

Factors escalating credit risk in Islamic Banks. Case study: Al Salam Bank Algeria

العوامل المصعدة لمخاطر الائتمان في البنوك الإسلامية. دراسة حالة: بنك السلام الجزائر

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Abstract:

This study aims to shed light on credit risk in Islamic Banks, through a field study in Al Salam Bank-Algeria to investigate the factors of the increase in the overdue amount. Therefore we carried out interviews with the bank staff members and questionnaire with the defaulting borrowers.

The results showed that there are several deficiencies in the system of the bank, while MCA showed four categories of defaulting borrowers.

Keywords: Islamic banks, banking risks, credit risk, credit risk factors.

JEL Classification Codes : G21, G32, D81

ملخص:

تهدف هذه الدراسة إلى تسليط الضوء على مخاطر الائتمان في البنوك الإسلامية، من خلال دراسة ميدانية في بنك السلام – الجزائر لتحرى أسباب الزيادة في المبالغ المستحقة. من أجل ذلك أجرينا مقابلات مع الموظفين واستبيان مع المقترضين المتخلفين عن الدفع.

النتائج أظهرت اختلالات في نظام البنك، بينما MCA أظهر أربعة أصناف من المقترضين

المتخلفين عن الدفع.

كلمات مفتاحية: البنوك الإسلامية، المخاطر البنكية، مخاطر الائتمان، أسباب مخاطر الائتمان

تصنيفات JEL: G21، G32، D81

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1. INTRODUCTION

Globalization and civilization phenomena, reintroduce the Islamic financing system to the economic world, by offering innovative financial instruments and transactions compliant with sharia principals. In spite of this, the Islamic financing system has been struggled by several events until its emergence.

Credit risk remains the leading source of problems in banks and particularly in Islamic Banks (IBs), which are witnessing an increase in bad loans. (Sarker , 1999)

This gap justifies new efforts to investigate the factors influencing credit risk. Therefore, the aim of this study is to examine the key factors influencing the credit risk in Al -Salam Bank Algeria in the first three months of 2019 when it recorded an increase in the volume of overdue. In order to ensure, the efficient credit risk management in this bank, and to provide for the other IBs a better understanding of the credit risk determinants.

Research question

From a decision problem, we formulated the research question as follows: « What are the different factors explaining the increase of the credit risk in Al Salam Bank Algeria? ».

2. Generalities about credit risk in Islamic banks

2.1 The literature review of the credit risk factors in IBs

Individual counterparties, economic situations such as a market recession, can influence credit risk. The ambiguous definition of collaterals and guarantees in IBs can be also a risk factor. Moreover, due to the latest establishment of Islamic financial contracts, there still a lack of effective quantitative and qualitative criteria to select the most appropriate client. Furthermore, the traditional financial institutions have a good relationship with their clients. In contrast to the new financial institutions, which do not consider this aspect, so it is difficult for them to make accurate predictions about the behavior of the client. The large numbers of the granted financing can also influence the credit risk. (Akkizidis & Khandelwal, 2008, p. 109)

We found in another research which studied the case of Greece banking sector that the non-performing loans are explained by

macroeconomic variables as GDP, unemployment rate, and the lending rate. The factors influencing the unsystematic credit risk are related to the individual customer and it includes credit insurance, general terms and conditions, financial situation and the personality of the borrower. (Louzis, Vouldis, & Metaxas, 2012)

In another study, the authors investigated the different factors of the credit risk in Malaysian Islamic banks, by using dataset of six Islamic windows and six conventional banks for the period from 1996 through 2002, they found that the risk-weighted assets, size, and management efficiency are the major factors of credit risk in IBs. (Ahmad & Ahmad, 2004)

Another study examined the risks in Islamic banks; they analyzed the data of 23 Malaysian commercial banks from 1988 through 1996. The study shows that the credit risk is influenced by the size of the banks in both Islamic and conventional banks. (How, Karim, & Verhoeven, 2005)

Furthermore, the IBs are not permitted to impose penalties for the defaulting borrowers, except in the case of intended delay and if this situation exceeds three months, they can charge them only administration and legal fees. Unethical borrowers can abuse this rule and delay the payment intendedly, which influences the credit risk. (Rahman & Shahimi, 2010)

2.2 The concept of credit risk in IBs

The credit risk is the main risk faced by banks, which stems from the possibility that the counterparty will fail to repay his loans that may lead the bank to bankruptcy, and which influence the bank's growth. (Saunders & Cornett, 2008, p. 173) We realize from this definition the significant impact of the credit risk on the bank performance. The credit risk in Islamic bank corresponds to: « lending in the Murabaha , leasing in the Ijarah , promises to deliver or to buy in Istisnaa and Salam , and investments failure in the Musharakah and Mudarabah contracts». (Akkizidis & Khandelwal, 2008, p. 145)

In the new basel capital accord II the default refers to credit risk which is defined as : « a default is considered to have occurred with regard

to a particular obligor when either or both of the two following events has taken place.

- The bank considers that the obligor is unlikely to pay its credit obligations to the banking group in full. Without recourse by the bank to actions such as realizing security (if held).
- The obligor is past due more than 90 days on any material credit obligation to the banking group. Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current out standings ». (Basel Committee on Banking Supervision, April 2003, p. 80)

3. Methods and Materials

We adopted mixed methods single case research (MMSCR) wherein we adopted the exploratory sequential design.

3.1 Qualitative approach (first phase)

We conducted seven semi-structured interviews with employees to reveal the factors of the credit risk from their perspectives.

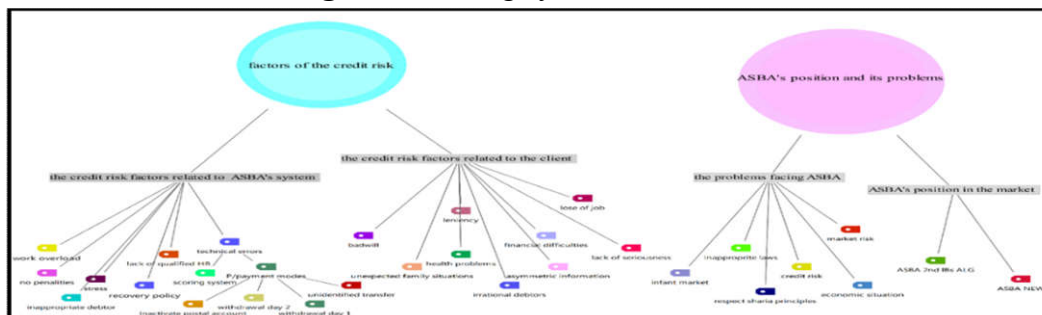
3.2 Quantitative approach (second phase)

We conducted questionnaire to reveal the factors of the credit risk from the perspective of the defaulting borrowers. We conducted a sample segmentation in which we categorized the defaulting borrowers into groups. Therefore, we conducted Multiple Correspondence Analysis (MCA) to achieve the objective aimed. The sample consisted of 195 defaulting borrowers of ASBA.

4. Results and discussion

The following figure shows the categorizing and coding of verbatim.

Figure 1. Coding system of verbatim



Source: created by the authors

4.1 Qualitative findings

We are going to present all the categories and codes related to each theme, and the verbatim of the interviews will form the basis of our discussion.

4.1.1 ASBA's position and its problems (First theme)

This theme involves two main categories: ASBA's position in the market and the problems facing ASBA.

4.1.1.1 ASBA's position in the market (First category)

This category involves two codes each one of them is detailed as follows:

a. ASBA NEW: ASBA still infant bank in 2018 it celebrated its 10TH years. They used to adopt only B2B strategy and exclusively with 'ADASSAT client', they applied B2C. Since May 2016 they have started the application of B2C strategy besides B2B, the interviewee mentioned that: «...in the beginning we had just two agencies then with the celebration of our 10TH years the number of agencies increases from two to fourteen branches and we will soon open two other agencies ...». **Participant 4.**

b. ASBA's 2nd IBs ALG: ASBA occupies a good position in the Algerian Islamic banking system with high service quality, the interviewee said about this: « Islamic banking system started with the implementation of Al Baraka in 1991 ... the quality of ASBA services also is well proven by the award got from JP Morgan bank... » **Participant 4.**

4.1.1.2 The problems facing ASBA (Second category)

The interviewee emphasizes the different difficulties facing ASBA, this category includes many codes each one involves one problem as follows:

a. Inappropriate laws & Respect of sharia principles: The following verbatim clarify those problems: «... on the one hand, we have to ensure full compliance with sharia principles, on the other hand, we have to respect laws set up by the central bank...we are supervised by two completely different laws... » **Participant 4.**

b. Infant market, Market risk & Credit risk : The following verbatim clarify these problems: « the Islamic banking system is still at a

development stage the Islamic bank as the conventional bank suffers from many risks such as ,market risk, credit risk ...»**participant 4.**

4.1.2 Factors of credit risk (Second theme)

The second theme includes two categories.

4.1.2.1 Credit risk factors related to the client (first category)

This category includes many codes and each one refers to a factor related to the client that influences the credit risk.

a. Lack of seriousness: About this factor the interviewee said: « if we don't force them to pay they don't pay ... they don't care at all »**participant 3.**

b. Financial difficulties: the client can pass by financial problems and default in payment, they also said about this: « ... some of them pass by real difficult situations... »**participant2.**

In the following verbatim, the interviewees mentioned others factors:

c. Health problem, unexpected family situations & Loss of job:

« Something like health problems, unexpected family situations like wedding or relocation or loss of job » **participant 4 .**

d. Bad will (bad faith): « ...We have never imposed penalties for the individual borrowers this is why they abuse the particularity of Islamic banks and they intend to delay in payment ...» **participant 2.**

e. Irrational debtor & Economic situation: «... the monthly income of many defaulted borrowers is less than 50000 AD ...and with the volatile economic situation they can't repay regularly their engagements, while others default in payment because they repay many credits at the same time ... » **Participant 4.**

f. Asymmetric information: «... we are aware that even with this system there will be defaulted borrowers because of the asymmetric information ...» **participant 5.**

4.1.2.2 Credit risk factors related to ASBA's system (Second category)

The second category as well involves many codes as follows:

a. Work overload: « ... Since 2018, with the launch of the new product 'BAI' bi taksit which consists of selling cars, since that the numbers of requests for financing and borrowers are increasing, and the number of defaulted debtors is increasing as well ...» **participant 6.**

b. Leniency: « The leniency of both the client and the staff members»
participant 1.

c. Recovery policy «...and the recovery policy... they are not severe with defaulted debtors » **participant 3.**

d. Lack of qualified HR: «...there are few numbers of experts and specialists in this field, who can give added value to the Islamic finance in general... » **participant 7** «... However, there are more problems facing our activity such as the lack of qualified human resources ...»**participant 1.**

e. No penalties: « ...We have never imposed penalties for the individual borrowers ... » **participant 2.**

f. Inappropriate debtor: « ... Although borrowers are conditioned to receive salary that exceeds 40000 AD, we still find defaulting borrowers who receive lower salaries than this ...» **participant4.**

g. Stress: this factor influences the ability of the workers: «... The client advisors can make mistakes when he inputs information ...because of task overload, stress ...» **participant 7.**

h. technical errors: « ... when a client has two accounts in ASBA saving account and cheque account... Most of time the client deposits his monthly loan installment regularly but the cashier deposits the amount of money in the saving account, instead of the cheque account ... When two Clients have the same name, the cashier can make mistake and deposits the money in the wrong account ...» **participant7.**

From these codes, derive sub-codes as follows:

h.1 Scoring system: « ...As you see here that the ex-ante evaluation is just a prediction of what can happen in the future, and it is just a way to minimize as much as possible the risk of counterparty... » **participant 5.**

h.2 p/payment modes: « ... from each mode of payment comes many problems that can influence the credit risk or the overdue amount ...»
participant 1 .

From this sub-code derives as well many other sub-codes as follows:

h.3 Withdrawal day 1: the problem of the transfer from postal current account to ASBA's accounts: « ... the withdrawal day is in 27th of the

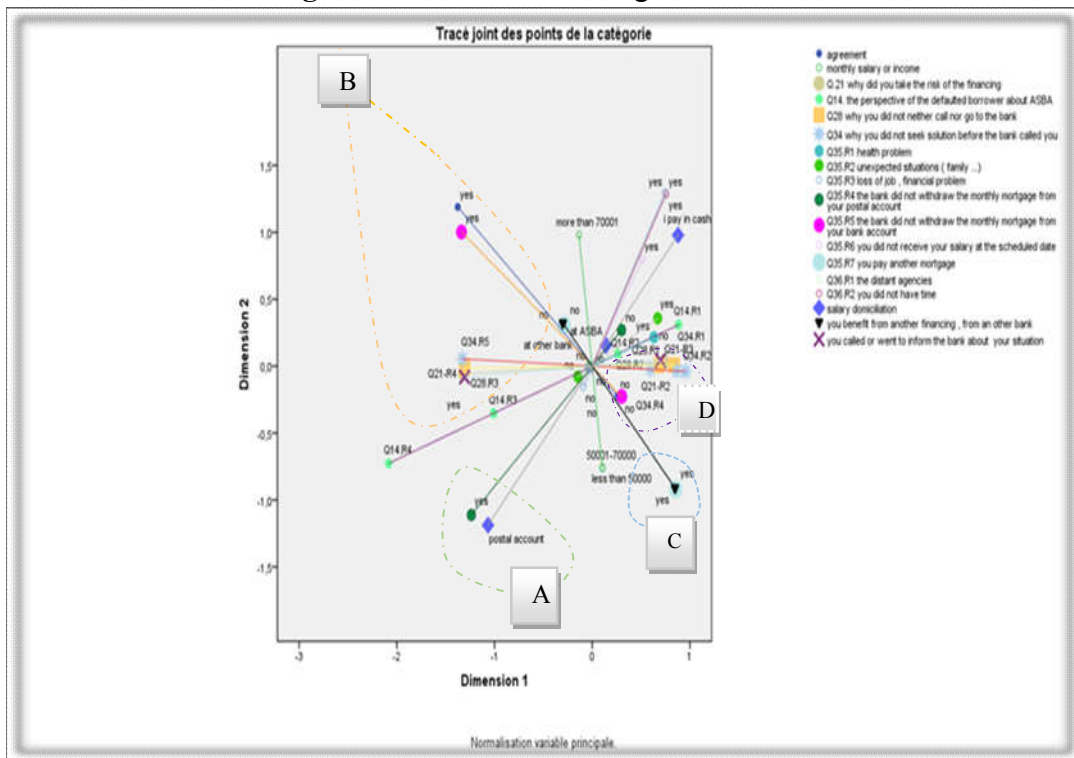
month, if they deposit money after this date they will be considered as defaulted borrower...» **participant 3.**

h.4 Withdrawal day 2: the unsuitable withdrawal date« mobilization operation...the problem emerges, because the withdrawal date is before the date on which the borrower receives his salary...» **Participant 4.**

h.5 Inactivated postal account: « ... Often, we find that the borrower has deposited the monthly mortgages regularly, however, because his postal account has not been activated, so the money will not be sent to his cheque account... » **participant 4**

h.6 Unidentified transfer: « The procedure of payment of the mortgages is done by the administrative agents of the enterprises... if the agent forgets to send the transfer order and/or the list of the employees (unidentified transfer) the system considers the borrowers as defaulted borrowers »**participant4**

Figure 2. MCA of defaulting borrowers.



Source: elaborated by authors

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Table1. Correlation table of MCA

	Variables																	
Variables	Q.21 why did you take the risk of the financing	you benefit from the financing	you called or went to inform the bank about your situation	Q28 why you did not neither call nor go to the bank	Q34 why you did not seek solution before the bank called you	Q14. the perspective of the defaulted borrower about ASBA	Q35.R1 health problem	Q35.R2 unexpected situations (family ...)	Q35.R3 loss of job , financial problem	Q36.R2 you did not have time	Q36.R1 the distant agencies	Q35.R7 you pay another mortgage	Q35.R6 you did not receive your salary at the scheduled date	Q35.R5 the bank did not withdraw the monthly mortgage from your bank account	Q35.R4 the bank did not withdraw the monthly mortgage from your postal account	Dimension	Valeur propre	
monthly salary or income	1,0	,50	-,47	,08	,45	-,09	,09	,14	-,09	,03	,03	-,40	-,12	-,08	,44	-,20	-,41	,33
salary domiciliation agreement	,50	1,0	-,10	-,61	-,11	,60	-,60	-,56	-,63	,00	-,17	-,46	-,15	-,10	-,11	-,04	-,03	,80
Q.21 why did you take the risk of the financing	-,47	-,10	1,0	-,58	-,26	,54	-,57	-,59	-,45	-,09	-,20	-,15	-,04	-,03	-,25	-,08	,91	-,21
you benefit from another financing , from an other bank	,08	-,61	-,58	1,0	,45	-,93	,99	,97	,82	,15	,35	,26	,08	,05	,43	,13	-,64	-,60
you called or went to inform the bank about your situation	,45	-,11	-,26	,45	1,0	-,44	,50	,53	,11	-,12	-,25	-,21	-,06	-,04	,95	-,11	-,28	-,26
Q28 why you did not neither call nor go to the bank	-,09	,60	,54	-,93	-,44	1,0	-,94	-,93	-,77	-,15	-,34	-,25	-,07	-,05	-,42	-,07	,54	,65
Q34 why you did not seek solution before the bank called you	,09	-,60	-,57	,99	,50	-,94	1,0	,97	,78	,14	,33	,24	,07	,05	,49	,12	-,63	-,62
Q14. the perspective of the defaulted borrower about ASBA	,14	-,56	-,59	,97	,53	-,93	,97	1,0	,76	,13	,29	,22	,06	,04	,51	,11	-,62	-,59
Q35.R1 health problem	-,09	-,63	-,45	,82	,11	-,77	,78	,76	1,0	,22	,40	,32	,11	,08	,11	,12	-,46	-,55
Q35.R2 unexpected situations (family ...)	,03	,00	-,09	,15	-,12	-,15	,14	,13	,22	1,0	-,10	-,07	-,02	-,01	-,12	-,04	-,10	-,10
Q35.R3 loss of job , financial problem	,03	-,17	-,20	,35	-,25	-,34	,33	,29	,40	-,10	1,0	-,16	-,05	-,03	-,27	-,08	-,22	-,23
Q36.R2 you did not have time	-,40	-,46	-,15	,26	-,21	-,25	,24	,22	,32	-,07	-,16	1,0	-,04	-,02	-,20	-,06	-,17	-,17
Q36.R1 the distant agencies	-,12	-,15	-,04	,08	-,06	-,07	,07	,06	,11	-,02	-,05	-,04	1,0	-,01	-,06	-,02	-,05	-,05
Q35.R7 you pay another mortgage	-,08	-,10	-,03	,05	-,04	-,05	,05	,04	,08	-,01	-,03	-,02	-,01	1,0	-,04	-,01	-,03	-,04
Q35.R6 you did not receive your salary at the scheduled date	,44	-,11	-,25	,43	,95	-,42	,49	,51	,11	-,12	-,27	-,20	-,06	-,04	1,0	-,10	-,28	-,29
Q35.R5 the bank did not withdraw the monthly mortgage from your bank account	-,20	-,04	-,08	,13	-,11	-,07	,12	,11	,12	-,04	-,08	-,06	-,02	-,01	-,10	1,0	-,08	-,09
Q35.R4 the bank did not withdraw the monthly mortgage from your postal account	-,41	-,03	,91	-,64	-,28	,54	-,63	-,62	-,46	-,10	-,22	-,17	-,05	-,03	-,28	-,08	1,0	-,17
Dimension	,33	,80	-,21	-,60	-,26	,65	-,62	-,59	-,55	-,10	-,23	-,17	-,05	-,04	-,29	-,09	-,17	1,0
Valeur propre	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
	6,7	2,9	2,0	1,3	1,1	1,1	1,0	1,0	,29	,22	,12	,09	,06	,05	,04	,02	,01	,01

Source: elaborated by the authors

We aim through the Multiple Correspondence Analysis (MCA) to find which variables are associated together, the significance of these associations, and we seek to understand the information within each category. Table 1 provides the correlation values of the variables associated together. Each category represents one group of defaulting borrowers who defaulted in payment because of the same reasons and/or have the same characters (attitude towards credit and the loan repayment ...etc).

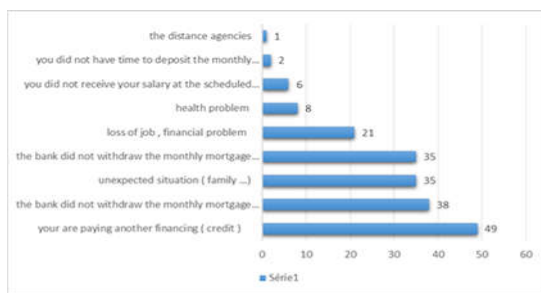
4.2 Quantitative findings:

Quantitative results are presented as follows:

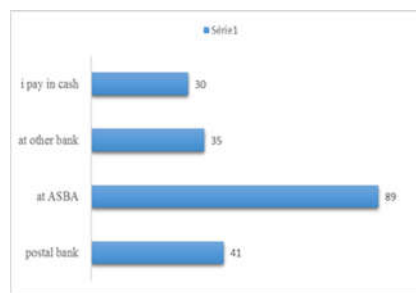
4.2.1 Category A

-From figure 2, we note that two modalities of two variables are associated inside this category, which are **Q35R4** and the **Postal account**.

Figure 3. Reasons behind the default on payment **Figure 4.** Salary domiciliation



Source: elaborated by the authors.



Source: elaborated by The authors

Table 2 .Reason Q35.R4 of the default on payment

		Frequency	Percentage	valid percentage	Cumulative Percentage
Valid	Yes	38	19,5	19,5	19,5
	No	157	80,5	80,5	100,0
Total		195	100,0	100,0	

Source: elaborated by the author

-From table1, we notice that there is a positive correlation between these two variables = 0, 8.

-The salary domiciliation (see figure 4), shows that 41 defaulted borrowers are domiciled in a postal bank (PCA).

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-From figure 3, we note that 38 defaulted borrowers said that they defaulted on payment because the bank did not withdraw the monthly mortgage from their PCAs. Therefore, we recognize that this category includes the borrowers who are domiciled in a postal bank and a large number of them defaulted on payment because ASBA did not withdraw the mortgages from their postal accounts (technical error).

4.2.2 Category B

-From the MCA analysis figure 2, we notice that the modality **Q35R5** is associated with the variables: **AGREEMENT**, **Q21R4**, **Q28 you called or went to the bank to inform them about your situation** and **Q34R5**, inside the category B.

Table 3. the financing through an agreement				
		agreement		Total
		Yes	no	
Q35.R5	Yes	31	4	35
	No	0	160	160
Total		31	164	195

Source: elaborated by the authors

-From table 1, we note that the correlation between **Q35R5 & agreement** is 0.91. We also notice from the table 3, that among 35 respondents who defaulted because the bank did not withdraw the monthly mortgage from their bank accounts, there are 31 of them got the financing through an agreement between ASBA and their enterprises. So all the borrowers who got the financing through an agreement defaulted because of technical error.

Table 4. Reasons of why the borrowers defaulted on mortgage payment **Source:**
elaborated by the authors.

		Q35.R5		Total
		Yes	No	
Q.21	Q21-R2	0	75	75
	Q21-R3	0	50	50
	Q21-R4	35	35	70
Total		35	160	195

-From table 1, we note that the correlation between **Q35R5** & **Q21** is - 0, 64 and from table 4 we notice that all the 35 borrowers, who belong to this category defaulted because the bank did not withdraw the mortgage from their bank accounts. They also took the risk of the financing because they thought that they could repay regularly **Q21R4**, and none of them took the risk because they knew that ASBA does not impose penalties of late-payment **Q21R2** , or the products offered were attractive **Q21R3**.

Table 5. Reaction(1) of borrowers after defaulting on mortgage payment				
		Q35.R5		Total
		Yes	No	
you called or went to inform the bank about your situation	Yes	31	37	68
	No	4	123	127
Total		35	160	195

Source: elaborated by the authors.

-From table 1, we notice that the correlation between **Q35R5** & **you called or went to the bank to inform them** about your situation is 0, 54.

- From table 5, we note that among the 35 respondents who defaulted in payment because of the bank account problem, there are 31 of them called or went to the bank.

Table 6. Reaction (2) of the borrowers after defaulting in mortgage payment

		Q35.R5		Total
		Yes	No	
Q28 why you did not	Q28.R1	4	51	55
neither call nor go to	Q28.R2	0	73	73
the bank	Q28.R3	31	36	67
Total		35	160	195

Source: elaborated by the authors

-From table1,we notice that the correlation between **Q35R5** & **Q28** is -0,63.

-From table 6, we note that among the 35 respondents who defaulted in payment because of the bank account problem, there are 31 of them called or went to the bank **Q28R3**.

Table 7. Reasons (1) why you did not seek solution for the default in payment

		Q35.R5		Total
		Yes	No	
Q34	Q34.R1	0	2	2
	Q34.R2	0	4	4
	Q34.R3	0	47	47
	Q34.R4	1	73	74
	Q34.R5	34	34	68
Total		35	160	195

Source: elaborated by authors

-From table 1, we note that the correlation between **Q35R5** & **Q34** is- 0, 62.
 -We note from table 7, that from 35 borrowers who defaulted on payment because the bank did not withdraw the mortgage from their accounts ,there are 34 of them did not seek a solution before that the bank called them because they think that it is the bank’s error **Q34R5**. We recognize that this category includes the borrowers who are domiciled in “other bank” and a large number of them defaulted on payment because the bank did not withdraw the mortgage from their accounts (technical error).

4.2.3 Category C

-We notice from figure 2, that **Q35R7** and “**you benefit from another financing from other bank**” variables are associated within this category.

Table N °8. Reaction (3) of borrowers after defaulting in mortgage payment

Source: elaborated by the authors

-From the table 1, we note that the correlation between **Q35R7** & **you benefit from another financing from another bank** variables is 0, 95, and from the table 8, we notice that from 51 borrowers who benefit from other financing or credit, there are 48 of them could not repay the financing for ASBA because they are paying other financing.

4.2.4 Category D

-From the figure 2, we notice that **Q28R2**, **Q21R2**, **Q34R4**, “**you called or went to inform the bank about your situation** ”are associated within the category D.

Table 9. Reasons(2) why you did not seek solution for the default in payment					
		Q.21			Total
		Q21R2	Q21R3	Q21R4	
Q34	Q34.R1	1	1	0	2
	Q34.R2	0	4	0	4
	Q34.R3	2	45	0	47
	Q34.R4	72	0	2	74
	Q34.R5	0	0	68	68
Total		75	50	70	195

Source: elaborated by the authors

-From the table1, we note that the correlation between the variables **Q34 & Q21** is 0, 97. From the table 9, we note that 72 borrowers within this Category took the risk of the financing because they thought that Islamic banks do not impose penalties for late payment **Q21R2**, and they did not seek solution before that the bank called them because they were sure that ASBA does not put the defaulting borrowers under pressure **Q34R4**.

Table 10. Reasons (3) why you did not seek solution for the default in payment

		Q14.				Total
		Q14R1	Q14R2	Q14R3	Q14R4	
Q34	Q34R1	1	1	0	0	2
	Q34R2	3	0	1	0	4
	Q34R3	39	4	3	1	47
	Q34R4	12	59	2	1	74
	Q34R5	6	0	62	0	68
Total		61	64	68	2	195

Source: elaborated by the authors

-From the table 1, we note that the correlation between the variables **Q34&Q14** is 0,76.

-From the table 10, we also notice that 59 borrowers who belong to this category did not seek solution before that the bank called them because they were sure that the bank does not put the defaulting borrowers under pressure **Q34R4**, and they think that ASBA gives the defaulting borrowers, chance before imposing legal action **Q14R2**.

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Table 11. Reasons (4) why you did not seek solution for the default in payment					
		Q28			Total
		Q28.R1	Q28.R2	Q28.R3	
Q34	Q34.R1	1	1	0	2
	Q34.R2	4	0	0	4
	Q34.R3	45	2	0	47
	Q34.R4	1	70	3	74
	Q34.R5	0	0	68	68
Total		51	73	71	195

Source: elaborated by the authors

-From table1, we note that the correlation between the variables **Q34 &Q28** is 0, 97.

-From table 11, we also note that 70 borrowers did not seek solution before that the bank called them, because they were sure that the bank does not put the defaulting borrowers under pressure **Q34R4**. In addition, they did neither call nor go to the bank because they were also sure that the bank does not put the defaulting borrowers under pressure, and it gives them more time to repay their engagements **Q28R2**.

Table 12. Reactions(4) of borrowers after defaulting in payment

		you called or went to inform the bank about your situation		Total
		Yes	No	
Q34	Q34R1	0	2	2
	Q34R2	0	4	4
	Q34R3	0	47	47
	Q34R4	3	71	74
	Q34R5	65	3	68
Total		68	127	195

Source: elaborated by the authors

-From the table 1, we note that the correlation between the variables **Q34 &you called or went to inform the bank about your situation** is - 0, 93.

-From the table 12, we also note that 71 defaulting borrowers who belong to this category did not seek solution before that the bank called them, because they were sure that the bank does not put the defaulting borrowers under

pressure **Q34.R4**, and they did not call or go to inform the bank about their situations. Therefore, we recognize from the previous results that the defaulting borrowers, who belong to category D, were sure that the bank does not put pressure on the defaulted debtors. Moreover, approximately all of them did neither call nor go to the bank because they were sure that the bank does not put pressure on the defaulted debtors and it gives them much more time to repay their engagements. Besides, approximately all of them took the risk of the financing because they thought that the IBs do not impose penalties.

Therefore, we recognize that the defaulted borrowers who belong to this category intended to delay in payment and they intended to abuse the particularity of IBs.

5. Conclusion:

The improvement of the Islamic banking system requires the development of efficient management that covers all areas of IBs, including credit risk, which is the major risk in banks.

By highlighting the key factors of the credit risk from the perspective of the staff members of ASBA and the defaulting borrowers, the study provides a wider understanding of the motives of the increase of the overdue amount in ASBA. Which can be summarized as follows: The staff members of ASBA influences the amount of overdue by making technical errors because of stress, work overload and leniency. There is also a lack of qualified human resources to select the appropriate borrowers and handle the different areas of IBs ,and particularly the credit risk .Furthermore, the inefficient recovery policy and the uniqueness of the IBs which arises from the sharia principles, which prohibit the imposition of late-payment penalties , and which was abused by number of borrowers.

From the MCA, we found four categories of defaulting debtors; each one of them involves the associated motives, which explain the reasons behind the mortgage delinquency of the group who belongs to this category as follows:

•**Category A:** it represents the defaulting borrowers, who are domiciled in postal bank and they defaulted in mortgage payment because of technical error;

- Category B:** it represents the defaulting borrowers who got the financing through an agreement between their enterprises and ASBA and they defaulted in mortgage payment because of technical errors;
- Category C:** this category represents the irrational defaulting borrowers who are paying many credits in the same time;
- Category D:** it represents the defaulting borrowers who act in bad faith;

This study was carried out at Al Salam Bank Algeria during 2019; however, the world and particularly Algeria have seen many changes, including the emergence of COVID-19 and the evolution of the legal environment of the Islamic finance in Algeria. Hence, for the future studies, we suggest the investigation of the impact of these changes on the credit risk in Islamic banks.

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7. Appendices:

A part of the questionnaire for defaulting borrowers

▪ **Q8 .What are the criteria that have stimulated you to choose Al Salam Bank Algeria?**

R1.The bank functions in accordance with sharia principles.

R2.The bank offers products adapted to my needs.

R3.The reputation of the bank.

R4.The quality of the service (rapidity).

R5.Proximity and reachability of the bank's agencies.

R6.I know someone who works in the bank.

R7.Transparency of the publication of the fees / margin.

R8.I have an account in ASBA.

Other ...

▪ **Salary domiciliation**

R1.Postal account.

R2.Current account in Al Salam Bank Algeria.

R3.Current account in other bank.

R4.I pay in cash.

▪ **Q14.In your opinion, how does Al Salam Bank treat the defaulting debtors?**

R1.It does not tolerate them at all and it applies against them the legal sanctions immediately.

R2.It gives them a chance before imposing legal sanction.

R3.It prefers the amicable arrangement.

R4.It is lenient with them.

Other...

▪ **Before asking for the financing have, you thought that might not be able to repay your engagement?**

Yes /no

▪ **Q21 If, yes why you took the risk?**

R2.I thought that Islamic bank does not impose penalties for late payment.

R3.The bank's offers are attractive.

R4.I thought that I could pay regularly.

Other...

- **Have you ever defaulted in payments?**

Yes /no

- **Q24.Do you benefit from other credits or financing?**

Yes/NO

- **Have you tried to contact the bank to inform them about your situation?**

Yes /no

- **Q28.Why you did not think to contact or to go to the bank?**

R1.I did not have any convincing explanation for this delay and my reputation is important for me.

R2.I was sure that the bank does not put pressure under the defaulting borrowers.

R3.I did not call the bank because there was technical problem at the bank.

Other...

- **Q34.Why you did not call the bank before that it called you?**

R1. The amount of money due is not important.

R2.None could lend me the owed money.

R3.I did not find any solution but my reputation is important for me.

R4.I was sure that the bank does not put pressure under the defaulting borrowers and it gives them time to repay their mortgages.

R5.The bank has technical problem.

Other...

- **Q35.What are the factors of this delay?**

R1.Health problem.

R2.Unexpected family situation.

R3.Financial problem (I lost my job).

R4.The bank did not withdraw money from my postal account.

R5.The bank did not withdraw money from my bank account.

R6.I did not receive my salary on the scheduled day.

R7.If you pay in cash why you defaulted in payment.

R8.I live far from the agencies of Al Salam Bank.

R9.I did not have time.

Other...