable in terms of promotion and learning. As they are prone to many challenging circumstances ,their inclination toward continuous learning is a main concern that is highly welcomed and encouraged by top management .

4.1.2.Human Resources and Organizational Behavior :

The table below illustrates the answers provided by the chosen sample for thirteen questions depicted in section one which explore certain aspects in the social and other internal relationships between the supervisors and their subordinates ,this includes financial benefits, job satisfaction,empowerment,learning policy ,and other key factors that have a salient influence upon employee’s attitude toward the working environment :

Table 4.6 Job Satisfaction and Empowerment (Percentage and Means)

	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly agree 5	Mean
	%	%	%	%	%	/5
1.Salaries and benefits are fair	11	36	14	39		2.82
2.Management applies Effective Learning Policy	4	39	25	32		2.86
3. There is an Effective Communication Between Top Management and Division	4	14	4	71	7	3.64
4.Easy Communication Between Top Management And Divisions does exist	7	7	4	71	11	3.71
5.Effective And Comprehensive Granting Procedures		11	11	75	4	3.71
6.Top Management Cares About Your Suggestions	4	18	14	61	4	3.43
7.Your Authorities Are Sufficient To Execute The Credit		25	14	43	18	3.54
8.Your Authority is Relevant to Your Responsibilities	4	36	11	43	7	3.14
9.You are Convinced By Your Role and consider it Interesting	4	11	14	54	18	3.71
10. You are Convinced about the Bank's Contribution Toward Economy	4	14	25	54	4	3.39
11. Your Top Management Trusts and Supports You	7	18	21	46	7	3.29
12. Troubled Credit Amount is Conversely Related With Your Experience	4	11	11	57	18	3.75
13. You Feel Confident and Able to Answer Questions without Consulting Top Management		7	14	57	21	3.93

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In the table, the degrees of satisfaction or agreement were translated into grades(mean) from 1 to 5 so as to be able to evaluate relevantly the answers. The 5-points scale with its anchors were converted into numbers. As it is an interval scale, the differences in the responses between any two points on the scale remain the same. “Strongly disagree” was converted to number (1), "disagree" was translated to number 2, and so forth until we reach the anchor “strongly agree” which was translated into number (5). Any number depicted in the mean table shows the degree of agreement out of 5.

The answers of the table content strongly agree with the *first hypothesis* that there is an inverse relationship between credit officer’s experience and empowerment and the amount of troubled credits as the degree of agreements for Q12 and Q 13 were 3.75 and 3.93 respectively, the highest scores in the table. The answers also show that people involved in credit activities are satisfied with their mission as the degree of agreement with question number 9 that discusses the issue of job satisfaction was 3.71 out of 5. The lowest grade was given to question number one that talks about salaries and other benefits which was given only 2.82. So, at the first glance, it seems paradoxical when comparing the question that tests the degree of satisfaction with 3.71 score with question number one about salaries and benefits with 2.82 score. The justification for this contradictory situation may be given by referring to the degree of empowerment and care top management pays for credit officers.

Questions that discuss the topics of communication and empowerment (Q 3, Q 4, Q 6, Q 11 and Q13) show relatively satisfactory scores. Moreover, the attributes of credit activities provide additional psychic income that is unique and precious to credit officers. The data shows that employees do not appreciate their top management’s

learning policy as the question about the issue (Q# 2) scored 2.86, the second lowest answer in the section.

Table 4.7: Job Satisfaction and Empowerment According to Geographical Area

	Ramallah and Albeireh		Nablus		Total	
	Mean	Number	Mean	Number	Mean	Number
1.Salaries and benefits are fair	2.77	22	3.00	6	2.82	28
2.Effective Learning Policy	2.82	22	3.00	6	2.86	28
3.Effective Communication Between Top Management and Division	3.73	22	3.33	6	3.64	28
4.Easy Communication Between Top Management And Divisions	3.55	22	4.33	6	3.71	28
5.Effective And Comprehensive Granting Procedures	3.73	22	3.67	6	3.71	28
6.Top Management Cares About Your Suggestions	3.41	22	3.50	6	3.43	28
7.Your Authorities Are Sufficient To Execute The Credit	3.50	22	3.67	6	3.54	28
8.Your Authority is Relevant to Your Responsibilities	3.32	22	2.50	6	3.14	28
9.You are Convinced By Your Role and consider it Interesting	3.64	22	4.00	6	3.71	28
10.You are Convinced about the Bank's Contribution Toward Economy	3.45	22	3.17	6	3.39	28
11.Your Top Management Trusts and Supports You	3.27	22	3.33	6	3.29	28
12.Troubled Credit Amount is Conversely Related With Your Experience	4.00	22	2.83	6	3.75	28
13.You Feel Confident and Able to Answer Questions without Consulting Top Management	3.86	22	4.17	6	3.93	28

Categorizing the answers according to geographical data shows that employees of Nablus branches are more satisfied of their salaries and benefits, this may be related to the different price index between Ramallah and Albeireh and Nablus area. The most prominent deviations appear while answering questions about the communication with top management which shows a contradictive answer as the mean of Nablus branches

was 4.33 compared to 3.55 of Ramalla and Albireh despite the contradiction they showed when they answers the previous question as the mean of Nablus was 3.33.

Moreover,Nablus branches’ employees do not agree with the hypothesis that troubled credit level is conversely related with the employees’ experience(Q12=2.83) ,but it seems to be that they are granted more empowerment since the answer of the last question about it shows that 4.17 feel confident and empowered ,while Ramallah and Albireh ratio was 3.86 .

The data within the selected population from which the samples were chosen indicates the deepen trend of gender inequality between men and women in major fields mentioned had been witnessed according to the following:

Table 4.8: Genders’ Records

Gender	Salaries and Benefits are Faire	Your Authorities Are Sufficient To Execute The Credit	Your Authority is Relevant to Your Responsibilities	You are Convinced By Your Role and Consider it Interesting	Your Top Management Trusts and Supports You	You Feel Confident and Able to Answer Questions without Consulting Top Management
Female	2.00	3.00	2.00	2.50	1.50	3.00
Male	2.88	3.58	3.23	3.81	3.42	4.00
Total	2.82	3.54	3.14	3.71	3.29	3.93

Women scored less in the main questions which discuss employee’s benefits, authorities ,empowerment, and mutual trust with top management. This may not be an accurate picture taking into consideration the limited sample selected ,but certainly the scores say a lot of thing about gender discrimination .

4.1.2.1. National Versus Arrival Banks :

The next step was to subdivide the sample into more articulated categories: National Banks ,Jordanian Banks ,and Foreign Banks. The aim for this division is to find the linkage between the nature of the answers and the bank’s nationality.

Table 4.9:Job Satisfaction & Empowerment According to Bank’s Nationality

	National	Jordanian	foreign	Total
Salaries and benefits are fair	2.63	3.00	2.82	2.82
Effective Learning Policy Does Exist	3.13	2.55	2.86	2.86

Effective Communication Between Top Management and Division Does Exist	3.44	3.91	3.64	3.64
Communication Between Top Management And Divisions is Easy	3.94	3.64	3.71	3.71
Effective And Comprehensive Granting Procedures	3.5	4.00	3.71	3.71
Top Management Cares About Your Suggestions	3.13	4.00	3.43	3.43
	National	Jordanian	foreign	Total
Your Authorities Are Sufficient To Execute credit	3.56	3.64	3.54	3.54
Your Authority is Relevant to Your Responsibilities	3.00	3.27	3.14	3.14
You are Convinced By Your Role and consider it Interesting	3.75	3.82	3.71	3.71
You are Convinced about the Bank's Contribution Toward Economy	3.25	3.55	3.39	3.39
Your Top Management Trusts and Supports You	3.13	3.45	3.29	3.29
Troubled Credit Amount is Conversely Related With Your Experience	3.75	3.73	3.75	3.75
You Feel Confident and Able to Answer Questions without Consulting Top Management	3.94	3.91	3.93	3.93

Since they are the main elements of the Palestinian Banking Sector, it is worthy to shed some light on what the data says about differences in major factors for National and Jordanian banks with regard to organizational environment and social atmosphere in the banking sector. Jordanian branches scored higher in different factors including financial benefits, the relationship with top management, and employees' belief about the effectiveness of their adopted credit procedures .

Palestinian banking sector is dominated by Jordanian banks. This can be explicitly shown as they save 79.2 % of the Palestinian deposit bulk at the end of 2004 .Meanwhile the ratio of credits to deposits was 49 % for national banks while it was 19 % for the Jordanian banks in the same period ,far away from the targeted ratio of 40 %. Jordanian banks have competitive advantages in comparison with national banks according to the following:

1. Politically, they are supported by more stable government and financially they are controlled by a professional supervisory authority that has the three

necessary monetary instruments to adjust their position against undesired risks .

2. These banks are an extension of profound long-aged experienced managements which have long deeds in the banking practices, some of which are considered among the pioneers in the Arab world and worldwide ,this denotes that they have gone through a vast array of banking practices and experience that gave them better immunity against risks.
3. They have better financial positions ,their general managements can cover any deficit on demand ,so they are better equipped to face difficulties and complications ingrained in the Palestinian economy.
4. They have better governance and more proficient management due to long time of running, they also have better controlling standards because geographical remoteness of their top management can be a positive factor as the ultimate decision makers are away from negative intervention .
5. They have greater influence on the PMA,according to the questionnaire, approximately 61% agreed or strongly agreed that Arab and Jordanian banks are more competitive than national banks despite the fact that 57.1% of the tested samples were national banks' employees, two questions listed in section number three show considerable perception about this assumption according to the following:

PMA's policies will support small banks and will inhance its ability to compete big banks	28	2.43
PMA is strict against small banks wile it is lenient toward big ones	28	3.39

Arab and Foreign banks are more competitive than national banks

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	1	3.6	3.6	3.6
	Disagree	8	28.6	28.6	32.1
	Neutral	2	7.1	7.1	39.3

	Agree	9	32.1	32.1	71.4
	Strongly agree	8	28.6	28.6	100.0

Table 4.10 :Bank's Nationality

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	National	16	57.1	57.1	57.1
	Jordanian	11	39.3	39.3	96.4
	Foreign	1	3.6	3.6	100.0
	Total	28	100.0	100.0	

Annual financial results also upheld such a conclusion; in addition, only 14.3% agreed that PMA support small banks(national banks in general) in their pursue to compete big banks according to Q11 section three .

6. The preceding factors in addition to other factors provide Jordanian Banks with competitive advantages to run their business with lesser cost and better efficiency, and as a result, with higher profitably:

- a. Customers perceive them as safer than national banks. So, they are ready to accept lower interest rate for their deposits because they weigh up the lesser difference in risk factor that leans toward Jordanian banks to be more significant than the excessive difference in interest rates paid that the national banks are willing to offer , taking into consideration the fact that most of the Palestinian investors are risk averse .
- b. Since they were found in an environment that is characterized by having wider access toward the world, they have well established correspondent banks' or offices' networking all around the world .This enables them to play a key role in the Palestinian international business. They are not forced to retain 100 % coverage for their operations overseas because they are trustworthy and well known to the corresponding banks, this can be an additional factor that can decrease their overhead expenses .Most of these banks are in the zone of Basel Accord's ratio.

c. The analysis of the questionnaire reveals that employees of Jordanian banks have better job satisfaction ratio than those of national banks :

- They are better trained as they base their performances and practices on experimented and documented policies and procedures that answer many of questions they may encounter during their working days. Department managers supervising the performance usually have deepen experiences that are continuously conveyed to subordinates. Moreover, answering the questionnaire revealed that Jordanian banks are more inclined toward investing in their human resources ,the next table answers the question included in section one about how many related courses the respondent has attended during the last two years:

Report Mean	
Bank's Nationality	Number of Related Courses
National	4.13
Jordanian	6.36
Foreign	2.00
Total	4.93

- As they are part of a crew that exists abroad , benefits and fringes achieved by or given to employees in Palestine or Jordan will be generalized to the other part of the working environment. Arab Bank is considered as a leading bank in all aspects related to banking industry in Jordan and Palestine. As they are experiencing a boom period, they are practicing policies dedicated to reward their employees .They are paying additional salary quarterly while most of national banks pay additional salary semiannually .Moreover ,their employees are paid a certain portion of the annual net income achieved, according to their performance and evaluation .Other Jordanian banks imitated these practices. The lucrative records enable these managements to empress their employees. Meanwhile, the national banks' employees are carrying the burden of the political circumstances that have a severe influence on the final annual results these banks are achieving.

- Since Jordanian banks are more capable of achieving better success, their employees are better motivated financially and psychologically because they feel that they belong to profound organizations; in addition, they are more secure at their working places and can count on their job for long time to come.

7. On the other hand, Jordanian banks' employees encounter several shortcomings related to several facts:

- a) Regional managements of Jordanian banks operating in Palestine are administered by senior employees sent by general management. As they have wider accessibility to top management in Jordan, those managers can shape its attitude toward other employees in their branches in Palestine. Their recommendations can substantially affect the potential advancement of the subordinates .
- b) There may be dissimilarities of criteria between employees in Palestine and their top management in Jordan due to cultural differences. For example ,strict discipline to regulations and policies in the outlets is something of paramount priority for Jordanian workforce ,hardly can anybody find such a disciplinarian conduct among Palestinian workforce .
- c) Employees working at Jordanian bank have a confined job description and are limited with specific tasks due to what Greenberg & Baron(2003) call it Quantitative Overload ,that talks about the belief that one is required to do more work than possibly can be completed in a specific period. Their skills are exclusively dedicated to perform certain tasks and they do not have enough time to direct their efforts toward other jobs . They are usually exposed to more stress and strain due to overloaded working demands.

4.2. Procedural framework and Anti-Troubled Credits Policies:

After scrutinizing the inner motivations and other social factors that are deemed to have a considerable influence upon the daily conduct of the credit staffs in banks, the next step was to dredge up toward obviating the procedural structure ,knowledge, policies and other factors that constitute the main ingredient of the credit decision .These factors are the key elements that may shape the strength and the soundness of credit portfolio the bank may have ,and as a result, the solidity of the banking sector as a whole. After forming the boundaries of risk exposures by the board of directors, the next step is to let top management form policies and procedures to mitigate the inherent risks and to get sure that the activities of the bank are within these boundaries. The section contains 20 questions that talk about the documented procedures and policies provided by top management ,the corporate governance which stipulates the professional rapport that links credit officer with his top management ,the quality of top management as indicated by seasonal or intermittent revision of the policies according to Basel II suggestions, and other internal control procedures that are of a great role in decreasing the impact of troubled credits.

The next table portrays these questions and the nature of answers the tested sample provided:

Table 4.11: Existence of Policies and Procedures

Questions	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean
	%	%	%	%	%	/5
1.Bank has Stipulated written Procedures for credit		11	4	68	18	3.93
2.Procedures and Policies Are Updated Periodically According to Economic Developments	7	25	14	46	7	3.21
3.Top Management Cares About Branch's Commitment of Policies	4	11	7	64	14	3.75
4.Sufficient Cash Flow and Adequate Collaterals Are Highly Required For Credit Decision Making		25	7	57	11	3.54
5.Borrower must Provide Audited Financial Statements When Applying for Credit		29	7	50	14	3.50
6.Borrower's Management Quality is Evaluated and Considered As a Gesture for Commitment		14	7	68	11	3.75
7.Top Management Interferes and Affects Your Conclusions About Borrower's Credibility	4	18	4	57	18	3.68
8.Criteria That Management Considers While Affecting Your Recommendation Are Understandable		11	21	61	7	3.64
9.Higher percentage of Troubled Credits is due to inability of payment rather than unwillingness to pay	7		7	75	11	3.82
10.Big Credits' Decisions Are Taken By Credit Committee			4	39	57	4.54
11.Credit department is effective in controlling credits and minimizing credit risks	4	25	7	54	11	3.43
Questions	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean
12. Controlling credits is performed by audit department		11	18	57	14	3.75

13.Bank performs effective early detection process on credit	7	18	18	50	7	3.32
14.Troubled credits are directly related with political instability		7	7	61	25	4.04
15.Computer system is integral and can deal comprehensively with all process of credit granting	4	14	18	57	7	3.50
16.Studying and answering credit application are not time consuming		7	4	82	7	3.89
17.Troubled credits would have been minimized if you were given additional role in credit decision making		18	14	54	14	3.64
18.The bank is committed with PMA central credit risk unit and informing any credit more than \$10000				61	39	4.39
19.You do believe that Arab and Foreign banks are more competitive than national banks	4	29	7	32	29	3.54
20.The bank controls the financial position of the borrower and gets sure about his good performance		18	11	64	7	3.61

4.2.1. Designing Credit Policy and Procedures :

The results in the table reveal that the banking sector is commencing a new trend toward basing their credit activities on sound and well established criteria .The challenging situation banks are facing pushes the decision makers in those banks to reevaluate their previous demeanors and to try to amend their trends toward more stable and rigid credit portfolio. Supervisory authorities including PMA direct the operating banks in Palestine to inaugurate unified documented policies and procedures and to direct their employees' activities according to them. These banks realized that increasing the quality of management and unifying their procedures are necessary steps in order to increase their abilities to compete .

It is important to have documented policies and procedure that will lead the decision makers toward the right track, but what is more important is to put these policies and

procedures into action by ingraining them as core elements in the banking thoughts and deeds. In certain circumstances, these guidelines are established to meet the requirements of the supervisory authorities and unfortunately they do not have a real influence upon the actual situation. Moreover, these guidelines may be merely a frontier that limit the lower and middle managements but can easily be bridged up by top management that abuses its jurisdictions, the conduct that may deepen the chronic infliction the banking sector has, or what is known as the Agency Problem. The table agrees with the content of the *second hypothesis* that political unrest and the second Intifada are the main factors that worsen the quality of credits granted and led to defaulted debtor (Q 14 that discusses the issue scored 4.04 out of 5) .

4.2.2. A tendency Toward Better Corporate Governance:

A considerable bulk of the troubled loans recorded in Palestinian banks is dated back to the early stages of the banking sector when the banks' top managements were illusively enchanted by the high level of positive expectancies about the horizon of the Palestinian economy, hoping that by easing their requirements, they will be able to allocate a bigger market ratio through which they can augment bank's profits. The deterioration of the political situation after Camp David Summit was a detrimental event that turned down every aspect in the Palestinian life including the banking sector. Individuals and companies were vulnerable to unforeseen circumstances during which they lost their ability to generate profits and hence, they were under liquidity drain. Anyhow, the data is showing a positive direction toward better corporate governance due to the fact that management is sending an increasing indications about its eagerness to revise policies and procedures , to facilitate its mutual communication and understanding with other lowered-level managements, and toward revising its approach for making decisions.

The majority of the respondents (Q #10= 4.54 out of 5) agree that big credits are signed by experienced committees ,by doing so ,the bank can guarantee that all

necessary criteria were integrated in the committee’s decision and that the inclination toward politicizing the decision making process will be minimized.

Table 4.12: Existence of Policies and Procedures according to Nationality

	National	Jordanian	Foreign	Total
1.The bank has stipulated written procedures for credits	3.75	4.09	5.00	3.93
2.Procedures are updated periodically according to economic developments	2.94	3.55	4.00	3.21
3.Top management check Branch's commitment of procedures and Policies	3.69	3.82	4.00	3.75
4.Sufficient cash flow and adequate collaterals are highly required for credits	3.62	3.36	4.00	3.54
5.Borrower must provide audited financial statements when applying for credit	3.50	3.64	2.00	3.50
6.Borrower's management quality is evaluated and considered as a gesture for commitment	3.69	3.91	3.00	3.75
7.Top management interferes and affects your conclusions about borrower's credibility	3.75	3.45	5.00	3.68
8.Criteria that management considers while affecting your recommendation are understandable	3.56	3.73	4.00	3.64
9.Higher Percentage of Troubled Credits is Due to Inability of payment rather Than Unwillingness to Pay	3.81	3.82	4.00	3.82
10.Big credits' decisions are taken by credit committee	4.63	4.36	5.00	4.54
11.Credit department is effective in controlling credits and minimizing credit risks	3.31	3.73	2.00	3.43
12.Controlling credits is performed by audit department and credit follow up	3.88	3.55	4.00	3.75
13.Bank performs effective early detection process on credit	2.94	3.82	4.00	3.32
14.Troubled credits are directly related with political instability	3.94	4.09	5.00	4.04
15.Computer system is integral and can deal comprehensively with all process of credit granting	3.00	4.18	4.00	3.50
16.Studying and answering credit application don’t take much time	3.81	4.00	4.00	3.89
17.Troubled credits would have been minimized if you were given additional role in credit decision making	3.62	3.64	4.00	3.64
18.The bank is committed with PMA central credit risk unit and informing any credit more than \$10000	4.38	4.36	5.00	4.39
19.You do believe that Arab and Foreign banks are more competitive than national banks	3.25	3.82	5.00	3.54
20.The bank controls the financial position of the borrower and gets sure about his good performance	3.75	3.36	4.00	3.61

The answers provided by the respondents favor Jordanian Banks’ performance in issues such as documenting and modifying policies and procedures ,and in imposing these policies and procedures on the branches’ practices .Moreover ,the answers show that employees in Jordanian banks value their managements better in the subject of

controlling credit facilities and minimizing troubled credit risks ,and in the subject of early detection which shows a big excursion from a degree of 3.82 out of 5 for Jordanian branches’ employees to 2.94 for Palestinian banks’ employees. The data also shows that computer systems and other auxiliary systems are more trustworthy in Jordanian banks since the mean of Jordanian branches’ employees who assent the credibility and efficiency of their computer system was 4.18 while the Palestinian national banks’ employees mean was 3 out of 5. It is well known that computer systems operating in Palestinian banking sector are of Jordanian origins. Computer system is a key element in creating a rigor and credible environment .Really it is a main ingredient of the competition campaign between banks. Any deficiency in the computer system may demolish the customer’s trust on the banking data or even an exaggeration of the **Operational Risk** Basel Committee considers it as a main element of the bank’s instability.

The questionnaire examined the banking sector’s perspective about the comparative competency of the Jordanian banks, Q19 shows that 59 % of the tested employees do agree that Jordanian banks are more competent than national banks.

4.2.3. Chosen Factors of Troubled Credits’ Aggravation:

Section two of part two further delineates six major factors that deemed to have contributed to the disquieting record of troubled credits, the respondent was requested to rate these factors that encompass both internal causes and external causes so as to obviate the prorated weight each factor is perceived by credit specialists :

Table 4.13 : Factors Surging Troubled Credits(Percentage & Means)

	First	Second	Third	Fourth	Fifth	Sixth	Mean
	%	%	%	%	%	%	
1.Weak credit examining and lack of information	14	21	32	18	4	11	3.07

2. Ignoring cash flows as a mean to pay installments	18	29	11	14	14	14	3.21
3. Weak or insufficient collateral	4	14	14	29	14	25	4.11
4. Individual or politicized decisions	18	21	14	18	25	4	3.21
5. Weak credit experience	14	11	11	14	25	25	4.00
6. Political environment and Intifada	32	4	18	7	18	21	3.39

The preceding descriptive table was structured to explicit the degree of importance respondents perceived each of the six factors listed. The descriptive table has categorized the factors according to their weighted average, the anchor labeled “ first important “was given number one, the anchor “sixth important” was given number six, etc. The question with the least score is the best because it will be the nearest one to number one or the first important factor.

The answers show that credit specialists classify internal factors that have contributed to the skyrocketing portion of troubled loans to be more important than the external factors noting that the nearest grade to number one (First Importance) was given to lack of sufficient information (=3.07). Banks simply gather information about potential borrower and use it with other screening mechanisms to select the most appropriate debtor. These mechanisms help to reduce information costs, overcome problems of asymmetric information, improve resources allocation and enhance growth. It is important to have the relevant information that may contribute to building a profound credit portfolio, but what is more important is to have these information in the right time and to use it successfully. The second important paralleled two factors were ignoring cash flow as a main source of payment, and basing decisions on unclear premises or politics, the two factors scored 3.21 for both of them. The first external factor these employees hinted to was the political situation and the Intifada which scored 3.39.

4.3. The role of the PMA in Managing Troubled Credits Issue:

4.3.1. The PMA's Inauguration and Challenges:

The Palestinian Monetary Authority (PMA) was established in late 1994, with its responsibilities and limitations delineated in the 1994 protocol on Economic Relations. These include licensing, regulating and supervising banks operating in Palestinian territories in accordance with "Basle Core Principles." The Banking Law of 1997 (revised in 2002) provides the PMA with broad authorities over the means for achieving these objectives, and designates the PMA as an independent entity. Although the PMA has some of the powers and functions of a central bank, it does not issue its own currency. It does not have the monetary instrument to affect and direct the economy according to predetermined objectives, the monetary instruments available to PMA have offered a limited scope for influencing monetary conditions in Palestine. Consequently, the PMA's main function is banking supervision, ensuring that capital adequacy ratios are respected and protecting depositors' interests.

Through the past ten years, the Palestinian financial system has been exposed to the most extreme of stresses—with rapid economic growth and hasty optimism in the mid to late 1990s followed by an abrupt and severe economic downturn in the wake of the Intifada at the end of September 2000. In such circumstances, one would have grounds for expecting the Palestinian Financial System to have been strained to the limit, and possibly beyond. But despite the decline in the economy, despite the awful situation of resident depositors and borrowers, and despite the logistical difficulties faced by the regulatory and supervision authorities, the Palestinian Financial System according to IMF 2003 report remains upright, functioning and liquid.

4.3.2. Comprehensive guidelines for Dealing with Troubled Credits:

The efforts of PMA concerning the issue of troubled credits culminated by promulgating Circular 93-D4/7/2001 dated 22/07/2001 that regulates several issues of

handling credits by the Palestinian Banking Sector toward enhancing the quality of its credit portfolio. The PMA Circular 93 dictates that banks in Palestine shall make loss provisions based upon the accrual and due payments of the installments or upon the situation of the creditor rather than upon banks' judgment about the quality of the loans. The main goal was to establish a vigorous credit portfolio based on actual substantial realities rather than hazy criteria. The characteristics and dimensions of the troubled credits' problem make it important to clarify the reasons for it, the nature of the coherent risks, factors that increase it, and procedures necessary to mitigate its effects. Banks are asked to allocate two kinds of provisions related to granted facilities : General Provision and Specific Provision. In order to calculate specific provisions, credits are classified according to the following categories:

1. Regular (Good) facilities standards are those where the repayment of principal, interest and other commissions related with the credit are made on schedule and according to the terms .
2. Specific care facilities are those where payment of principal ,interests and/or commissions is 30-90 day past due ,and as a result, the facilities require special alarm ,but does not need a specific provision .
3. Irregular facilities not paid according to the approved terms because of the borrower's inability to serve and repay the due amounts for more than 90 days while the bank lacks sufficient, liquid collateral .Irregular facilities are further divided into three categories:
 - a. Substandard facilities where repayment of principal and /or interest is 91 to 180 days past due. In addition ,it includes any facilities where the borrower faces financial difficulties ,or the bank does not have sufficient collateral. The minimal provision ratio applicable on this category is 20% of the outstanding amount after deducting the admissible collateral.

b. Doubtful facility where repayment of principal and/or interest and other commissions is 181 to 360 days past due. In addition, it includes any facility where the borrower is facing severe hardships. The minimal provision ratio applicable on this category is 50% of the outstanding amount after deducting the admissible collateral .

c. Loss facilities where the principal and/or interest and other commissions are more than 361 days past due. In addition, it includes any facility that is considered uncollectible within a reasonable period. The minimal provision ratio applicable on this category is 100 % of the outstanding amount after deducting the admissible collateral.

The aforementioned circular articulated the admissible collateral types and their acceptable rates. The legal environment and political unrest we are facing make it difficult to count on these collaterals ;for example, equity stocks of banks, institutions and public shared companies traded on the Palestinian Stock Exchange are 80 % accepted as a collateral, these stocks are valued at lower of cost or market according to the circulation. Practice showed many instances during which the market prices of such stocks declined for 5 % per day. Turbulent political instability may deteriorate the market value of any collateral quickly, leaving the bank with devalued collaterals .Moreover, in practice, there is no stipulated guidelines for using personal guaranties .These guaranties of renowned key figures are 100 % admissible up to \$25000.00 even if the he is not a customer of the lending bank. Banks use these guaranties as an evasive leeway to ease their lending conditions despite the fact that it is unpractical to litigate a non-customer guarantor if the main debtor violates his commitment to pay.

In the Palestinian banking sector's practice, customers are allowed to use an unplanned overdrafts to fund short-term obligations. Under such dangerous practice, there is no documentation on this form of credit extension ;furthermore, they usually

lack any admissible collateral. Customers more often use this kind of credit as a permanent source of fund although they are not created to finance long-term operations ,meanwhile, the bank lacks any instrument to force the borrower to adhere to his commitment for paying the overdraft. These examples show some gaps inherent to regulations promulgated by the PMA which may contribute to the increasing amount of troubled credits .

4.3.3. PMA Laborious Inertia:

4.3.3.1. Adequate Authority, Credit to Deposit Ratio and Oversees' Deposits:

It is obvious that PMA does not have adequate authority to steer the banks toward full compliance of its regulations and objectives:

1. There always has been a paradoxical attitude linking the PMA and banks' top managements. Among other roles PMA is seeking to achieve is creating a profound and credible banking sector that will substantially contribute to the national economy. On the other side, top managements and BOD are responsible toward stockholders who will scrutinize the top management's deeds and conducts according to the financial outcomes.

Two interrelated issues can show how PMA is partially paralytic for achieving its goals .These two issues are the ratio of credits- to -deposits and the issue of banks' deposits overseas. These two issues are interrelated and led to a decreasing contribution of the banking sector in the process of developing national economy .Circular 20A-98 dated 5/6/1998 aimed at intensifying the contribution of the banking sector's role in enhancing the economy. It calls for increasing the ratio of credits to deposits from 30 % to 40 % ,and for reducing the average overseas' deposits at that time from 90 % to 65 % of the deposits.

The circular was published as a reaction to the escalating rumors that banks, especially the arrival ones ,are sending the greatest portion of their deposits to their

head quarters abroad. Unfortunately, the circular explicitly lacks articulated practical steps or even a logical time span toward achieving these goals ,by rewarding the complying banks and punishing the abstaining ones.

Data below was published by PMA to manifest the banking sector’s position for the main types of assets and liabilities at the end December 2004 (in millions U S) :

Table 4.14:Key Ratios in the Palestinian Banking Sector quoted from PMA Annual Report 2004.

/DOS TD	Deposits Overseas (DOS)	/PSF CT	PSF/TD For banks	Private Sector Financing (PSF)	/Bank’s CD Total CD	Customers Deposits (CD)	Total Deposits TD	Banks
40.3%	364	49.6%	40.86%	369	18.85%	746	903	National
58.6%	1928	18.6%	17.35%	571	77.74%	3076	3290	Jordanian
16.8%	22	64.6%	54.19%	71	2.80%	110	131	Egyptian
60.0%	15	12.4%	12.4%	3.1	0.63%	25	25	Foreign
57.0%	1965	20.1%	20.10%	645	81.1%	3211	3446	Arrival Banks
53.6%	2329	25.63%	23.31%	1014	100.00%	3957	4349	Total Banks

Easily, it can be seen that PMA was unable to achieve its targeted credits -to-deposit (=40 %) ratio despite the fact that six and half years of promulgating the circular elapsed. In the year 1998,the ratio was 30% in Palestine, while it was 86 % in Israel and 80 % in Jordan. At that time, according to Dajani, Awartani Dajani, Awartani, Eshet & Schiavo, more than half of credit granted to private sector was in the form of overdraft facilities which usually are given in small amounts for short period ,so they are not the best way to finance productive investments .Banks claim that the turbulent economic environment and high risks are big obstacles that preclude banks from extending their contribution to the economy. They further claim that any lax in their credit policies to achieve such a goal will ruin the banking sector as a whole. The lack of lucrative investment opportunities, the unqualified

management, the disintegration between the private sector and public sector, and the high level of country risk can justify banks' point of view.

4.3.3.2. Nurturing New Infant Sector:

As a supervisory authority, PMA was unable to nurture the infant-national banking industry in order to enhance their ability to compete against the entrenched profound arrival banks in the local market. The data is implicitly referring to the tendency of the majority of Palestinian public toward entrusting the arrival banks at the account of the national banks. At the end of 2004, the arrival banks were keeping approximately 81% of customers' deposits.

Palestinian banking sector according to Dajani, Awartani, Eshet & Schiavo (2001) is dominated by local branches of Arab branches which are backed by the assets of head offices. The branches of three Jordanian banks operating in Palestine (Arab Bank, Cairo-Amman Bank and Bank of Jordan) accounted for more than 68 percent of total Palestinian deposits in June 2002.

4.3.3.2(i). Arrival Bank's Contributions:

There are many advantages arrival banks can add to the Palestinian banking sector:

- a. At the first glimpse, one can conclude that they have a greater ability to tolerate recession as they are backed by head offices quartered in a more stable environment and as they represent entities with sound financial positions. Any unforeseen risk can be absorbed by an assistance of the head office. So, Arab and Foreign branches are less prompted to keep high liquid reserves. They are in a position to extend their credit facilities and to bear more risk due to their strong adequacy bases.
- b. Arab branch banking system saves on idle resources, i.e. in resources that are not used for productive purposes.
- c. In developing economic system, international banks bring in know-how, expertise and personnel, fostering the quality of the economic sectors in the local country. In

fact, many of the senior managers in national banks are former employees of Jordanian banks who left their position for better statuses these banks offered.

d. Strong supervisory of the head offices on their branches operating in Palestine will help PMA in its mission to increase the quality and safety of the banking sector and to decrease the level of systemic risk.

4.3.3.2(ii).Arrival Banks' impediments :

Meanwhile, arrival banks do not lean toward domestic economy's needs.

a) From the PMA's point of view, dealing with foreign branch is more complicated, because of their ability to circumvent regulation by means of operations abroad and because of the unforeseen political and economic intricacies that may arise due to their substantial importance in the local environment.

b) It is true that these branches are privileged by being supported by external profound headquarters, but what is also true in this regard is that a great portion of the head quarters' financial strength comes from Palestinian market. Top management perceived Palestinian market as a virgin land that can provide additional deposits and revenues to foster its position in its local market .This can give an answer for the anxiety of the arrival banks toward inaugurating branches in the Palestinian economy and an answer of why 90 % (65% after adjustment) of the deposits were crossing the Palestinian borders toward external world .It is true for many arrival banks that their return from acting in Palestine scales up the country risk and other risks inherent to Palestinian economy

c) As we are living in a hectic world, any unpleasant or unforeseen changes that their head quarter may face will inevitably have a considerable impact on the Palestinian market. Arrival banks are prone to country risks adherent to their headquarters' operating environment and to those of the host country.

The PMA became concerned that circumstances could arise whereby a branch of a foreign bank could fail, but the parent might refuse to cover local losses to depositors,

or that the parent might fail, but choose to favor depositors with the parent at the expense of those at the (local) branch.

With banks having a high ratio of overseas assets, which might be beyond the reach of the PMA in circumstances such as these, the PMA might be unable to ensure adequate compensation for local depositors. PMA took a critical step to mitigate the effects of such a risk:

First of all, and according to the PMA's 2002 banking law, arrival banks whose customers' equivalent deposits exceeded thirty million U.S. Dollar had been requested to increase the capital of their branches operating in Palestine, from US\$5 million to US\$20 million by mid 2004. The capital was to be held locally in the form of land, property or liquid assets.

In the case of Palestinian National Authority, arrival banks have been asked to hold half of their capital at the PMA with remuneration at market rates less a $\frac{1}{4}$ % for administrative charges. The PMA has also offered these banks to convert to local incorporation should they prefer.

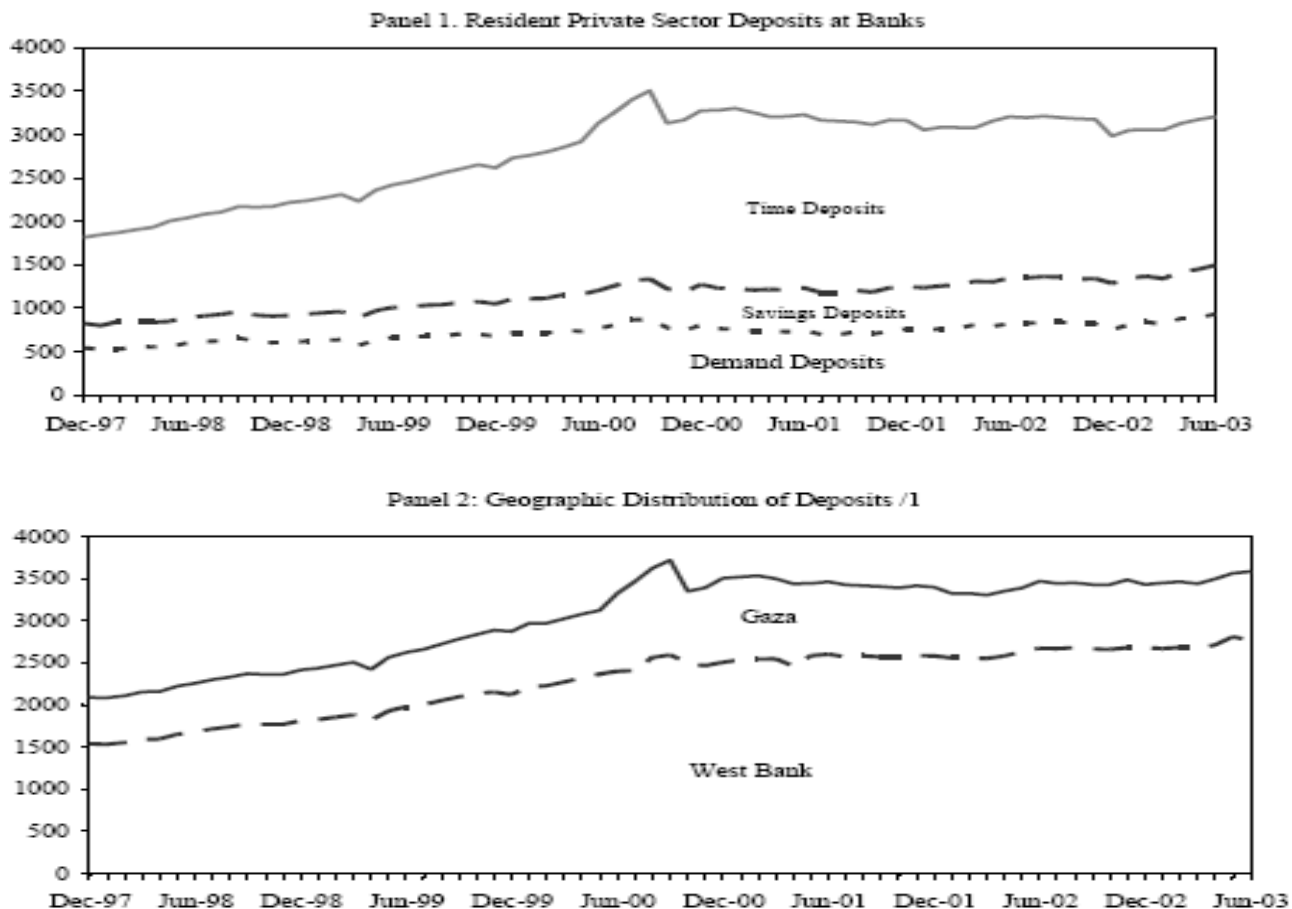
Second, should foreign banks choose not to comply with the above, differential required reserves on all deposits would be raised from the normal 8 and 9 percent to 20 percent. These reserves would be held at the PMA and remunerated at market rates, less the $\frac{1}{4}$ % administrative fee. They would be deducted automatically from each banks' current account with the PMA. Penalties would be applied for non-obedient, although the exact format for the penalty is unspecified.

By mid-2003, the PMA was able to report that the majority of the banks were complying with the new regulation which thereby precluded the imposition of the higher reserve requirement.

d) Under the recent situation, banking sector is a multi-currency system through which money supply is determined via balance of payment rather than through determination of the economic needs. Although the banks operate in three main currencies, by far

the largest share of currency denomination, in both deposits and lending, is in terms of U.S. dollars . The trend toward the dollar has been mostly at the expense of the Jordanian Dinar and began soon after the Oslo accord. By 1998, more than 60 percent of deposits were denominated in U.S. Dollars, with about 24 percent in Jordanian Dinars and 14 percent in Israeli Sheqel.

Figure 4.1 :The Composition of Palestinian Deposits ,1997-2003 in Million \$.IMF2003



Arrival banks are not obliged to provide hard currencies to the local economy. This situation encouraged Arab banks to inaugurate branches without being vulnerable to currency fluctuation risk as their central bank can control the bulk of money supply in Palestine. This shows that PMA lacks the technical instruments to influence their branching policy in Palestine.

e) The tendency of many customers for dealing with arrival branches provided these banks with competitive advantage against national banks . This competitive advantage makes them be more selective toward their customers. They tend to deal with credible customers who have better financial position while restraining dealing with risky customers. So, the balance sheet of national bank is characterized by having more risky credits in the asset side and less amount of deposits and capital adequacy in the liability side. The following data was provided by the PMA for the year 2004 ,it shows that credit portfolio of arriving banks is better than that of national banks:

Table 4.15. Data about Credits ,Special Care Facilities, Irregular Facilities and Provisions

The Account	National Banks	Arrival Banks	Total
Credits	452,781,521	974,813,369	1,427,594,890
Banks' Credits to Total Credits	32%	68%	100%
Special Care Facilities	2,106,553	3,809,927	5,916,480
Irregular Facilities	58,385,188	90,370,764	148,755,952
Irregular Banks' Facilities to Total Irregular Facilities	39%	61%	100%
Irregular Banks' Facilities to Total Facilities	13%	9%	10%
Provisions	57,144,743	86,151,015	143,295,758
Banks' Provisions to Total Provisions	40%	60%	100%

The ratio of national irregular facilities to total credits was 13 % while it was only 9 % for the arrival banks.

Although the banking system remains highly concentrated and dominated by the branches of foreign banks, there has been some decline in their share in the last five years. In 1998, the share of the three largest Jordanian banks in total deposits was 80 percent. By June 2002 according to IMF 2003 report ,this had declined to 58 percent. In addition, the contribution of arrival banks' credit portfolio is decreasing these days . This no doubt reflects more attractive lending opportunities available to Jordanian banks outside Palestine, as well as possibly a less conservative lending policy on the part of the small but growing Palestinian banks. It also may reflect more risk taking by

Palestinian banks, and reported lower lending by Jordanian banks to the Palestine in 2002 .

4.3.3.3. Inability to Play the Role of the Lender Of The Last Resort:

One of the major reasons that preclude PMA from playing its highly needed vital role of fostering the financial system is its incapability to play the role of a lender of last resort as it can not create money, this fact pushes the operating banks to hold higher liquidity ratio. This can support the banks' stand against extending credit base in the local market. Palestine is considered as high in term of country risk, and as the PMA's resources for using monetary instruments are inadequate ,the ability for the PMA to intervene is thus limited to its ability to borrow in local and international markets or to obtain credit from the Palestinian National Authority. Virtually, the lack of Palestinian currency prevents the PMA from credit creation. This fact, in addition to the lack of deposit insurance, suggests that the PMA should focus on failure prevention measures, enforcing more efficiently bank regulation and enhancing its supervisory abilities.

4.3.3.4. Fragile Legal Environment:

The absence of a proficient legal system and high dependency on other countries' economies is the fourth reason: due to political fluctuation in the Palestinian territories, the legal system was a constitution of different legal visions and references. As was mentioned before, the military acts imposed on the occupied West bank and Gaza Strip overwhelmed Jordanian laws in the West Bank and Egyptian laws in Gaza Strip . As the occupation eased its rule at the threshold of Palestinian National Authority proliferation, the old Jordanian and Egyptian laws were resumed again, and a long process of unifying the legal acts and regulations was inaugurated. Banking activities are strongly related and dependent on a profound and credible environment since the financial and legal relationships between different parties need a bounding system to be obligatory.

The legal and institutional environment was also very unsatisfactory: with limited land and real estate registration, there was little of them available for collateral, and the court system for supporting commercial claims was shaky at best.

4.3.4. Empirical Analysis of The PMA 's Role :

4.3.4.1. Rules and Regulations:

The first part of third section which contains fifteen questions is discussing the nature of relationship between PMA and the operating banks in Palestine ,and how credit specialists in these banks perceive the role of the PMA in creating a profound credit portfolio , mitigating the sequences of troubled credits and in preserving high standards for the local financial system as a whole. The second part contains six factors deemed to have direct impact in prohibiting the PMA from playing the highly desired role in the banking sector.

Table 4.16: The Perceived Role of the PMA(Percentage & Means).

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean
	%	%	%	%	%	
1.You are convinced that PMA crews are efficient and capable of auditing and adding knowledge to you	4	46	21	29		2.75
2.Issues that are audited during their visits are comprehensive and cover all aspects about credits	4	50	18	25	4	2.75
3.Circulars published by PMA are performed after consulting the operating banks		39	39	21		2.82
4.Top management strictly complies the PMA's circulars and follows up and handles mistakes as soon as possible	4	7		61	29	4.04
5.Circular related with credits are based on sufficient consideration of the Palestinian business environment and updated	4	25	57	14		2.82
6.PMA practices an effective controlling and supervisory role		46	25	29		2.82
7.PMA practices an effective corrective and remedial role	4	57	29	10		2.46

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean
8.Credit granting procedures and practices are committed with PMA circulars and		7	7	54	32	4.11
9.Regulation promulgated by PMA about credit are strict and unpractical		29	43	18	11	3.11
10.Punishment policy adopted by PMA against discrepant banks will push them to adhere and comply with its regulation		36	14	43	7	3.21
11.PMA policies will support small and national banks and will enhance their abilities to compete big banks	18	36	32	14		2.43
12.PMA is strict against small banks while it is lenient toward big ones		21	39	18	21	3.39
13.Credit to deposit ratio above 40 % will increase the risks volume while pushing them to ease their conditions	4	18	4	64	11	3.61
14.Credit to deposit ratio above 40 % will add a supportive contribution to the Palestinian economy	11	32	18	36	4	2.89
15.PMA Institution for banking studies adds knowledge and increase credit officer's competency	7	18	18	54	4	3.29

The data in the table shows that the role of PMA is not highly appreciated by the staffs operating in the credit field. When asked about the competency of PMA' crews ,only (2.75/5) indicated their contentment about the professionalism and experience of PMA staffs. Banks' employees are unsatisfied with the level of coordination between their banks and PMA as they answer question number three about coordination with operating banks and question number five about integrating the environmental factors in the contents of the published circulars with scores of 2.82 for both. When asked about its contribution for the banking sector(Q11), only (2.43/5) of the tested employees agree that PMA is upholding the position of small and national banks against the big one. This low percentage can be seen as assentation that PMA does not take the necessary steps to strengthen the position of small banks .

The next question which supposes that PMA is strict toward small banks and lenient toward big ones has gained more consensus, the mean of the tested sample who agreed with the assumption was 3.39. The tendency of the majority of the respondents toward signing neutral anchor (neither agree nor disagree) can be perceived as a gesture that they are not aware of the nature of the role PMA is playing or that they are not feeling of its aftermath on the banking sector. This indication entails that PMA must launch additional steps toward enhancing its interaction with the banks' employees and getting involved with true requirements of the working places. When asked about their consensus that role of the PMA is vital and effective in controlling the issue of troubled credits, 71 % of the respondents were either disagree or neutral about the assumption. When asked about their evaluation that PMA has a corrective role in dealing with the issue of troubled credits, the astonishing answers show that 4 % were strongly disagree, 57 % were disagree, 29 % were neither agree nor disagree (neutral). This means that 90 % of the tested sample believes that PMA steps are not effective or not sufficient in combating the issue of the troubled credits or in minimizing their consequences. These results are strongly supporting the **third hypothesis** that PMA does not have a vital role in restraining the upward slope of the troubled credit ratio. The perception can be stemmed from the fact that PMA usually has a subsequent rather than a preceding role in dealing with the credit facilities.

Answering question number 13 shows that 75 % of the respondents strongly agree or agree that increasing credits-to deposits ratio above 40 % will be a harmful step against the common interest of the banks in light of the current situation, harmonious with the next question's answer that shows only 40 % either strongly agree or agree that credits-to-deposits ratio above 40 % will add positively to the local economy. This means that 75% of the sample support the **fourth hypothesis** that there is a direct relationship between easing credit standards and the amount of troubled credits.

When categorizing the answers according to the nationality of the bank to which the respondent belongs ,we have the following table:

Table 4.17. :The Perceived Role of the PMA According to Bank’s Nationality

	National	Jordanian	Foreign	Total
1.You are convinced that PMA crews are efficient and capable of auditing and adding knowledge to you	2.63	3.00	2.00	2.75
2.Issues that are audited during their visits are comprehensive and cover all aspects about credits	2.94	2.55	2.00	2.75
3.Circulars published by PMA are performed after consulting the operating banks	2.81	2.82	3.00	2.82
4.Top management strictly complies the PMA’s circulars and follows up and handles mistakes as soon as possible	3.81	4.36	4.00	4.04
5.Circular related with credits are based on sufficient consideration of the Palestinian business environment and updated	2.81	2.82	3.00	2.82
6.PMA practices an effective controlling and supervisory role	2.75	2.91	3.00	2.82
7.PMA practices an effective corrective role in dealing with credits	2.38	2.55	3.00	2.46
8.Credit lending procedures and practices are committed with PMA circulars and regulations	4.00	4.27	4.00	4.11
9.Regulation promulgated by PMA about credit are strict and unpractical	2.94	3.27	4.00	3.11
10.Punishment policy adopted by PMA against discrepant banks will push them to adhere and comply with its regulation	3.13	3.18	2.00	3.21
11.PMA's policies will support small banks and will enhance its ability to compete big banks	2.00	2.91	4.00	2.43
12.PMA is strict against small and national banks while it is lenient toward big ones	3.44	3.36	3.00	3.39
13.Credit to deposit ratio above 40 % will increase the risks volume while pushing banks to ease their conditions	3.56	3.82	2.00	3.61
14.Credit to deposit ratio above 40 % will add a supportive contribution to the Palestinian economy	2.75	3.18	2.00	2.89
15.PMA's Institution for banking studies adds knowledge and increase credit officer's compete	3.13	3.36	3.62	3.29

The data shown is not that much directive or illustrative because the discrepancies between answers are not conspicuous. This means that both have the same perceptions toward the PMA. What may attract attention is that the mean of the Palestinian credit officers who agreed that PMA support small and national banks at the account of big ones was 2, while the Jordanian banks operating in Palestine agreed with the assumption with a mean of 2.91.The paradoxical trend appears when answering Q14

about the contribution of banks to the local economy, as the mean was 2.75 for the Palestinian banks' employees who agreed that credits-to-deposits ratio above 40% will contribute positively to the local economy while it was 3.18 for the Jordanian branches' staff agreed with the assumption.

There is approximately a unanimity (4.11) among employees, no matter what nationality do their branches belong to, that their banks are committed with the regulations addressed by the PMA according to respondents' answers for question number eight . This harmony can be construed that the banks do comply with and are receptive to additional constructive involvement by the PMA which represents the supervisory authority , and also they are looking for additional cooperation despite the fact that they have certain reservations toward the current level of such a cooperation .

4.3.4.2. Hindering Factors :

The second section of the third part asks the tested sample to prioritize six factors that preclude PMA from playing a vital role in managing the inherent credit risks and in mitigating bad consequences of troubled credits according to their importance. The factors listed are both subjective and objective. Number one will be the most important were as number six will be the least important. The factor with the least mean will be the most important factor because of its adjacency to number one .

Table 4.18: Hindering Factors According to Their Importance(Percentage & Mean)

Factor	First	Second	Third	Fourth	Fifth	Sixth	Mean
	%	%	%	%	%	%	
Weak legal environment	14	29	32	14	11		2.79
Weak controlling practices by PMA and lack of competent staff	32	21	25	7	14		2.50
Lack of communication and coordination between PMA and banks	14	25	14	29	18		3.11
Political circumstances and the Intifada	25	14	21	29	11		2.86
Absence of punishment policies adherent to	11	11	7	18	43	11	4.04

regulation breach							
Other factors	4			4	4	89	5.71

The table shows that the majority of the respondents refer to a subjective factor to be the first important cause of precluding a vital role the PMA is required to play when they pointed out that weak controlling practices and lack of competent staff is the most important factor in this regard. This sign all together with question number seven in section one of this part do support the hypothesis that the PMA is not playing the vital effective role of minimizing the volume of troubled credits . Actual data on practice support the hypothesis as well. The second prioritized factor was the weak legal environment which is a key integral component in creating a credible and sound financial system. The tendency toward bringing forward the legal factor connotes the deepen state of frustration and impotence credit officers feel toward our domestic legal environment which is considered as one of the key factors for fostering the trust among the parties in the financial system , enforcing contracts between investor , guaranteeing debtor's compliance toward the credit covenants . Indeed, much of the PMA’s inability to impose its vision of a sound financial system is due to the absence of a bounding legal environment and the existence of political instability.

Chapter Five

Conclusions and Recommendations

Summery :

The thesis has obviated that the delicate capital structure of the Palestinian banking sector renders the skyrocketing ratio of troubled credits crisis intolerable. The thesis also delineates some factors that deemed to have direct effects on the crisis .The empirical analysis shows a considerable consensus between the respondents about these factors. The thesis has reached conclusions about the roles and duties each related party has to perform in order to mitigate the consequences of the troubled credits crisis.

5.1. Conclusions:

The preceding diagnosis tells a lot about Palestinian Banking Sector. It is important after more than twelve years of its outset to evaluate the industry's conducts and achievements and to delineate its pros and cons in order to designate a proper vision for future performance. Notwithstanding the fact that banks are categorized as organizations dedicating their main efforts for profit generation, their overlapping with the whole elements of the local economy on one hand, and their overwhelming influence on every aspect of life in the other hand make it important for regulatory authorities and other policy makers to address regulations and policies to monitor their conducts and to stifle their adverse effects. Being acting in the midst of free markets does not mean that the bank can take exclusive policies aloof from the other sectors or factors that compromise the economy. The decision does not rests with the bank alone in performing services and making decisions ,any wrong doing may lead to loosing trust in the banking sector which may lead to what is called Domino Effect as other banks will collapse, leaving the whole economy in a big dilemma . A lot of financial

crises in the global economies including developed countries such as Japan went through deepen crisis merely due to wrong practices of the banks. International trade, inflow of external investment, trust and credibility which are the main components for internal and external trade can severely be affected if the banking sector loses its trust.

What about Palestinian Banking Sector which if forced to maneuver in a working environment saturated with contradictory intricacies that preclude it from playing the required role in the development process? The preceding era showed a lot of success ,the banking sector provided the public community with a doable instrument that was able to get a great portion of its savings as aforementioned in different places in this thesis, it facilitated the mission of investment by paving the way between saving groups and investors ,it played a considerable role as a gate for cultural and technical changes toward adopting up-to-date ways of thinking and modernization; and after all, it made a substantial economical contribution by providing an additional medium of exchange and by being a main source of employment.

On the opposite side, there are many setbacks and shortcomings that have to be articulated in order to be properly handled .These bad traits can be attributed to subjective and objective causes .Many steps needed to be done in order to put the banking sector on the right track:

1. It is important for the whole economy to stipulate what is exactly required from the banking sector. In the modern management, it has been prevalingly perceived that company that makes it self accountable toward the surrounding economy according to what is called *social responsibility* can guarantee a substantial percentage of success and prosperity. Customers are no longer content with those organizations that are exploiting their needs and harvesting gains without providing contributions to the community they are working with. The point can be more prompting when we talk about Arab and Foreign banks

operating in Palestine. Till now, we are talking about institutions that rarely make any contribution, what so ever, to the economy ,other than their traditional services and activities. The public sector, represented by the government and PMA on one hand and the private including banking sectors on the other hand must reach an agreement about a stipulated development plan to assign the rights and duties every side has to offer for the opposite side.

2. On the premise of the preceding point ,and after specifying its required role , a comprehensive process must be launched in order to define the banks' identity. Banks can be categorized ,according to their fund resources, into depositary banks and non-depositary banks (specialized and development banks). The banking structure in Palestine shows that its main ingredient is commercial banks acting as agents that receive and run short and medium- term deposits on behalf of their depositors .As the main source of fund is characterized to be short or medium –term, banks can not act as real partners in the process of development since they are unable to provide investors with long-term loans . This dilemma can be resolved at least by three approaches: forefront of all is by enhancing their capital adequacy , doing so will enable them to provide long-term loans and endure fluctuation in the market .Secondly, according to Abdulkarim (2004), they can exploit the concept of liquidity management and benefit from slow moving deposits and other dormant deposits to provide long-term loans and facilities. Thirdly, enhancing their role in the long-term investment can be attained by choosing the model of universal (comprehensive) banks that combine both traditional banking services and long-term investment and loans financing either by issuing long-term bonds or by long-term borrowings from non-depositary units such as the government or other international financing agencies. The model is successfully applied in different countries including Japan wherein giant industrial and commercial corporations

have as subsidiaries this kind of banks to support their operations and contribution to the whole economy.

3. After more than a decade of functioning in the Palestinian market, banks' conduct is experiencing a minimal development. The main point in this regard is that banks are suffering from a chronic disease called bad corporate governance. According to Wheelen & Hunger(2004), corporate governance refers to the relationship between shareholders, board of directors and management. There is a clear overlapping in authorities between these three bodies. In many situations, approvals to grant credits may be based on unprofessional or even on politicized standards merely because a prominent person was able to affect the decision makers' way of thinking regarding the application. Having a solid corporate governance with better overseeing by both active board of directors and shareholders will ensure that a profound and thorough process of decision making will be in place regarding credit portfolio.
4. The working environment through which banks are operating is far away from transparency and information. Disclosure rules are very narrowly applicable and the social principle of secrecy has a considerable influence upon banking practices. Information is a main ingredient in any decision making process. As the mean of information swapping is at minimum levels, any troubled debtor can obscure his financial position to get additional credits from other banks. It is a hard mission to have precise sufficient information about the applicant. PMA has its own centralized unit of banking risks, this unit provides information about debtors whose financial liabilities toward a sole bank are more than \$ 10,000.00. These information are updated at the end of the month. On one hand, the bank can delay or abstain notification about the debtor's commitment. Debtor could maneuver the process's restriction by borrowing less than \$10000.00 from different banks. Recently the PMA has

promulgated a new circular to amend this gap, banks are required to inform the PMA about any credit ,even if its amount is less than \$10000.Moreover, notifying PMA about credit granting is a voluntary action, if the bank or the officer who represents the bank refrain informing the PMA ,there is no penalty against him despite the fact that such a conduct may lead to a debtor's default if his commitments toward banks are beyond his ability . Banks can over bridge the consequences of lack of knowledge by combining their efforts with PMA to initiate an active credit bureau than can provide banks with timely sufficient information about the applicant financial and non-financial information.

5. Banks have to distinguish between different kinds of borrowers by using a uniform credit rating approach that takes into consideration the factors that can predict the behavior of the debtor in the future, this will assure that the process of decisions making will be based on a profound basis away from tendentious interventions. Indeed this was one of the revolutionary recommendation Basel II has suggested. In addition, credit officers' abilities must be enhanced by paving the way for them to acquire contemporary credit knowledge including financial analysis and new approaches of rating the customers.
6. It is ironic to say that although the banking activities are deeply affected by several kinds of risk, rarely can anybody find effective risk management committee in any bank ,and the concept of risk management does not have its relevant handling in the management's mentality. Banks and the PMA are confining themselves within a narrow traditional frame without thrusting the new fields international banks are professing.
7. Banks have to upgrade their computer systems to deal with the issue of credit facilities properly. The ramifications of credit details make it impossible to rely solely on manual handlings. There are systems that can not show the exact amount of liabilities the debtor owes the bank. Upgrading computer systems

can be a threshold to provide inter-banking connection that may be a great step toward better information availability and toward E-Banking. In the late nineties of the last century, PMA and for the purpose of settlement system, worked hard in order to inaugurate an inter-banking electronic information network, but for unknown reasons, they did not conclude their work.

8. Banks must not give any credit before guaranteeing at least two sources of payments. Operating cash flow as the main source of payment must be carefully determined. In addition, the debtor must provide an admissible collateral to be used in case the first source of payment was deteriorated. PMA must reconsider its decision about certain immaterial admissible collaterals such as personal guarantee and other collaterals that are substantially vulnerable to market risks. Moreover, PMA shall be more decisive in its trend toward preventing banks from accepting cheques under collection as an admissible collateral because if the drawer does not provide the necessary amount to cover the cheque, the bank's collateral will fade away. In many circumstances, debtors can use kitting cheques to convince the bank to provide him a credit that will be paid back from the cash flow of these delusive cheques.
9. With reference to the first suggestion about the need for the whole society to decide what is required from the banks operating in Palestine, banks should make it clear that cooperation is a mutual process. Banks in their turn have to stipulate prerequisites that the society has to provide in order to conclude a real partnership. Successful banking services are a function of credible and active economy combined with a trustworthy legal environment. Markets that are characterized as being high risky lead the operating banks to demand high prices in terms of amounts and interest rate for their credits. Banks can not ease their condition in a turbulent market because such an action will be ruinous not only on the banking sector, but also on the whole economy. Statutory

legislation and other executive parties must work hard in order to endorse acts that will restore the trust to the Palestinian economy and encourage external investors to enter the our local market.

10. As an extension of the previous point, the government ,bureau of statistics and other related private sector's institutions must make it available for the banks to have up –to date information regarding the main indicators of the economy. Till now, the governmental sector unfortunately did not address a strategic plan for future development, and hence, banks have to depend on their own resources to run their business. A profound decision is a function of sound information .Banks in order to minimize their risk lean toward diversifying their credit portfolio .Despite the fact that we are living under sophisticated circumstances , a state of inequality has been noticed in the degree of effect these circumstances have upon the different sectors in the economy , Abdulkarim (2004). If they have adequate information and accurate economical figures about different sectors in the society , banks can prorate a greater portion of their credit portfolio to those sectors that are the less affected by the bad situation, so, the ratio of troubled credits may be minimized.
11. Banks must not give any credit before guaranteeing an ample study of the factors that answer the two questions previously gestured ,would the borrower pay ?can the borrower pay? These factors that encompass the debtor's willing and abilities are condensed through what is referred to as the five Cs factors. Credit analysis is critical in avoiding the subsequent credit default because at this stage, banks can determine the level of credit risk that will be inherent to any single credit in the following steps. By going through additional stages, the bank will gradually loose its ability to adjust its position or to reconsider its decision.

5.2. Proposal for Better PMA Role :

1. The establishment of a self-governing authority without a complete sovereignty created a mismatch between authorities and responsibilities. As previously mentioned ,PMA can not play the role of a lender of the last resort ,so they do not have the ability to guide the banking sector and to monitor the quantity of money supply properly. Therefore, they have to look for alternative approaches to safeguard the deposits and credits in banks. The role that PMA plays is subsequent to the credit decision making. They can not be active in confining the issue of trouble credit merely by using promulgated circulars and performing intermittent audit tours. With regard to rejected cheques ,PMA had initiated what is so called black list that contains names of customer whose banks have rejected certain numbers of cheques on their accounts within three months, the list is circulated monthly to all banks . Any indulgent bank which opens an account to any black list customer may be penalized and fined \$10000.00 for not complying with the related regulation.PMA does not apply similar standards against defaulted borrowers or lenient banks that facilitate their granting covenants despite the fact that troubled credits may be much more detrimental on the banking sector than rejected cheques. PMA may create a separated list for those defaulted debtors and may impose a greater fine against those indulgent banks that grant credit for those defaulted debtors .

2. In their pursue to enhance the quality of banking management especially for those national banks which are struggling in the midst of unfair circumstances , PMA has to adopt more strict approval policy of the banks' top managers. It must also encourage these banks to adhere to the criteria of good corporate governance.

3. PMA has some of the functions of a Central Bank but not the right to issue national currency. The existence of a multi- currency standard has the potential for increasing the costs associated with fluctuations in exchange rates typical of a flexible exchange rate regime. In addition, a multi- currency tends to reduce the ability of commercial banks to perform their function of transforming debt maturities, because of currency mismatching of assets and liabilities. This can discourage them from extending long-term credits, which are essential for investment and growth. Furthermore, the existence of a multi- currency standard renders the Palestinian economy vulnerable to shocks originating in the states that printed these currencies. Given the present economic conditions, the goal of securing confidence in the proposed new Palestinian currency should be given a top priority. One arrangement under consideration is the issuance of an independent Palestinian currency. The PMA would have the option of intervening in the market to peg the exchange rate at a certain rate or within a specified interval. This arrangement might be attractive since an independent national currency is both a symbol of sovereignty and an instrument of monetary policy. It would also allow the PMA to choose a monetary policy compatible with the pace and requirements of the Palestinian reconstruction and development program.

4. PMA must reconsider its decision about certain immaterial admissible collaterals such capital stocks, personal guarantees and other collaterals that are substantially susceptible to market risks. Moreover, PMA shall be more decisive in preventing banks from accepting cheques under collection as an admissible collateral because if the drawer does not provide the necessary amount in his account to cover the cheques, the bank 's collateral will be vanished.

5. Data about the structure of troubled credits shows that a high percentage of these credits is dated to the early stages of the banking sector 's inauguration phase when the atmosphere was saturated with hope for prosperity and tranquility. In those days, many credits were given to Jerusalem citizens .PMA and other governmental related parties must seek a convenient coordination with the Israeli side or other judicial parties to find a practical solution with those defaulted debtors who are living in Jerusalem or other areas where Israeli rule prevails. This is a real dilemma faced by banks operating in Palestine. According to PMA regulations ,and as a gesture to disaccording with the Israeli illegitimate decision to annex East Jerusalem to its realm unilaterally, Jerusalem citizens are treated according to the same way like other Palestinian citizens who live within the borders of 1967. But in practice, there is a legal disconnection since we are talking about areas under different legal statuses. Banks are not asked to have a special permission to grant a credit for an average Jerusalem citizen, but if the credit defaulted , there would be many obstacles including the freedom of transportation that might preclude the Palestinian banks from perusing the debtor.

6. An other approach to minimize the risk that a depositor will not be able to recapture his deposit in case of institution's or debtor's failure is by insurance policy that covers such a risk by a third party. In this case, the insurer will charge a fixed premium per each unit value of the currency deposited. An insured depositor has in this case two claims :one against the bank and another against the insurer .This will minimize the boundaries of agent problem and will encourage banks to increase their credits . From the perspective of the banking sector ,banks can bear the additional premium because the spread between interest paid and interest earned from credits is very wide. This practice is uncommon in the surrounding economies ,but the

situation we are living under makes it worthy to initiate creative and supportive solutions .

5.3. Recommendations:

A lot of articles ,researches and comments have been written about the previous performance ,current condition and the future vision of the Palestinian Banking Sector from different standpoints. Readers of these essays will find a lot of dissimilarities in diagnosing the nature of these deficiencies due to the their serious complications, but certainly there should be a common conclusion ; a lot of work has to be done in order to reshape the structure and the direction of the Palestinian Sector. Under globalization ,there is no chance for vulnerable . The boundaries that was used other days to safeguard national entities and products are no longer exist. Surely there will be other suggestions about how to uphold the level of performance of the hirkled Palestinian banking Sector, but the galloping accomplishments the external world is achieving will not wait for us. On the premises of the preceding discussions, one can put forward certain suggestions that may provide a help for safeguarding the resources of the banks and as a result, increasing the total contribution of the banking system in the development process. Despite the fact that these suggestions will not provide the magic solution to the banking crisis, they are certainly worthy to think about because they deal with grand problems our banking sector is inflicted with :

1. Establishing a credit bureau by a syndication of all banks in Palestine, that will facilitate the process of information swapping between banks. Having transparency in the working environment may be fruitful in providing more information that entails soundness in the decision making process and prudence from the customers' side as they will be aware that they are under censorship by an

unbiased third party which can determine the nature of their relationship with banks and other financial institutions.

2. Establishing factoring firms(financial companies) which are ready to bear the burden of credit collections versus certain commissions .These agencies are managed by professional staffs including lawyers and specialists with fully acquaintance of collecting loans . Banks can sell the defaulted credit with or without recourse by paying certain percentage as a commission for such a process.
3. Creating an insurance agency comprised by the association of all banks operating in Palestine to provide further security for credits and deposits. This agency will be a key component of the Palestinian financial system as it provides more assurance for soundness of the banking sector and immunity against hazardous circumstances.
4. Enhancing capital adequacy and assets quality management by confining the process of licensing to those investors who are capable of providing sufficient threshold capital and to those who have adequate and relevant banking experience. Another renowned approach to increase the capital adequacy is by encouraging the merger of small banks in order to sustain their ability to compete.
5. Categorizing banks operating in Palestine according to their remoteness from the targeted Basel ratio of 8 % ,and putting a deadline for each category and each bank to reach this targeted ratio. Meanwhile, performing a follow up process to assess the bank's trend with regard to this objective.
6. Adopting more decisive approaches regarding the necessary guidelines and conditions for profound credit portfolio and a compliance process for banks to adhere. This process should be linked with an effective punishment system for those not complying banks. It does not suffice for the PMA to provide indicatory guidelines in this field of the banking services. Moreover ,the circulars PMA is

disseminating have to be issued after sufficient consultation with the operating banks .

7. Palestinian banking sector should get involved in new contemporary banking fields such as Risk Management.PMA should pave the way for banks to have adequate knowledge as the first step, later on ,PMA may order Palestinian banks to form Risk Management committee in order to sustain the Palestinian Banking Sector.
8. PMA may adopt an evaluation system for rating the quality and the performance of every bank's management according to certain criteria ,this rating system can be used as a criterion for evaluating the abilities of their top management by the board of directors .
9. Last but not least, PMA should get sure that all banks have their own policies and procedures that shape a unified track in dealing with the issue of credit facilities.

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بسم الله الرحمن الرحيم

استبيان حول موضوع الديون المتعثرة

مدراء وضباط الائتمان المحترمون

، تحية طيبة

وبعد، أضع بين ايديكم استبياننا مصمما لدراسة العوامل والمتغيرات التي يمكن ان تكون ذات علاقة بمشكلة الديون المتعثرة وزيادة مستوياتها، والاجراءات التي يمكن ان تخفف من تاثيراتها على اداء البنوك العاملة في فلسطين ، وهو موضوع الرسالة التي اعلم على تجهيزها استكمالا لمتطلبات التخرج من برنامج الماجستير في ادارة الاعمال في جامعة بير زيت .اعتقد ان المعلومات التي ستشرون اليها ستتيح لي فهما افضل لظاهرة التسهيلات المتعثرة ومسبباتها.ارجو منكم الاجابة على التساؤلات المبينة في الاستبيان بمسؤولية وموضوعية بالنظر لانكم الاقدر على وصف الحالة وتحديد مؤثراتها ، مشيرا ومؤكدا الى ان المعلومات التي ستزودونني بها ستعامل بسرية مطلقة ولن تستخدم الا في الغاية التي بينتها انفا.

شاكرًا لكم الجهد والوقت الذي ستخصصونه للإجابة على الاستبيان.

مع الاحترام

راغب حمدان

: القسم الاول

1. العمر : (أ) من 22 - 30 . (ب) من 31-35 . (ج) من 36-45 . (د) اكبر من 45 سنة.
2. الجنس : (أ) انثى (ب) ذكر.
3. المؤهل العلمي : (أ) دبلوم (ب) بكالوريوس (ج) ماجستير (د) غير ذلك:-----
4. طبيعة دورك في قسم/دائرة التسهيلات: (أ) موظف (ضابط) (ب) نائب رئيس قسم (ج) رئيس قسم (د) مراقب (هـ) غير ذلك (الرجاء التفصيل):----- .
5. عدد سنوات الخبرة في موضوع التسهيلات والقروض : (أ) اقل من 5 سنوات (ب) ما بين 5 الى 10 سنوات (ج) اكثر من عشر سنوات.
6. عدد الدورات ذات الصلة التي تلقيتها خلال الثلاث سنوات الاخيرة :

القسم الاول: الاسئلة التالية تهدف الى التعرف على مدى اهتمام الادارة العليا في البنك في تحسين مستواك

المهني وتدعيم خبرتك في مجال تخصصك ،الرجاء الاجابة عليها :

اعارض بشدة	غير موافق	لا رأي	موافق	موافق بشدة	
					1.تعتبر المزايا التي تقدمها الادارة بمايشمل الرواتب عادلة بالنسبة لمسؤولياتك ومقدار الجهد الذي تقدمه.
					2.سياسة التدريب التي تنتهجها الادارة تجاهك تعتبر سياسة فعالة وتحسن من نوعية الخبرة لديك.
					3.الاتصال ما بين القسم/الدائرة التي تعمل بها والادارة العليا فيما يتعلق بالتسهيلات هو اتصال نوعي ويعمل على تحسين اداء

					الطرفين .
					4.الاتصال فيما بين القسم/الدائرة والادارة العليا سهل ولا يتطلب وقتا واجراءات ادارية رتيبة.
					5.الالية المعتمدة في موضوع منح الائتمان متكاملة وذات كفاءة عالية وتقدم لك مساعدة كافية لتنفيذ خطوات المنح والاجابة على معظم التساؤلات.
					6.يتم التعاطي من طرف الادارة العليا مع مقترحاتك باهتمام ،وتؤخذ بعين الاعتبار عند اجراء أي تعديل على السياسات والاجراءات.
					7.الصلاحيات المعطاه لك غير كافية لتنفيذ الائتمان .
					8.الصلاحيات المعطاه لك مناسبة لحجم مسؤولياتك .
					9.انت مقتنع بالدور الذي تقوم به وتعتبر ان طبيعة عملك ممتعة.
					10.انت مقتنع بتوجه البنك لتقديم مساهمات ذات مغزى لصالح الاقتصاد الوطني من خلال منح الائتمان.
					11.انت مقتنع بان الادارة العليا تثق بادائك وتعزز من قدراتك وصلاحياتك حاليا وبالمستقبل.
					12.حجم القروض المتعثرة يتناسب عكسيا مع ازدياد خبرتك .
					13.تشعر بثقة وقدرة عالية على الاجابة على تساؤلات طالبي الائتمان ونادرا ما تحتاج الى الرجوع الى مستوى اداري اعلى.

أمور اخرى تتمنى لو وفرتها الادارة لك وتعتقد باهميتها لتطوير ادائك وتحسين

قدراتك:-----

القسم الثاني:الاسئلة التالية تهدف الى معرفة مدى فعالية السياسات والاجراءات التي قررتها الادارة

العليا في البنك لادارة التسهيلات والحد من تاثيرات الديون المتعثرة على اداء ونتائج البنك:

1. البنك الذي تعمل به : (أ)وطني (ب) اردني (ج)مصري (د)اجنبي .
2. نسبة التسهيلات المتعثرة الى مجموع التسهيلات الممنوحة في البنك ككل : (أ)اقل من 7% . (ب)من 7-13% . (ج)اكثر من 13% .

اعارض بشدة	غير موافق	لا رأي	موافق	موافق بشدة	
					1.يعتمد البنك في تسير اجراءات منح التسهيلات على اجراءات وسياسات مكتوبة وملزمة وذات كفاءة عالية.
					2.يتم تعديل السياسات والاجراءات بشكل دوري وبما يتناسب مع

					التطورات على صعيد الاقتصاد الوطني.
					3. تقوم الإدارة العليا بالتنقيش دوريا وبشكل كاف للتأكد من التزام الفروع بالسياسات والاجراءات المعتمدة.
					4. ينتهج البنك سياسة متشددة في موضوع توفر ضمان اضافي للتسديد الى جانب التدفقات النقدية للمقترض او المشروع.
					5. يشترط البنك توفر بيانات مالية مدققة حسب الاصول ومعتمدة كشرط لدراسة طلب المقترض.
					6. يتم تقييم فعالية ادارة المقترض واعتبارها مؤشرا على قدرته على الالتزام بشروط العقد والتسديد.
					7. تتدخل الادارة احيانا بطبيعة التوصية التي تقترحها بخصوص قبول او رفض التمويل لطالب التسهيل
					8. الاعتبارات التي تنطلق من خلالها الادارة في حال تدخلها بطبيعة توصيتك هي اعتبارات واضحة ومقبولة بالنسبة لك .
					9. تعزى النسبة الاكبر للقروض والتسهيلات المتعثرة الى عدم قدرة المقترض على السداد وليس الى عدم رغبته بالسداد.
					10. القرار الائتماني في القروض الكبيرة يتم من خلال لجنة تسهيلات وليست قرارات فردية.
					11. تعتقد بقدرة وفعالية دائرة التسهيلات في الادارة العليا على الرقابة على الائتمان وتقليل مخاطره .
					12. الرقابة على التسهيلات تتم من خلال دائرة التدقيق ودائرة متابعة الائتمان.
					13. الالية المتبعة في البنك للكشف المبكر عن التعثر ومتابعة المقترض تعمل بصورة فعالة وتحقق النتائج المرجوة.
					14. زيادة نسبة التسهيلات والقروض المتعثرة متناسبة طرديا مع مستوى عدم الاستقرار السياسي.
					15 النظام البنكي المستخدم لديكم يستوعب احتياجات عملية منح الائتمان ويساعدك على استكمال الدراسة الائتمانية.
					16. الوقت الذي تستغرقه عملية دراسة الائتمان والرد على طلب المقترض مناسب .
					17. تعتقد انه كان بالامكان تقليل حجم التسهيلات المتعثرة لو تم منحك دورا اكبر في عملية اتخاذ القرار الائتماني.
					18. البنك حريص على التعاطي مع موضوع مركزية المخاطر وتبليغ

					سلطة النقد بالتسهيلات التي تزيد عن 10000 \$.
					19. تعتقد ان البنوك غير الوطنية على درجة من الكفاءة اكبر من تلك التي تمتلكها البنوك الوطنية.
					20. يهتم البنك بمراقبة اداء المقترض ومعرفة مركزه المالي خلال عمر القرض والتأكد من حسن تنفيذ الغاية التي تم منح القرض لتنفيذها.

الرجاء ترتيب الأسباب التي تؤدي الى حدوث حالات التعثر لدى البنك وفقا لاهمية بحيث يمنح السبب الالهم: المنزلة الأولى والأقل أهمية المنزلة الثانية وهكذا

الدرجة	العامل	
	ضعف الدراسة الائتمانية وقلة المعلومات عن المقترض	1.
	عدم اعتماد التسهيلات على التدفقات النقدية للمشروع كوسيلة تسديد اولى	2.
	ضعف الضمان او عدم كفايته	3.
	القرارات الفردية او تلك القائمة على اعتبارات غير مهنية	4.
	ضعف الخبرة المصرفية لمتخذ القرار	5.
	الانتفاضة والاضاع السياسية العامة	6.

جوانب اخرى تتعلق بالادارة العليا في البنك تعتقد باهميتها في ادارة محفظة ائتمان نقيه من التسهيلات
-----:المتعثرة

القسم الثالث: الاسئلة التالية تهدف الى تقييم طبيعة الدور الذي تلعبه سلطة النقد كجهة رقابية في موضوع الحد من اتساع مشكلة التسهيلات المتعثرة وذلك من وجهة نظرك :
* عدد الزيارات الميدانية التي قامت بها لجان التدقيق التابعة لسلطة النقد الى البنك المتعلقة بالتسهيلات خلال الثلاث سنوات الاخيرة:

عدد الزيارات	2003	2004	2005

1. انت مقتنع ان طاقم سلطة النقد الذي يقوم بالتدقيق ذا كفاءة	موافق بشدة	موافق	لا رأي	غير موافق	اعارض بشدة

					واهلية عالية ويقدم لك الفائدة اثناء جولاته .
					2.المواضيع التي يتم التركيز عليها هي مواضيع شاملة وغطت نشاط الائتمان بصورة كافية.
					3.التعاميم التي تصدرها سلطة النقد بخصوص التسهيلات تتم صياغتها بعد التنسيق مع البنوك العاملة.
					4.تعامل الادارة العليا تقارير سلطة النقد بمنتهى الجدية وتحرص على معالجة الملاحظات التي وردت فيها بالسرعة الممكنة وتحرص على عدم تكرارها.
					5.التعاميم الصادرة من قبل سلطة النقد ذات العلاقة بموضوع التسهيلات قائمة على دراسة وافية لطبيعة بيئة الاعمال الفلسطينية ويتم تحديثها بشكل مستمر .
					6.تمارس سلطة النقد دورا رقابيا فعالا بالنسبة لموضوع منح التسهيلات وموضوع صيانة المحفظة الائتمانية.
					7.تمارس سلطة النقد دورا علاجيا فعالا بالنسبة للتعامل وإدارة القروض والتسهيلات المتعثرة.
					8.الية منح التسهيلات لدى البنك تلتزم بالتعاميم الصادرة عن سلطة النقد .
					9.الاجراءات والقرارات التي اصدرتها سلطة النقد بخصوص تنظيم عملية منح ومتابعة الائتمان تعتبر في نظرك متشددة وغير واقعية.
					10.انتهاج سياسة عقابية مدروسة بحق البنوك المخالفة هي الطريقة الامثل لاكساب قرارات سلطة النقد في موضوع التسهيلات صفة الالزامية.
					11.تنتهج سلطة النقد سياسات تهدف الى دعم البنوك الوطنية الناشئة وإعطائها قدرات تنافسية مقابل البنوك غير الوطنية.
					12.تنتهج سلطة النقد سياسة متشددة اكثر تجاه البنوك الصغیرة بينما تتساهل مع البنوك الكبيرة.
					13.اقرار نسبة تسهيلات الى الودائع اكبر من النسبة النسبة المحددة حاليا(40%)من شأنه ان يزيد حجم المخاطر التي تتعرض لها البنوك المانحة واجبارها على تخفيف شروطها.
					14. اقرار نسبة تسهيلات الى الودائع اكبر من النسبة المحددة حاليا(40%)من شأنه دعم الاقتصاد الوطني.

					15.تقدم سلطة النقد عن طريق معهد الدراسات التابع لها معارف مفيدة لتطوير كفاءة العاملين في البنوك
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•الرجاء ترتيب الاسباب التي قد تحول دون تنفيذ سلطة النقد لدور رقابي فعال في موضوع منح التسهيلات والحد من مخاطرها وذلك حسب درجة الاهمية بحيث يعطى العامل الالهم الدرجة الاولى والاقل اهمية الدرجة الثانية وهكذا بالنسبة لباقي العوامل :

الدرجة	العامل	
	ضعف البيئة القانونية بما فيها سلطة القضاء	1.
	ضعف الجانب الرقابي لدى سلطة النقد وقلة كفاءة العاملين لديها	2.
	ضعف التواصل والتنسيق فيما بين سلطة النقد والبنوك العاملة	3.
	الوضع السياسي والاقتصادي العام بما في ذلك الانتفاضة	4.
	عدم ربط قرارات سلطة النقد بنظام عقوبات رادع بحق المخالفين	5.
	عوامل اخرى لم تذكر:	6.

امور اخرى تعتقد انه كان على سلطة النقد تحسين اداءها فيها من اجل تحقيق رقابة امثل في موضوع ادارة مخاطر التسهيلات والحد من المتعثر منها:

.....انتهى الاستبيان، اشكر لك تعاونك

مع الاحترام

راغب نهاد حمدان

