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Legally non- performing bank loans：Associated risks and metigation measures

Préstamos bancarios morosos: marco jurídico, riesgos y medidas de mitigación

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Abstract

The objective of the present study is to uncover the phenomenon of ineffective bank loans as an interface between the laws and economics through analysis of the nature of the problem and contributing factors as well as the consequences of this phenomenon. The study will also investigate the present-day efficacy of existing laws and financial frameworks in both terms of prevention and remedy of credit defaults. Thus, the study arrives at the conclusion that the problem of credit defaults can be solved through the adoption of a comprehensive approach combining legislative initiatives with banking solutions and prudential banking supervision as an early warning mechanism of credit risks.

Keywords: Loans, Bank Credit, Bank, Non-Performing Loans.

Resumen

Este estudio analiza la morosidad de los préstamos bancarios desde una perspectiva jurídica y económica. Examina la naturaleza del problema, los factores que contribuyen a su aparición y sus consecuencias. Asimismo, evalúa la eficacia de los marcos jurídicos y financieros vigentes para prevenir y gestionar el incumplimiento de las obligaciones crediticias. El estudio concluye que la morosidad bancaria puede abordarse mediante un enfoque integral que combine medidas legislativas, soluciones de gestión bancaria y mecanismos de supervisión prudencial que permitan detectar tempranamente los riesgos de crédito.

Palabras clave — préstamos, crédito bancario, banca, préstamos morosos.

Introduction

Although Arab banks in the Arab world face some challenges and issues, some of which may be attributed to the economic downturn or reduction in the activity of banks, the causes of these challenges are mostly different.

When it comes to banking operations, especially commercial banking, it is crucial that loans given to bank customers make up a considerable amount of bank assets and hence one of the most important sources of income for commercial banks.

The presence of loans that go unpaid represents one of the major threats to the stability of the finance and banking industry since it relates to the inability of the borrower to make timely payment of the debt he owes.

In order to properly understand this phenomenon and the effects it causes, one needs to analyze the nature of its root causes. Non-performing loans rarely have a singular cause; on the contrary, they are the result of numerous factors, which may have different impact on the specific bank. Therefore, it is reasonable to arrange those factors by their importance. In order to reveal the reasons for loan defaults, banks need to conduct detailed analysis of the client's activity and behavior.

Banks should rely on sound credit decisions to minimize the risk of default, despite the many factors beyond their control that may contribute to credit risk. These factors may be interrelated, going into the borrower or into the nature of their business activities.

Like any phenomenon that has negative effects on the economy, non-performing loans and financially troubled borrowers require efficient measures to tackle, or rather abate. To eliminate the risk of a loan default entirely is

beyond any bank and even the most judicious one, most unfortunately. So, banks must always strive to bring about measures which analyses based on legal and academic investigation have identified, which should fall under both the categories, that is, preventive measures and remedial approaches, to arrest it.

In order to guarantee that this research does not consider the issue of inactive loans only from the economic point of view, it analyzes the legal aspects pertaining to each of the issues whenever necessary, focusing on the legal means of preventing and solving the problems at the level of bank accounts.

The work will try to answer the following important question:

"To what extent non-performing loans threaten the stability of the banking system and how soon can the existing legal and financial measures being implemented help to reduce their influence?"

Main aims:

- To analyze the situation with non-performing loans.
- To determine the reasons for non-performing loans.
- To investigate the consequences of non-performing loans.
- To find ways of solving the problem of non-performing loans.

Research Design

In order to meet the objectives of the study, the descriptive-analytical approach is used to provide an in-depth description of the issue of non-performing loans and investigate the underlying causes of the issue as well as the consequences it may have on the economy and banking operations using the available literature and legislative material. The descriptive-analytical method is supplemented by comparative analysis that allows the author to explore different methods used by various banks to deal with the problem.

Study Outline

The study consists of two main parts that correspond to the research questions of the current study with the first part focusing on defining the notion of non-performing loans and their characteristics, while the second part is devoted to discussing the issue of management of non-performing loans.

1. The Nature of Non-Performing Loans

Bank loans are a primary source of revenue for banks and represent one of their most important financial activities. For this reason, banks pay particular attention to lending in order to minimize the risks associated with credit operations.

Among these risks, non-performing loans, also referred to as non-performing debts, are a major concern. Although they are recognized as an inherent risk of banking activity, a combination of unexpected circumstances and contributing factors may cause them to develop into a serious problem.

Accordingly, this section examines the concept of non-performing loans and the factors that contribute to their occurrence.

1.1 The Definition of Non-Performing Loans

In order to comprehend non-performing loans well, it is inevitable to start with the overall description of the loan and various classifications before approaching the essence of non-performing loans.

First: The Concept of Loans

As emphasized by some scholars, "loan agreement is a contract whereby a bank agrees to provide a certain sum of money to a borrowing party, which is obliged to repay the sum within the given timeframe with the interest and after providing the necessary collateral" (Foudil, 2005, p.142).

According to the law, the term loan means "transfer of ownership of the capital or the cash to another person, who promises to repay the equivalent amount of this money or capital to the lender on the expiration of the loan period" (Jordanian Civil Code, Official Gazette n°43, 1976, Art.636).

As per the laws in Algeria, lenders are banks which lease out money to their clients against pledges. The above-mentioned activities of banks belong to the types of operations used in the commercial practices of the financial institutions (Law on Money and Credit, 2003, Official Gazzette, Art 68).

Loans can be classified based on various criteria such as the maturity of the loan, the borrowers receiving the loan, the purpose of the loan, and the collateral for the loan. It is essential for the banks to analyze the classification so that the banks can keep an eye on their lending activity with respect to their strong and weak points (Al-Taher, n.d., pp 66–67).

A. Classification Based On Maturity (Duration)

- Short-term loans: Loans that have a maturity period of less than a year are referred to as short-term loans.

- Medium-term loans: Loans that need to be paid back within five years are referred to as medium-term loans and they are mainly meant for financing capital investments.

-Long-term loans The loans that are maturable in more than five years are referred to as long-term loans and they are usually taken for financing projects related to construction of buildings, land reclamation, and setting up of factories.

B. Classification by Purpose

We can categorize loans into types: consumer loans, production loans, commercial loans, or investment loans.

C. Classification by Security

We know that loans can be either secured or unsecured:

- Secured loans:They are issued against tangible security or a personal guarantee which gives the bank the option of recovering its money by selling the collateral in case of default.

-Unsecured loans: They are issued without any form of tangible security or personal guarantee that the bank could use to recover its money in case of default. The only safeguard that lenders would have as per such loans is the verbal commitment made by the borrower in favor of the lender.

D. Classification by Borrower Type

Loans can be given to individuals, companies, public sector organizations, banks, consumers, or producers.

It is essential for banks to carry out some due diligence when granting loans, making sure that they know and understand who is receiving the loan. There could be special situations or external forces that could prevent borrowers from implementing their commitments.

Second: Non-Performing Loans

Even though when lending operates within parameters set forth by sound banking principles, lending still carries an element of risk. It is for this reason that banks categorize their loans according to their classifications so that they can determine the legal status of each loan in their portfolios, unlocking the secrets of how and when loans stop performing.

Among many definitions offered, there is no single universally agreed definition of non-performing loans. Nevertheless, some definitions define non-performing loans as loans for which borrowers are not able to repay dues according to the agreed-upon schedule, often due to issues such as bad faith and failure to provide required documentation to the bank.

According to other experts, non-performing loans are defined as "loans that have stopped making interest income to the financial institution, as well as loans that need to undergo rescheduling according to the given borrower's personal financial circumstances" (Hanafi, 2005, p. 210).

In general, non-performing loans are debts that have reached certain conditions, namely that the bank cannot expect to recover the debt within a reasonable time frame according to the borrower's financial circumstances and the collateral securing the loan. This is due to the fact that given the assessment made by the financial institution, certain factors make the debt too risky to expect a repayment (Al-Najjar, 2009, p. 17).

It would be a mistake to believe that doubtful debts are exclusively caused by loans given out contrary to good banking practices. The presence of these debts could also arise in lending transactions that have complied with good banking practices but carry other risks associated with lending. As a result, the emergence of these debts may occur as certain combination of expected and unexpected factors.

2.1. Causes of Non-Performing Loans

The reasons why loans become delinquent (non-repaying) has previously been discussed as loans are always subject to credit risks. Whenever a loan is granted by banks, there is always a danger of the borrower defaulting irrespective of whatever guarantees they have provided. Credit risks are an integral feature of lending and there are numerous reasons why credit risks might arise. It is not only the borrower’s creditworthiness which matters. There can be other causes either internal or external and they are often dependent on the level of the economy in general.

According to classification criteria, academics have categorized delinquent loan causes into various groups. However, broadly speaking, the causes can be divided into three categories. These categories are: causes that are directly related to banking performance, causes that are attributable to the borrowers, and causes that can be categorized as external forces.

1.2.1. Influences on Bank Performance

Often, banks have negative consequences that result not only from external impacts but also from their own mistakes. For instance, many bad debts that occur in banks originate from their own shortcomings. Mistakes could be caused by bad judgment with respect to collateral and poor evaluation of repayments.

1.2.1.1. Offered Guarantees

The guarantee might also be viewed as a form of property and can either be tangible or untouchable property. This will turn into cash and cover the loan amount, the interest accrued and paying off anything additional. Nevertheless, guarantees are usually valued in a wrong way. (Al-Khudairi, 1996, p. 101):

a. Inflation of Guarantees

The overvaluation of assets the customer offers as security for the funds borrowed from the financial institution, when guarantees are valued far above their actual value. For instance, it may mean an inflated evaluation of equipment and machines (Al-Hindi, 2005, p. 112).

The failure to meet the imposed conditions regarding the guarantees that must be fulfilled with respect to ownership, pledging, possession, and the regulations governing their alienation and sale as outlined in Articles 156 and 157 of the Algerian Commercial Code.

b. The absence of measures to ensure periodical, continuous and abidance investigations into the type and condition of the goods pledged from various perspectives. This should guarantee the coverage of the pledged goods with insurance policies and measures that can protect the goods from various hazards in the periods of pledging and storage as well as the implementation of regular inspection trips to the client's depots. In addition, it would be necessary to make sure that the goods of the pledge are in compliance with the good quality standards in order to avoid negative impact on the value of the pledge (Al-Khudairi, op. cit., p. 103).

c. Absence of Obtaining Assurances That Pose a Discouraging Influence on the Customer

Failure to procure sureties that exert a definite influence on the customer by way of applying social and psychological pressure so as to persuade any client to think twice about committing any illegal acts against the bank or making an attempt to run away from its money.

1.2.1.2. Credit Analysis

Credit analysis is one of the key contributors of loan defaults in commercial and specialized banks. While credit analysis forms a basis for credit decision-making and is essentially done so that risks associated with lending are controlled, on occasion, it can lead to the opposite. Credit analysis might fail for a number of reasons – of which the most significant ones are listed below:

a. Failure to Apply Sound Lending Principles in Credit Decisions

The failure to apply sound lending principles in credit decisions stems from the lack of attention paid by those responsible for making such decisions to credit analysis, as they rely instead on their personal experiences and expertise, despite their limitations (Matar, 2008, p. 182).

a. Failure to examine customers' credit applications adequately, whether in terms of the customer's character and legal capacity to enter into contracts or in terms of anticipating future factors that may affect the ability to repay, particularly those related to the project itself (Al-Shammaa, 2011, p. 43).

b. Failure to ensure that the credit analysis complies with the limits and controls established by the bank's credit policy, as well as failure to support the analysis with accurate and realistic data concerning customers and their circumstances. This may result either from the failure to employ scientific methods as essential tools for conducting a sound credit assessment or from the failure to verify the authenticity and validity of the documents submitted to the bank by the customer (Al-Hamzawi, 1997, p. 369).

One of the most significant contributing factors is the persistent neglect of monitoring the use of credit facilities, including verifying that the conditions governing their use are met and that all required conditions and procedures have been fulfilled.

1.2.1.3. Poor Credit Management

Poor credit management is considered one of the most serious causes of loan default, to the extent that it has been described as poor banking management. It is regarded as the primary underlying cause of the preceding factors and is closely linked to them. As the saying goes, *"If credit management is poor, the bank's management will consequently be poor as well."*

Credit analysis is, therefore, a process that involves personal judgment. However, this does not justify overlooking the excessive expansion of personal lending, the granting of loans to distressed businesses under the pretext of helping them overcome their financial difficulties, or, ultimately, attempts to circumvent the regulations imposed by the Central Bank (Al-Khudairi, op. cit., p. 369).

1.2.2 Customer-Related Causes

These reasons can be connected to the factors of creditworthiness (Al-Shammaa, op. cit., p. 102), which the financial institution has evaluated while making its lending decision. But various situations may arise which will change the client's personal conditions or the business idea even after the loan was issued, so the list of reasons

is numerous and can't be compiled exhaustively, as these causes are also changing according to the changes in the situations of clients who obtain loans:

1. Any cases of poor experience of the borrower in the business in question or any cases of conducting affairs with which they are not familiar without informing the bank together with the use of the credit resources of the bank for financing these activities.
2. Faulty management of borrowed funds, financial frauds, and absence of accountability, especially when the company depends on people lacking experience or simply without necessary professional competence and body of knowledge to conduct the activities.
3. Willfully misleading the bank by presenting false information that disguises the real state of affairs in the business thus making it possible for the bank to give the customer a loan without making any verification of what the recipient has said.
4. The failure of the client to follow the bank's advice and recommendations, or not complying with its rules and regulations coupled with his/her incapability to plan, coordinate, manage, and oversee the different investments in the project, both financially and managerially (Al-Khudairi, op. cit., p. 85).

Another cause which has become more common in recent times is the dishonesty of the customer and his/her reliance on personal contacts and attempts to obtain money from the bank through illicit ways. The customer may confess to bankruptcy and leave for another country or get engaged in legal disputes.

1.2.3 Causes Beyond the Control of Both Parties

Credit decisions are most often determined and influenced by a given context. Such context refers to political, economic, social, or legislative facets that may affect the activities of credit extension by banks.

Factors may include sudden government interventions through various policies such as fiscal and monetary policy (Al-Khudairi, op. cit., p. 125) or other events that correlate with the development of a credit problem. Unhealthy competition among banks means that financial institutions have set up more or less conscious systems of competition whereby they compete aggressively but without relying on sound scientific or other objective assessment.(Al-Shawarbi, 2006, p. 747).

Legislative fluctuations may also affect credit performance, particularly changes in laws governing imports and exports, foreign exchange, customs tariffs, and exchange-rate instability. These changes can have a profound impact on various economic activities. However, their effects have declined in recent years as greater emphasis has been placed on what is known as legal security and legislative stability (Ghanem, 2001, p. 51).

All these factors reflect serious shortcomings in the applicable legal framework, particularly its lack of comprehensiveness and its failure to address many issues that would help ensure appropriate action is taken at the right time and with minimal damage. Furthermore, the penalties prescribed by law are not always reasonably structured or proportionate to the seriousness of the violations committed.

The problem of external debt and the international economic system should also not be overlooked, as a significant portion of external borrowing in these countries is not directed toward development purposes.

All these causes must also be considered alongside force majeure events and unforeseen incidents that cannot be anticipated, such as fires and earthquakes. Collectively, these factors and events account for many of the causes underlying credit problems, exposing the domestic economy as a whole, and the banking sector in particular, to a series of crises that negatively affect the level of economic activity. Such consequences can be mitigated only if the situation is addressed in a timely manner through the use of appropriate measures to contain the problem.

2. Dealing with Non-Performing Loans

Non-performing bank loans constitute a serious problem that entails substantial costs, in addition to the complex consequences arising from them. Their impact is not limited to the banking institution itself but extends to the country as a whole. These consequences impose greater responsibility on banks to understand and address the problem, whether through preventive measures or corrective actions. Accordingly, this section will examine the consequences of non-performing loans and the measures used to reduce their incidence.

2.1 Consequences of Non-Performing Loans

The seriousness of non-performing loans lies in their adverse consequences, which may initially affect the banking system and subsequently extend to the country's national economy.

2.1.1 Micro-Level Effects

These effects may concern the parties involved in the credit relationship, namely the customer and the bank. They can be summarized as follows:

1. Freezing a Significant Portion of the Bank's Financial Resources

A substantial portion of the bank's financial resources becomes tied up in non-performing loans and credit facilities that are difficult to recover. This is accompanied by a general decline in the bank's revenues, as the returns

associated with these debts must be set aside or written off. Consequently, the bank's competitiveness may deteriorate because of the higher cost of funds required to secure additional resources to compensate for those immobilized in the form of non-performing loans (Al-Shawarbi, op. cit., p. 747).

2. Substantial Financial Losses

These losses involve the following:

a. Non-performing loans require specialized treatment and qualified managerial, supervisory, and operational expertise. Such expertise is costly and difficult to secure for a bank facing financial distress or insolvency (Ghanem, op. cit., p. 4).

b. The appointment of experts and consultants within the bank to manage non-performing loans. Once their assignments have been completed, the bank may be forced to reassign them to routine duties, without fully benefiting from their specialized skills.

c. A contraction in the bank's operations and market presence, potentially leading to the closure of some branches and the sale of certain tangible assets. Furthermore, monetary authorities may impose a series of restrictions on the bank's management, accompanied by pressure from the public and customers. These circumstances may threaten the bank's continued operation or ultimately lead to the termination of its independent activities through a merger with another bank.

d. Increased scrutiny from journalists and media organizations, whose investigative reports may expose the bank's mistakes and subsequently criticize the institution and its management. This can create a negative public image, reduce the bank's business volume, and potentially push it toward insolvency or bankruptcy.

These consequences cannot be exhaustively enumerated or examined in detail at the level of every branch of the banking system. However, their seriousness is undeniable, particularly because their effects can extend to the national economy as a whole.

2.1.2 Macroeconomic Effects

The effects of non-performing loans extend to the national economy and threaten the process of economic development due to their significant impact on the investment climate and the liquidity of businesses. The most important effects can be summarized as follows:

1. Adverse Effects on Economic Development and Public Revenue

Non-performing loans hinder the implementation of government plans aimed at promoting investment and creating additional employment opportunities. They also reduce the value added generated by both the banking sector and the distressed businesses themselves, ultimately leading to a slowdown in the growth of national income. Furthermore, the state budget is deprived of a significant portion of its public revenue due to the decline in tax revenues collected from both the banking sector and distressed businesses (Matar, op. cit., p. 185).

The consequences of loan defaults are not confined to the institutions directly concerned; they also place a substantial burden on the public treasury. Non-performing loans erode the tax base in two ways. First, banks' profits decline because they are required to set aside provisions to cover potential losses from non-performing loans. Second, the productive performance of borrowing companies deteriorates, potentially resulting in the suspension or cessation of their business activities (Sami, op. cit., p. 320).

2. Increased External Debt and Adverse Effects on Domestic Policy

Non-performing loans may contribute to an increase in the country's overall external debt and adversely affect domestic economic policy (Bank of Algeria Report, 2023, p. 68).

The severity of these risks varies according to the extent to which the banking sector is integrated into the economic development process and the degree of its influence on monetary stability and domestic fiscal policies. These concerns have prompted efforts to identify measures for mitigating and managing such risks, which generally involve a range of available alternatives.

2.2. Measures to Mitigate Non-Performing Loans

The measures adopted to address this problem are not intended to eliminate all credit risks, but rather to mitigate their severity and prevent them from escalating into serious problems. These measures may be classified as preventive measures, which aim to avert the occurrence of non-performing loans, and corrective measures, which seek to resolve them and restore the loans to a sound status, with particular emphasis on the relevant legal aspects.

2.2.1. Preventive Measures

The most effective way to deal with non-performing loans is to prevent them from occurring in the first place. Banks should therefore take all necessary measures to avoid the emergence of such loans. Although these measures vary from one country to another according to its specific circumstances, a general framework can nevertheless be established.

2.2.1.1. Ensuring the Soundness of Credit Decisions

Banks must ensure that credit-granting decisions are made in accordance with established banking principles and procedures, without departing from these standards. This requires compliance with internal credit controls throughout the entire lending process, from the submission of a credit application and the approval of the credit facility to the implementation of the lending decision and the subsequent monitoring of the borrowing client's activities (Al-Khudairi, op. cit., p. 748).

This approach is reflected in the adoption of prudent credit practices and the effective implementation of follow-up and monitoring procedures, drawing on lessons learned from previous experience. Such practices include ensuring accuracy, clarity, and transparency when preparing and updating credit assessments. All these measures should be implemented within the framework of a written lending policy and supported by internal loan reviews (Al-Hamzawi, op. cit., p. 186).

2.2.1.2. Ensuring That the Loan Is Used for Its Intended Purpose

The bank must monitor and supervise the borrower's use of the loan to ensure that the funds are utilized in accordance with the predetermined schedule and for the purpose specified in the loan application submitted to the bank, which forms the basis for the bank's decision to grant the loan.

If the borrower uses the funds for a purpose other than that for which the loan was granted, this may be considered a breach of the loan conditions. In such a case, the bank may terminate the agreement concluded with the borrower and demand repayment of the outstanding amount. However, the bank may exercise this right only if it is expressly stipulated in the loan agreement.

2.2.1.3. Avoiding Excessive Overdrafts in Customer Accounts

The bank should permit overdrafts on a customer's account only to meet temporary, exceptional needs and for limited periods. When granting an overdraft facility, the bank establishes a specific limit that the customer must not exceed when withdrawing funds. In determining this limit, the bank must take into account the financing needs of the project and the amount of monthly interest payable.

Accordingly, when assessing an application for credit facilities, the bank should consider the possibility that the borrower may exceed the authorized overdraft limit. However, this does not mean that the bank should refrain from providing additional financing when necessary (Al-Shawarbi, op. cit., p. 784).

2.2.1.4. Monitoring the Customer's Account

The bank prepares account statements to provide itself with an important and effective means of monitoring account transactions, regardless of the type of credit facilities associated with the account. Current accounts, which are among the most common accounts in banking practice, require particularly close monitoring because of their nature. In addition to reviewing account statements, the bank can monitor such accounts through the following measures:

- Monitoring account transactions: Examining the volume of withdrawals and deposits and determining whether account activity has become stagnant. The bank should establish whether this inactivity affects both withdrawals and deposits or only one of them.
- Comparing withdrawals and deposits with financial projections: Comparing actual account movements with the projections set out in the feasibility study and cash flow schedule. Any discrepancies between actual transactions and projected figures may indicate potential financial difficulties.
- Reviewing returned cheques: Examining cheques deposited into the customer's account that have been returned unpaid by other banks.
- Monitoring the customer's financial position: Keeping track of the borrower's individual circumstances and any changes that may occur over time, whether they concern the financed project or other projects undertaken by the borrower (Al-Najjar, op. cit., p. 39).
- Developing banks' early warning systems: Improving early warning mechanisms to identify potential signs of financial distress and credit deterioration at an early stage.

In general, it can be argued that diligent monitoring by the bank of the customer's financial situation, accounts, and financed project is no less important than the initial credit-granting decision; indeed, it may be even more important.

2.2.2. Corrective Measures

Various alternatives have been proposed to address the problem of non-performing loans. Some of these alternatives have been derived from solutions implemented in practice in countries such as those in the Gulf region and Egypt, while others have not been put into practice and remain merely recommendations or proposals.

Although different classification systems have been adopted, the proposed solutions generally fall into the following categories:

Rescuing the Borrower: This approach applies when a borrower experiences financial difficulties as a result of a setback affecting their business activity. The bank may grant the borrower a grace period during which repayment

of the principal and interest is deferred. It may also consider waiving part of the accrued interest and reducing the interest rate applied to the credit facilities granted to the borrower (Al-Khudairi, op. cit., p. 337).

- **Rehabilitating the Borrower:** Under this approach, the bank takes more advanced measures involving direct or indirect intervention in the borrower's management. The bank becomes a full partner in the borrower's business and works to restore financial balance between the project's revenues and expenditures (Hilal, 2007, p. 290).
- **Revitalizing the Borrower:** This approach aims to transform a financially distressed borrower into a financially viable one by granting new loans under favorable terms, enabling the borrower to undertake replacement and modernization operations. However, implementing this approach requires that a specific set of conditions be met (Hindi, 2004, pp. 425–427).
- **Rescheduling Non-Performing Loans:** This approach involves granting concessions to the borrower and providing an opportunity to reorganize business operations through a series of measures. One of the most important and critical steps is negotiating with the borrower and assessing the accuracy and objectivity of the information collected about them. Based on this assessment, a debt rescheduling plan is agreed upon. A draft of the agreement is then submitted to the legal department for review before being signed by both the borrower and the bank once it has been approved.

In general, debt rescheduling may take place either before or after the maturity date of the credit facility granted to the borrower, although each situation requires a specific approach to treatment. The process is closely linked to a key legal concept: the **maturity date** (Sami, op. cit., p. 325).

- **Merging the Distressed Project with Other Projects:** This is one of the important approaches to dealing with non-performing loans, particularly when the project's financial difficulties result from its small size or its failure to operate at its full capacity.
- **Liquidation of the Borrower:** This is the most drastic and sensitive alternative, as it involves several risks that may threaten the bank's reputation, stability, and market growth. Banks resort to liquidation only as a last resort, after all other available solutions have been exhausted (Sami, op. cit., p. 340).

Regardless of which of the aforementioned alternatives is selected, consultation among the bank's various departments is essential. In particular, the Credit Department and the Legal Affairs Department should coordinate to determine the most appropriate methods for addressing non-performing loans and safeguarding the bank's rights in its dealings with borrowers. Arab countries have accumulated experience in this field, particularly Kuwait (Al-Arabiya, 12–14/2015).

Conclusion

The study reaches a conclusion that there is a problem with bad credit that consists of not only functioning as a temporary gap in the balance of banks, but is a sophisticated phenomenon encompassing the combination of both internal factors such as insufficient management and bad credit evaluations as well as external factors beyond the borrowers' control, which appear as a result of economic changes and unexpected circumstances.

Based on the analysis, it has been determined that no matter what the cause of bad debts is, it poses a serious threat to the sustainability of banks' liquidity. The impact of the problem is more significant than merely affecting lending institutions, since it has implications on the national level in terms of growth of the economy itself.

Findings

• Non-performing loans cannot be seen only as a financial or administrative issue because this is a complex situation that has appeared as a result of the interaction of a great number of factors and root causes.

• Credit risk is an important characteristic of bank activities that can’t be avoided completely, but there is a possibility to manage this risk and control its level.

• Twofold effect: Non-performing loans can cause a number of negative effects and consequences not only for the given banks but also for the process of lending and the national economy in general.

• The research has shown that even a right credit decision is not enough by itself. Continuous monitoring in the regions and permanent control over how the loan is being utilized is of paramount importance.

• There are many ways to deal with the problem of non-performing loans. The solutions must be implemented with maximum legal and economic flexibility.

• It is necessary to have a well-balanced legal framework. The agreements should focus on amicable and contractual solutions such as restructuring and rescheduling debt.

Recommendations and Proposals

- Formulate detailed written credit policies: Banks are advised to prescribe written credit policy guides outlining the practices for their employees in charge of dealing with credit. Such policies should take cognizance of all the relative circumstances concerning any decisions made regarding credit.
- Reschedule debts on reasonable conditions: Banks are expected to reschedule debts on reasonable conditions and avoid litigation, especially in cases where debtors cannot pay their loans because of circumstances beyond their control.
- Increase the frequency of the field visits on financed projects: Banks should conduct regular field inspections not only before the loans but also continuously and periodically assessing the viability of the projects and ensuring that the business activities of the borrower are in accordance with the indications highlighted in the feasibility reports.
- Encourage mediation and arbitration in banks: Banks ought to promote mediation and arbitration as an alternative financing mechanism for settling disputes related to financial difficulties and defaults on loans.

Getting back to the key points, the process of managing bad debts is rather complex as it implies necessary consideration of both banks' and depositors' interests and the ability to support the borrowing company and preserve operations in the country. Therefore, it needs to be understood that while evaluating the activity of banks, it is insufficient to avoid risks of default as the transformation of risks into opportunities for the recovery of the business is also vital. It should also be noted that if corrective measures function properly those would not help to avoid bad loans in full but would lead to their reduction in the banking sector as well as in the economy.

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