An-Najah National University

Faculty of Graduate Studies

UNSYSTEMATIC RISK IMPACT ON BANKING STABILITY: ISLAMIC VS. CONVENTIONAL BANKS IN PALESTINE AND JORDAN

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Declaration

I, the undersigned, declare that I submitted the thesis entitled:

UNSYSTEMATIC RISK IMPACT ON BANKING STABILITY: ISLAMIC VS. CONVENTIONAL BANKS IN PALESTINE AND JORDAN

I declare that the work provided in this thesis, unless otherwise referenced, is the researcher's own work, and has not been submitted elsewhere for any other degree or qualification.

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Date 16/3/2023

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Abstract

The main objective of this study is to verify the relationship between credit risk and liquidity risk on the stability of banks for a data set of 35 Conventional Banks (CB) and Islamic Banks (IB) belonging to Palestine and Jordan - with the following distribution (11) conventional banks and (3) Islamic banks in Palestine, and (17) conventional banks and (4) Islamic banks in Jordan was observed during 2008-2019،By performing a panel smooth threshold regression model, where this model was used because it takes into account the linear and non-linear relationships. The Z-score (ROA) was used as a dependent variable, non-performing loans from loans, and the ratio of liquid assets from assets, a proxy for credit risk, and liquidity risks, respectively, refer to transition variables, in addition to a set of control variables associated with the characteristics of bank and the macroeconomics. The results show that the relationship between the bank's stability and credit risk, and the bank's stability and liquidity risk is non-linear, and is characterized by the presence of two optimal thresholds equal to 11.41% for credit risk and 20.15% for liquidity risk. The results showed that credit risks do not affect the stability of banks, while liquidity risks negatively affect stability. With regard to the control variables that are bank-specific, the results show that both size and capital adequacy have a significant positive effect on stability, and after the threshold, it becomes negative in both equations. In terms of macroeconomic variables, it was found that political stability has a strong effect on the stability of banks. It was also found that the type of bank affects stability, as conventional banks are more stable than Islamic banks in Palestine and Jordan. Therefore, to ensure the stability of banks, the study recommends that banks choose the appropriate restructuring to ease their small size and enhance capital.

Keywords: credit risk**,** liquidity risk, stability, PSTR model, Islamic bank, conventional bank.

Chapter One

Introduction

1.1 Preface

Countries seek to achieve economic stability, but in light of globalization, and the increased international competition, it is difficult to define and even harder to measure but crisis situations seem to have a larger effect on the economic stability of many countries. Such a challenge requires attention to face both expected and unexpected events that could face the banking sector (Rupeika-Apoga et al., 2018; Kasri & Azzahra, 2020).A strong financial sector is a key ingredient for economic stability and should be able to withstand the various shocks Banking and financial institutions are essential intermediaries within the financial sector. Hence, the need to ensure their stability. (Odeduntan et al., 2016; Zaghdoudi, 2019).The financial sector is exposed to multiple risks like other sectors, therefore, in order to maintain its safety and stability, these risks must be known and understood and work to be well managed to reduce their impact, as risks can be divided into two types, the systemic risks that affect the economy completely but in varying proportions, such as interest rate risk, exchange rate risk, and non-systemic risks specific to a particular company, such as operational risk, liquidity risk and credit risk (Ghenimi et al., 2017). The transfer of short-term liabilities into long-term assets is the main activity carried out by banks, therefore, liquidity risk (unexpected withdrawal of funds by depositors) and credit risk (failure of borrowers to pay the loan amount and interest on time) are considered the most important risks Which banks are exposed to and need constant monitoring to maintain the stability of the banks (Smaoui et.al., 2020).

If we go back a little in time, we see the world has witnessed many crises that affected the economy, but many considered the global financial crisis of 2007-2008 was one of the most dangerous crises the world had witnessed since the Great Depression. the crisis began when real estate prices fell sharply in the first half of 2007, which made the international financial markets, especially the United States suffered from defaults in the payment of financial obligations and dues from borrowers especially loans granted borrowers with low credit ratings (are called subprime mortgages loans) and difficulty in collecting these loans. This led to the spread of uncertainty and panic in the financial

markets, it helped increased requests for withdrawals by depositors because of the fear of a liquidity crisis (Crotty, 2009). The financial crisis has greatly affected the global economy, as its impact continues to this day. In order to avoid the recurrence of these crises, researchers and analysts working on knowing the financial causes of the crisis through studying and analysing financial institutions and the practices of the financial system, doubts were cast on the quality of risk management practices. so Banking put stricter regulations on liquidity according to Basel III (Vazquez & Federico, 2015). The financial crisis made the world more awake and focused on the importance of the stability and safety of the financial sector in light of the risks, because the impact of the crisis was not limited only to the financial sector, but also extended to other sectors. In light of the negative aspects that the world witnessed from the financial crisis but emerged the role of the Islamic financial sector Because was not affected like the conventional sector by its nature in avoiding risky financial products (Parashar, 2010). In recent years, several studies have examined the factors that ensure the stability of banks or those that destabilize them. In particular, credit risk and liquidity risk are retained by the majority of authors who considered them major risks, the empirical results show that the results are different, as these results can be divided into three types: the first supports the positive impact on stability for both liquidity and credit risks (Zaghdoudi 2019; Rupeika-Apoga et al. 2020), and the second type supports the negative impact of both risks on stability (Hassan, et al., 2019; Korbi & Bougatef (2017). The third proves the insignificant impact of these two risks on stability (Amara & Mabrouki, 2019), so the controversy about the relationship between liquidity risk, credit risk and stability is still not conclusive.

1.2 Study importance

Palestine and Jordan are considered interesting cases to study because they are considered small countries with limited resources that depend heavily on external support and resources and the lack of investment opportunities available due to the political situation, and the inability to use new financial methods due to the weak infrastructure of the financial markets (A Kasasbeh & Alzoub, 2019; Zaghdoudi, 2019). In addition to the link between the Palestinian and Jordanian sectors, where there are 14 banks operating in Palestine, there are 7 of them Jordanian, so there is a major role for them in financing the Palestinian economy and the banking sector dominates the role of

financial intermediation. According to the statistics of the performance of the Palestinian and Jordanian banking sector for the year 2018, we find that loans constitute the largest part of the direct credit facilities they provide, as they constitute 82% for the Palestinian banking sector and 65% for the Jordanian sector, and the ratio of direct facilities to total deposits is 62% and 77% Respectively, These ratios confirm that the primary activity of banks in both the Palestinian and Jordanian banking sectors is the process of converting deposits into loans, and thus they are assumed to be highly exposed to liquidity and credit risks. In addition, the commercial banking sector dominated the banking system, where share of Islamic banks constituted 15% for Palestinian sector and 16.4% for the Jordanian sector, the presence of Islamic banks could threaten stability of conventional banks. Furthermore, Palestinian economy is linked to the Israel economy, according to the Paris Economic Agreement. Palestinian banks remain at the mercy of Israel policies regarding the acceptance of surplus cash in the shekel currency, which may affect the stability of Palestinian banks and increase liquidity risks, and the use of the US$, NIS and JD currencies legally valid for use in Palestine This exacerbates the difficulties facing banks operating in Palestine (Abdelkarim & Burbar, 2007), the safely of the banking sector is an indicator of the health of the economy so there need to study the effect of these risks on stability.

1.3 Study problem

Banking risks and impact on the banking sector had the attention of extensive researchers all over the world. Several researchers have investigated the relationship of stability with credit risk and liquidity, each of Amara & Mabrouki, (2019); Ghenimi et al., (2017) worked on studying the effect of liquidity risk and credit risk on the stability of the banking, while Zaghdoudi, (2019) added the effect of operational risks on stability, and each of Albaity et al., (2019); Smaoui et al., (2020) compared the stability of Islamic banks with Conventional banks. Albaity et al., (2019) as studied the effect of competition also. All these studies used a variable (z-score) as a measure of stability, while Hassan et al., (2019) worked on studying the relation between risks and stability by applying (Distance to Default and z-score) as a measure of stability, and all studies assumed the linear relationship between risks and stability, while Djebal i& Zaghdoudi, (2020) proved the nonlinear correlation among risks and stability, where he worked to determine the optimal limit for the use of risks and measure their effect on the bank's

stability using only a sample of commercial banks, to our knowledge there is no literature that has studied the relationship between risks and the stability of the banking sector in Palestine from a nonlinear perspective, therefore, this study is performed using the panel smooth threshold regression that was followed by Djebali & Zaghdoudi, (2020) but we added banking model type for comparison as an important part of the Palestinian and Jordanian banking system. Through this thesis, you will help understand the impact of unsystematic risks represented by liquidity and credit risks on the stability of the financial system; With regard to the type of business model for both Islamic and conventional banks, it stems from the difference in the features and framework of the business model of these banking types, as the framework of Islamic banks is based on compliance with the provisions of Islamic Sharia; Which differs from the Conventional interest-based banks, and therefore it is necessary to explore the presence of differences in the response of banking stability to the differences in banking business models represented by Islamic and conventional banks operating side by side in Palestine and Jordan.

The study problem can be formulated with the following question:

- Do unsystematic risks affect the stability of both Islamic and conventional banks?
- Does the banking business model type affect banking stability?

1.4 Study objective

As mentioned previously, banking stability is an indication of the health and strength of the financial sector. Because of the basic activity of banks in financial intermediation, it is necessary to focus on credit risks and liquidity risks to represent unsystematic risks. Therefore, the main objective of this thesis is to:

- Determine if unsystematic risks affect the stability of both Islamic and conventional banks.
- Determine if the banking business model type affect banking stability.

In addition to our specific objectives, through this research we will also be able to achieve general objectives, as we can: a) identify the expected effect of the stability of the banking sector on the development of the economy, b) identify the similarities and differences between the Islamic system and conventional banking system business

models, c) identify the unsystematic risks that the banking sector is exposed to, d) explore the Palestinian and Jordanian banking sector and knowing the risks they face, e) study the impact of macroeconomic factors on the stability of the banking system, f) study the impact of bank-specific factors on the stability of the banking system.

Chapter Tow

Theoretical framework & Literature review

2.1 Introduction

Financial and monetary stability is important for the active performance of the economy. It establishes the groundwork for making rational decisions about the provision of actual resources over time, thereby improving the environment for saving and investing. Thus, preserving stabilization is a major goal of the financial authorities (Crockett, 1996).According to studies that dealt with financial stabilization and issues related to it, the interest in specialized questions on how to maintain financial stabilization has become clear, especially in recent decades. The reason for the growing concern about financial stabilization issues is the cause of the financial crises that have occurred. Academically, there are two well-known schools in the financial literature that dealt with the concept of financial stabilization. The representatives of the first school prefer to tackle the concept of financial instability. The representatives of the second school study the concept of financial stabilization. The first school finds that financial instability is related to savings and investment. It represents the deviations in saving plan due to the inefficiency in the performance of the financial management to employ the financial system or because of the instability of the system in the face of potential shocks. In terms of the second school, the concept of financial stabilization represents the ability of the financial system to achieve stabilization by avoiding imbalances in the structure so that it can resist shocks without having cumulative effects that would transform the provision of savings to investment opportunities, and payment and settlement processes in the economy (Tawfeq, 2015; Anatolyevna & Ramilevna, 2013)

A stable financial system indicates that it is able to allocate resources efficiently, manage and assess financial risks, maintain employment levels close to the normal rate of the economy, in addition to eliminating the relative price movements of real or financial assets that will affect monetary stability or employment levels. The financial structure is considered in a state of stabilization when it absorbs shocks through self-correcting mechanisms, which prevents them from causing a destructive effect on the actual economy or on other financial structures. As a result, the financial structure is said to be stable when it manages financial inequities that arise internally or because of

unexpected negative events. As a result, financial stabilization is important for economic development because the financial structure helps the mainstream of transactions in the actual economy. (Bank, 2015). Financial stabilization refers to the efficient operation of the financial structure's markets and institutions (as stability in one achieves stability in the other) (Crockett, 1996).

Banks refrain from financing profitable projects during periods of insecurity. Payments may not arrive on time if asset prices deviate significantly from their intrinsic value. The true real value is better manifested here. Great instability causes a rush of banks, excessive inflation, or the collapse of the stock market, all of which can destabilize confidence in the entire financial structure and economy (Bank, 2015).

Financial stabilization is related to the financial structure in banks, and its components and activities are associated with it. Therefore, this structure is subject to many risks. Risks can occur inside or outside the banking financial structure. Banks have distinctive contractual problems that arise from their primary function as a financial intermediary. The bank’s management can influence, in some cases, the volume of internal risks and the possibility of their occurrence through processes of regulation, control and crisis management. On the contrary, it is difficult to control the external risks that affect financial stabilization (Schinasi, 2005, 5-6).

Conventional banks can offer additional agency services to depositors, making it possible to make illiquid loans that were previously only possible within a short amount of time at a low price due to the unlikeliness of a simultaneous liquidation of the law of large numbers. As long as borrowers and lenders trust the bank's ability to fulfill its contractual duties, it can be considered a conventional bank, contributing to value-added in the shape of improved information (summary information asymmetry) and more liquidity. As a result, the market's balance improves.

(Running) in a bank is a result of confidence being lost in the bank, which is a well-known phenomenon. The weakness of banks is due to an interaction among liquid liabilities that can be paid immediately and illiquid assets that may only be realized in little time by accepting discounts on book value (Diamond & Dybvig, 1983).

A bank's realization that it has an expanding portfolio of bad loans is typically cause for concern, but why do banks continue to make credit judgments that turn bad? Certainly, decaying recollections of previous bad experiences play a role (Kindleberger,1978). Furthermore, new research has shown that other phenomena, such as disaster myopia, herd behaviour, perverse incentives, the principal-agent problem, and negative externalities, have a systematic effect. These behaviours have an aspect of simple irrationality while being basically more difficult. The disaster of economic myopia (subjective expectations) about reality (objective possibilities) (Guttenta & Herring, 1984) in addition, disaster myopia can result from a lack of foresight since disasters happen so rarely it is difficult to allocate a probability to their occurrence in the future, or a modification in policy can boost economic circumstances beyond the limits considered when making lending decisions. In addition to herd behaviour, it sometimes refers to a dissimilar way of lending procedures that often leads to problems. It may be a demonstration of irrationality; however, it also reflects normal maximization in situations of uncertainty (Davis, 1995). Negative externalities stand when some costs of firms accumulate decisions on strangers. It may happen in any industry, especially in the banking department due to the nearly small reserve of funds related to the total size of the balance sheet (Dewatripont & Tirole, 1994).

Behavioural tools that lead to variability in financial organisations may refer to effects of competition and market dominance, or by their vulnerability to a contagion of failure across organisations. Contagion is said to occur in the financial industry for two chief reasons. First, via the interbank market, OTC derivatives transactions, and the payments and settlement system, there is a net of claims and overlapping liabilities (Schoenmaker, 1996). Second, due to the inconsistency of publicly available information, creditors find it difficult to assess the financial institution's strength. As a result, the spread of bank failures is likely to be faster and more widespread, resulting in a greater number of failures and greater losses for creditors, harming the economy as a whole. Furthermore, a large portion of real estate is funded through borrowing and accepting real estate as a guarantee for a variety of financial activities. Therefore, any change in real estate prices will affect the financial structure.

Banks constantly seek to reduce risks in order to protect bank clients from loss (the consumer protection aspect), decrease the risk of contagion (the systemic risk aspect),

evade losses for the deposit insurance fund or last-resort (the financial aspect), and develop resource provision in the financial aspect (the efficiency argument) (Quinn, 1996).

There are two approaches to banking regulation: one focuses on adjusting the activities of controlled organisations, while the other confirms that they have enough capital to cover the risks to which they are exposed. Under the Basel Capital Agreement, banks were requested to maintain a minimum level of capital concerning the credit risk of their portfolios. Supervisory authorities identified qualified capital, the risks of various asset classes, and the suitable ratio between the two. One of the main mechanisms that were usually used to reassure depositors is the lending mechanism of last-resort. As the capital increase has clear benefits, namely increasing the reserves against losses and thus the stabilization of the structure as a whole, informing the bank's management of the need to appropriately pricing risks and finally reducing moral risks by increasing the share of private banks in the achievement of their risk management strategy (Crockett, 1996; Hickson & Turner, 1999).

The difficulty of analysing stabilization indicates that many crises are shown in a way that seems distinctive and continuously requires diverse policies to the treatment. The regular feature of most crises are always increased defaults and low profitability in the banking department, as studies have shown that the volume of non-performing loans increases sharply before and during the crisis. The performance of banks is important to the study of financial instability, due to their importance in transferring monetary policy and financial stabilization. They affect liquidity and credit expansion. Therefore, the money supply in the economy depends on the portfolio of the banking department (Tsomocos, 2003).

There is substantial indication that banking problems are connected with a much deeper economic and financial fall. Banks play an important role in credit intermediation, directly and indirectly, as lenders, market makers, and providers of supportive liquidity and payment services. It is high financial as its liabilities consist almost entirely of debt with a very low proportion of equity. In many cases, the bank's limited liability and the bankers' short-term compensation structure create an incentive for them to maximize the bank's influence. Consequently, banks are particularly vulnerable to the possibility of bankruptcy because their liabilities consist largely of debt.

2.1.1 Capital and stability

No property rights and insolvent: this is why banking capital regulation has attracted significant interest and controversy following the 2007-2008 global financial crisis because numerous banking institutions - especially the largest banking groups - were undercapitalized and highly leveraged. Understanding the role of bank capital, it is necessary to focus on the bank's balance sheet. First, the balance sheet describes the bank's assets, for example loans, investments, cash, buildings, and equipment. Second, the balance sheet lists its liabilities, which mainly include debt and equity. Debt liabilities include deposits and other borrowings. Share capital includes equity of paid-in capital, i.e. the amount paid for a bank's share on issue, which provides rights to all remaining assets including the bank's ownership. Capital also consists of retained earnings, which is the bank's income at the end of the fiscal year, after deducting expenses, earned during that year, less any dividends paid to shareholders. The share capital also consists of preferred shares, which are entitled to specified dividends that may accrue if not paid, but which provide limited equity, the value of which may be permanent or have a fixed term. Preferred stock is a less pure form of capital that closely resembles debt and does not usually absorb the losses of a company as a continuous concern. The capital can also be the surplus profit from the sale of shares in excess of their face or declared value. Reserves, such as stock reserves, can also constitute capital when they are set aside from revenue to pay, e.g. dividends on preferred stock or large debt. (Alexander, 2015).

The capital of the bank has four main purposes: absorbing losses, for example, depreciation of assets due to non-performance, expected losses due to insufficient reserves of loan losses, and ultimately bank failure; to provide financing for the start of early operations of the bank; to decrease losses in deposit insurance programs by offering a way to refund depositors' and creditors' claims against a failing bank, providing motivations for shareholders and directors to have greater caution in supervising the bank's processes. The capital of the bank acts as a storehouse from which any losses are taken, and provides a reserve from which depositors and creditors of the banks can be finally repaid when losses cannot be absorbed in the event of a bank failure. The bank is insolvent if liabilities exceed its assets. Balance is required by

regulators on a bank's balance sheet. The net worth and viability of a bank are primarily determined by the difference between assets and liabilities. (Alexander, 2015).

If a bank is in severe insolvency, its assets may not be enough to fully compensate the deposit insurance company for its payments to insured depositors. However, having a larger stock reserve would give the bank the ability to absorb larger losses before becoming insolvent. The deposit insurance company would be less likely to incur losses as a result of bank liquidation. Essentially, bank capital is important at the micro-prudential level of a bank to protect creditors, including depositors. (Herring, 2002)

Balance sheet management

The scope of a company is determined by its balance sheet. The value of its liabilities is typically determined by the scope of its balance sheet. Essentially, the greater a company's assets, the greater its liabilities to fund those assets. These liabilities are debt rather than equity, which introduces more leverage, makes the company appear riskier, and raises return expectations for both debt and equity investors. This ultimately results in a higher cost of capital (Adam, 2007).

The bank's management is extremely sensitive to investor expectations and thus constantly monitors the size of the bank's balance sheet. As long as the decision to reduce assets is made, the options available are limited. Direct selling is an option, but it is hampered by two factors when the primary assets are loans. First and foremost, illiquid loans may be difficult to sell. Second, loan sales (usually to other banks) are unpopular with the borrower, who usually does not want to change his creditor group (Alexander, 2015).

2.1.2 Basel and stability

There were major failings in risk administration, corporate governance, market transparency, and regulatory quality. Actually, there has been an overemphasis on company-specific risk management and inadequate realization of how system-wide risks can occur under stress.

The Basel Committee's reforms tackle these faults via micro- and macroprudential scales. Obviously, micro and macroprudential improvements are inextricably linked, because more resilience at the individual bank level decreases the risk of system-wide

shocks. (Stefan Walter,2010). Post-crisis market developments have placed a greater emphasis on banks' ability to manage their "economic capital": the equity capital required for banks to mitigate the risk of expected asset losses. "Regulatory capital" addresses the risk of unanticipated losses. Basel I Capital classified assets using a few classes. The economic capital approach employs a model to calculate the riskiness of an asset portfolio and the amount of capital required. Basel II and Basel III seek to link regulatory capital to "risk sensitivity."

The Basel Capital Accord is the primary global financial guideline agreement. The first agreement (Basel I) was signed in 1988 with two chief objectives in mind. First, internationally active banks must maintain a certain level of capital against their risk-based assets. Second, it promotes equal opportunities in banking capital regulation on a global scale.

Basel 1 demanded banks to hold 8% of supervisory capital on the majority of their credit risk assets. The 8% capital requirement is made up primarily of Tier 1 and Tier 2 capitals. Tier 1 capital was critical and valuable to controllers because it primarily involved common stock and equivalent and reserved earnings that may reduce losses for the bank as a continuous concern. Tier 2 capital, on the other hand, is primarily made up of subordinated debt and other debt-like instruments, for example preferred stock and convertible instruments. Tier 2 capital has been less effective at containing losses than Tier 1 capital because these instruments can only absorb losses at the point of bank restructuring or failure as a continuous concern. For regulators, Tier 2 capital was less flexible as it could not enforce losses on the bank as a continuous concern. This is because Basel I required Tier 2 capital to account for no more than 50% — or 4% of risk-based assets — of the regulatory capital requirement of 8%. Tier 1 capital should account for at least 4% of risk-based assets, and at least 4% of 50% — or 2% of risk-based assets — should be Tier 1 capital, which includes Common capital, equity shares, and retained earnings. Tier 1 seed capital was favoured by regulators because it could absorb losses completely for the bank while it was going on.

Though Basel I attained its primary goal of developing the level of supervisory capital in the global banking structure, it included numerous national ratings, loopholes, and motivations for banks to make riskier short-term loans and offload less risky assets from their balance sheets. 20 In 1999, Basel II was offered to tackle many of these gaps. As a

result, Basel II introduced the concept of "three pillars" - I minimum capital, (ii) supervisory review, and (iii) market discipline - designed to complement one another and provide motivations for banks to improve risk assessment and running. Basel II's overall goal was to make regulatory capital more sensitive to the partial prudential risks that banks face, as well as to align regulatory capital with the economic capital that banks already had.

Pillar 1 permits banks to gauge regulatory capital by using statistical models that estimate credit, market, and operational risk based primarily on historical default and loss data. The second pillar establishes controlling evaluation principles that allow regulators to demand banks to adhere to general corporate governance principles and to implement an Internal Capital Adequacy Assessment Process (ICAAP) designed to develop risk assessment and running. Pillar 3 employs market control to compel banks to offer more information to the market, allowing shareholders and creditors to more effectively supervise the bank's management so as to confirm the bank's safety and future plans.

Basel II extended using risk weighting in assessing the risk of banks' assets. Some parameters govern asset risk weighting, such as loan maturity date, default probability, and the bank's loss and exposure in the event of a default). Lower risk weighted assets typically necessitate lower capital fees, whereas higher risk weighted assets necessitate higher capital fees. Short-term corporate loans have lower risk weights (lower capital fees), whereas long-term corporate loans (seven years or more) have higher risk weights (higher capital fees).

The Basel II operation offered banks motivation to advance their risk running by providing condensed regulatory capital if they can show that their risk-based models sufficiently measured the risks that the bank met separately against creditors and depositors. However, the risks that Basel II emphasized were essentially a partial precautionary risk; that is, risks that were mainly external to the bank's balance sheet rather than risks that the bank creates for the financial structure - the so-called internal risk - due to its size, interdependence, and exposure to liquidity risk. As a result, Basel II did not demand banks to hold sufficient capital to handle the social costs incurred by banks, as well as systemic risk.

The main problem in Basel II regarding regulatory capital was that the models of economic capital used by banks had been accepted by regulators as valid reference points for calculating regulatory capital. Basel II economic capital models fail to anticipate macro prudential risk. Basel II essentially exemplifies the failure of financial policymakers and regulators to integrate systemic risk into the design of regulatory capital and risk management.

Recent amendments to the Basel Capital Agreement, otherwise known as Basel III, raise important issues regarding whether banking capital regulation has become sufficiently macro prudential in its focus and objectives. Although Basel III is largely based on the Basel II framework, it attempts to address many of Basel II's flaws that contributed to the crisis. Basel III raises the core regulatory Tier 1 capital requirement from 2% to 4.5 %, plus a 2.5 % capital protection reserve, as well as a stricter definition of Tier 1 capital to comprise only common stock and reserved earnings (excluding instruments of equivalent value) (Alexander, 2015).

It also established the international liquidity standard to add capital regulation. As capital is an essential condition for bank flexibility, it is insufficient. As a result, I requested that banks be able to withstand a system-wide liquidity shock for 30 days, in addition to preserving a more vigorous structural liquidity profile. Undoubtedly, this will increase the cost of financing in usual times and have an impact on business models. Actually, banks should do more to insure themselves against tight liquidity periods, as they must hold capital to deal with unforeseen losses, so liquidity should not be regarded as a free good and should be appropriately priced. (Stefan Walter,2010).

The Committee supported the Pillar II guiding review process in Basel II, which included corporate governance, risk appetite, risk pooling, and stress testing, in addition to improved Pillar 3 transparency requests for more complex capital market activities, resulting in considerably improved risk coverage. Banks should keep enough capital on hand for less liquid and credit-sensitive assets that have much longer holding periods.

Regarding macroprudentiality discussed in Basel III, it tried to address the defects revealed by the financial crisis, through the leverage ratio. It played a role in easing the burden of risk-based requirements. According to a latest study conducted by the Basel Committee's Regressive Capital Adjustment Group, the leverage ratio performed the

best job of distinguishing between banks that eventually required formal sector support and those that did not. Tangible common stock to risk-based assets was the only risk-based ratio that did well. Nonetheless, the leverage ratio serves a macroprudential function. It stops the growth of excessive leverage in due times and thus reduces the dynamism of deleveraging in bad times. Besides, the leverage ratio shields the system from the unpremeditated consequences of the risk weighting system. Many asset classes can appear to be low risk when regarded through the eyes of a single company. However, when you look at the system level, it may pose significant threats to financial stabilization.

Aside from increasing capital levels in due times so that it may be withdrawn in bad times to decrease pro-cyclicality. If the bank's capital plummets below the 2.5% precautionary reserve, the managers will limit distributions and bonuses, tackling the pre-crisis challenge of teamwork, i.e. market pressure to continue paying dividends. Actually, this will guarantee that capital is preserved in the event of a decline and rebuilt in the recovery. They also worked to establish a capital reserve to counteract cyclical fluctuations and protect the system from excessive credit growth, as the most tough problems are preceded by credit bubbles. Actually, when these bubbles burst, the banking industry is the first to suffer. As we cannot continuously be able to avoid such bubbles, we can help banks be more adaptable. In addition, Basel III reforms significantly increase capital and liquidity requirements for the most systemically risky trading, derivatives, and funding activities.

Increasing public ownership of the banking department from 7% to 8% decreases the yearly likelihood of a banking problem by at least 1%. Reducing the likelihood of a problem by one percentage point results in an expected annual production benefit of 0.2%-0.6%. They are known approximations. However, it is clear that a better capitalized banking department has significant economic benefits. As a result, the Basel Committee, in collaboration with the Financial Stability Board, is developing a method for assessing the systemic significance of international financial organizations that includes quantitative and qualitative indicators. It also assesses the extent to which global systemic banks will absorb losses. Lastly, this additional loss-absorption capacity is expected to be met through both common stock and equity (Stefan Walter,2010).

2.1.3 Banking sector stability in Palestine and Jordan

The value of the overall index of financial stability ranges between zero and one. The closer the value is to zero, indicating a weakness in the financial structure, the closer it is to one, and the greater the degree of stability in the financial structure.

In Palestine, the data indicates a failure in the value of the index from 0.52 points in 2018 to 0.41 points in 2019 and another decline in 2020 to 0.30, as the financial stability index relies on evidence from the banking department, the capital market and the insurance sector and macroeconomic indicators, but the indicator shows the significance and role of the banking department indicator in guiding the overall indicator of financial stability. It improved in 2020 to 0.03 compared to 0.26 in 2019 due to improved liquidity. However, it still reflects a good degree of stability of the financial structure in Palestine. (PMA, 2020). As for capital adequacy, a circular was issued to implement capital adequacy requirements in accordance with the decisions of the Basel II Committee, whereby banks were asked to raise the percentage weight of claims against the Palestinian government from 10% to 15% as of the financial statements on 12/31/2019 and to increase To 20% as of the financial statements ending on 12/31/2020, however, the capital adequacy ratio remained at the level of both local and foreign banks higher than the minimum limits stipulated in the recommendations of the Basel Committee (the percentage should not be less than 9%) and according to the Monetary Authority (The percentage should not be less than 12%), and the requirements of the Basel Committee indicated that the indicator of the extent of basic capital coverage of the bank's total assets should not be less than 3%.

In Jordan, the Financial Stability Index improved in 2019 as it reached 0.55, compared to 0.46 in 2017 and 2018. This indicator was developed in 2016 after studying many international experiences in building its own financial stability index. The indicator showed that the degree of stability of the financial structure in Jordan is considered good, taking into account the political and economic changes in the region and their influence on financial stability. (PMA, 2020)

The financial sector in Palestine and Jordan is still characterized by a sound and stable financial sector compared to some countries that developed the index with almost the same methodology used, as Jordan ranked third compared to 20 other countries.

2.1.4 Islamic and conventional banks stability

The financial structure is considered to be unstable in the case of high price fluctuations and excessive dependence on debt. Thus, financial stability is significantly affected in the event of inefficient treatment of both financial risks, financial crises and external factors. The financial system helps to manage the economy because of its financial intermediation services (savings mobilization) and transactional facilities for individuals and companies. Two financial systems in the world, the conventional system and the Islamic system, are dealt with. When considering the returns of both systems, there is no big difference, however, the nature of the financing and the risks differ greatly between them. The conventional financial system was established in accordance with the principles of capitalism, as capital is a factor of production, since the main source of revenues and costs is interest; it is collected through lending and deposit acceptance. Thus, interest (increasing its stabilization on the principal amount without participating in the business process) is the main engine of operations of conventional banks. The purpose of financing is to pool wealth and increase fixed assets (Hanif, 2014). According to the Macroeconomic Approach, it is clear that in the event of an economic boom, conventional financial centres become heavily indebted. As they prefer debt financing over property rights, the economy is therefore highly vulnerable to debt contraction because the investor is encouraged to enter into high-risk activities following speculation. Once these activities are financed in addition to their debt duties, they have higher interest rates. If the return does not win the amount of the debt, this will lead to bankruptcy of speculators. In the conventional system, therefore, it relies on the financing of speculative activities rather than real investments. This provides evidence of the fragility of the conventional financial structure. It also poses the problem to the central bank to act, as it raises interest rates and tightens Monitory policy. It can therefore cause an increase in the debt deflation crisis. While the partial economic approach focused on importance of asymmetric information and illogical behaviour of investors, rumours in circulation may cause panic among depositors, so it will lead to large withdrawals, making the bank in a state of instability, as an example of the weakness of the global crisis (2008) caused by the lack of market instability; it will make bubbles explode (Belouafi, et al., 2015).

In view of these bailouts facing the conventional system because of excessive reliance on debt and financial leverage, there was a need to focus on another financial system that could deal with these problems in a better way. The Islamic financial structure was more efficient than the conventional system during the financial crisis. This system is based on the basis of Islamic sharia, since banks are prohibited from forming money. Money is a mere means of exchange. The Islamic system relies on a set of principles first sharing profits and losses, as it conducts its operations through various financial contracts in order to obtain profits (which is variable based on the nature of the business activity). Portion of the losses must be borne if they occur. In addition, it relies on financing patterns based on equity financing and the principle of avoiding uncertainty. They may not enter into unclear contracts and (speculation) to obtain wealth easily, or by coincidence, (gambling); one person wins, others lose, as the permitted financing is compatible with Islamic Sharia only, meaning they must avoid forbidden activities, in addition to the principle of supporting its investments with real assets. This principle is considered an advantage of the Islamic system. This allows the system to accept more shocks than the conventional system. Based on that way, the Islamic financial system, if applied in the right way, guarantees justice for both parties (the source of money and its user): the stability of the financial sector and prosperity of the economy: Despite this, there are many challenges it faces, such as the additional risks resulting from financing and the lack of skilled human resources in an application the Islamic system accurately, working in an inappropriate environment in light of the spread of conventional services. In addition, Islamic banks cannot claim interest on the mandatory reserve that is held with the central bank and cannot claim the time value of the defaulters' money. It also invests only in Sharia-compliant financial securities, meaning not all stocks are available to them. Despite all of this, they must compete with conventional banks. The growth in the Islamic system constitutes 66% all around the world (Bourkhis & Nabi, 2013; Hijazi & Hanif, 2010).

2.2 Islamic and conventional banking

The global financial crisis not only cast doubts on the tasks of the conventional banking business, but led to an increase in interest in Islamic banking as well. Due to the principles of fixed lending, Islamic financial institutions are becoming more successful even with non-Muslims in the world. Sharia is a combination of Islamic and modern

principles, and its services are available to both Muslims and non-Muslims. Since the start of the global credit crisis, non-Muslim investors have been looking for less risky alternatives.

A financial structure helps in managing the economy by offering certain services. It mobilizes savings from savers to businessmen. It provides public utility services such as money transfer, international trade facilitation, advisory services, safekeeping of valuables, and any other fee-based service. There are no restrictions on Islamic banks providing such services because they do not contradict Sharia, as Islamic banks operate in the same societies as conventional banks and perform all of the functions expected of a financial institution. However, the mechanism for mobilizing money from savers to entrepreneurs differs. Savings mobilization is divided into two stages: accepting deposits and extending financing and investments (Hanif, 2014).

2.2.1 Balance sheet in conventional and Islamic banks

The balance sheet structure shows the nature of banks and their role as a financial intermediary. Deposits are taken from savers in both types of banks in exchange for a reward, regardless of whether the bank operates under a conventional or Islamic system. The distinction is in the reward agreement. It is fixed and predetermined in the conventional system, whereas in the Islamic system, deposits are accepted through participation and speculation, as the reward is variable. The second stage of funding and investment is represented by mobilizing savings to expand credit facilities for business and industry for the sake of return. Both Islamic and conventional institutions provide funding for production channels in exchange for a reward. The funding agreement is what makes the difference. conventional banks provide a loan with a fixed reward, whereas Islamic banks cannot do so because interest cannot be collected. Profits on investments may be charged by Islamic banks, but not interest on loans. Customers receive three types of loans from conventional banks: short-term loans, overdrafts, and long-term loans. Nonetheless, Islamic banks can only make interest-free loans, Qard hassan (Hanif, 2014). The Islamic system is founded on the link between the financial sector and the real sector. Islamic financial institutions cannot provide credit facilities without deducting the support of the real sector. Funding is done through risk and profit sharing, or it should be supported by assets. Also, a distinctive feature of the Islamic

financial structure is speculation that can play a catalytic role in transforming society into wealth by offering capital facilities to skilled people who lack capital.

Table 1

Balance sheet in conventional banks

Assets	Liabilities
Loans and advances to customers	Customers deposits
Cash and balances with other banks	Due to banks and other financial institutions
Investments	Other liabilities
Financial assets held for trading	Sundry creditor
Cash and balances with the central bank	Equity and reserves

We may see much more diversification on the asset side of the conventional balance sheet. This distinction is created by marketable securities, trading accounts, and even corporate and consumer lending. Liabilities are created through deposits without considering the goal of using money on the asset side; this contradiction arises between liabilities and assets because the liquidity generated by short-term liabilities covers long-term assets. It raises the bank's chances of encountering a maturity mismatch.

Table 2

Balance sheet in the Islamic bank

Application of financing	Sources of financing
Cash balances	Demand deposits (amanh)
Funding assets (murabaha, salam, ijara, istisna)	Investment accounts(mudarabah)
Investment assets (mudarbah, musharakah)	Special investment account (mudarabah, musharakah)
Fee-based services (ju'ala , kafala)	Reserves
No banking assets (property)	Equity capital

In Islamic banks, the balance sheet consists of the assets side of qardhassan and investments (musharakah and mudarabah) in addition to financing and trade contracts (murabahah, salam, istisna and ijarah). On the liabilities side, there are deposits in addition to unrestricted investment accounts. xxxx. (2018).

2.2.2 Islamic system

The Islamic system is similar to conventional banking services in that it earns profits on capital by investing a portion of its profits in Sharia-compliant projects. Islamic banks do not conduct business on an interest-based basis. It is governed by Islamic Sharia principles known as Fiqh al-Moamalat (Islamic Guidelines for Transactions). The fundamental principle of Islamic banking is the sharing of profits and losses, as well as the prohibition of usury. The main argument against usury (interest) is that money should be earned by selling goods and services rather than as a commodity with which one can profit.

Islamic banks typically use the following products, according to well-known Islamic finance theories and models: profit and loss sharing (mudaraba), joint venture (musharaka), cost plus (murabaha), custody deposit, lease (ijara), and Islamic insurance (takaful). Interest, gambling, and taking excessive risks are all prohibited. promotes social equality and safeguards the interests of all market participants (Ahmad, 2000; Chapra, 2000). Islamic banking, according to Iqbal & Molyneux (2005), is based on the principles of friendship and mutual assistance. It is known as a system of distributing equity, risk, and profit. Islamic finance broadens the system of investor and fund user participation and collaboration.

Sharia is defined in Arabic as "the right path to take." Sharia is primarily derived from (1) the Qur'an (Muslims' holy book). It is Allah's word, (2) the Sunnah (the principles and practices of Prophet Mohammed, may Allah bless him and grant him peace) or hadith (narrations related to Prophet Mohammed's actions and sayings, may Allah bless him and grant him peace), (3) consensus (agreement among classical Islamic scholars on explicit issues not mentioned in the Qur'an or the Prophet's Sunnah), and (4) hadith (narrations related to Prophet Mohammed's actions and sayings, may Allah bless him and (5) Qiyas (methods of judging matters not mentioned in the Qur'an or Sunnah). While some scholars combined consensus and qiyas into a single category known as ijtihad. It refers to Muslim scholars' reasoning and agreement (Hassan, 1989; Masood, 2011, p. 229). There are four primary schools of legal thought: (1) Shafi, (2) Maliki, (3) Hanafi, and (4) Hanbali. They all recognize the Qur'an and Sunnah as the primary sources of Islamic Sharia. Islamic banks are not financial intermediaries between depositors and borrowers, but rather direct investors. Because Islamic banking

operations are based on the parties sharing profits and losses, the relationship between the investor and the debtor is redefined in Islamic banks as opposed to conventional banks (Grassa, 2012).

According to the following ethical principles, which are founded on the Islamic system, Islamic banks should behave when making investments (Warde 2000; Lewis & Algaoud 2001; Gait & Worthington 2007; Hussein 2010). Islam forbids making projections about a loan's profitability. It favors a proportion of the borrower's business venture profits and losses over a fixed return on the loan amount (which is viewed as unfair behavior). Gambling is prohibited, as are games of pure chance (Hassan and Lewis, 2007), making money off of the agreement's other party (Kamali, 2000, p. 152) and avoiding gharar (uncertainty) in transactions. The imposition of zakat, an Islamic tax with the meaning "purity," is a method of wealth redistribution that may assist every Muslim in maintaining a decent level of living. The annual cash or in-kind savings that Muslims make from all types of assessed wealth are subject to a 2.5% tax that is required under Islamic Sharia. Investment in unlawful pursuits that go against Islamic principles, such as the sale of alcohol, prostitution, gambling, and pork, is forbidden.

Murabaha (cost plus profit margin), mudaraba (profit and loss sharing), musharaka (joint venture or partnership company), salam and istisna (forward contract), ijara (leasing), and qardhassan are the seven Islamic banking tools (Seddiqi 2008).

2.2.2.1 Murabaha

A-Rahman (2010) claims that the majority of short-term financing for Murabaha contracts is done through Islamic system institutions. In Murabaha contracts, the phrases "consumer goods, raw materials, real estate, machinery and equipment, and documentary credits" are actually commonly used. In this kind of financing, the bank buys the asset and then sells it to the client for a predetermined price plus a profit margin that may be established by deferred payment or a flexible repayment schedule. The pricing and payment terms are agreed upon by the two parties, the bank and the consumer, prior to the contract. The customer won't be charged any further fees if he misses the deadline for payment.

Prior to the contract, the two parties, the bank and the customer, agree on the price and payment terms. If the customer fails to pay within the specified time frame, he will not be charged any additional fees.

The fundamental elements of a murabaha contract differ. First, the merchandise must be clearly specified and categorized in accordance with the accepted criteria, and it must be present at the time of sale. Second, the product's cost price should be stated at the time of sale. This should be made clear to the client. Third, the bank must own the goods or property at the time of sale. Fourth, specify the time for payment and delivery of goods (Iqbal & Molyneux, 2005; Obaidullah, 2005; Lewis & Algaoud, 2001).

Iqbal & Al-Omar (2000) Murabaha and Ijara contracts account for a large portion of Islamic banks' assets due to their ability to fairly predict the return on these tools. Furthermore, these two tools provide consistent cash flows, which help the Islamic bank meet its liquidity requirements.

2.2.2.2 Bay' Al-Muajjal

Is indeed a financing technique used by Islamic banks in which the bank profited from the purchase price and allowed the buyer to pay the price of the goods in one payment or in instalments at a later date; it is a type of credit sale.

2.2.2.3 Musharaka

According to Siddiqui (2008), musharaka financing is commonly used by banks for trade finance, imports, and the issuance of letters of credit in agriculture and industry. Islamic banks share equity and risk with the customer in this mode of financing. Profits are distributed among the partners in accordance with the agreed-upon ratio, and losses are distributed among the partners in accordance with their proportion of equity.

Ayub (2007) asserts that when partners collaborate, they can determine that one partner will run the company with no input from the other partners. According to a contract, an Islamic bank lends funds to be used in conjunction with funds from other organizations and the business sector (Rammal & Zurbruegg, 2007). The partnership agreement has the following characteristics: (1) It is a short-term contract for a specific project; (2) earnings will be split in accordance with a predetermined ratio; and (3) losses will be split in accordance with capital investment.

2.2.2.4 Mudaraba

This type of legal contract is entered into by two parties to share profits and losses in the course of doing business, uniting human and financial resources. One of the parties is the rab al-mal (financier), and the other is the mudarib (entrepreneur). The contract states that one party invests in the project while the other manages it based on its expertise. The profit percentage is predetermined between the two parties; however, the financier bears losses only if the speculator is negligent or fraudulent in his handling of the funds (Henry & Wilson, 2004; Siddiqui, 2008). The most common example of this type of financing is the profit and loss account, in which the customer deposits money in the bank for investment and the bank invests that money in profitable projects.

The general rules for speculative transactions are as follows:

a. Profits must be divided among the parties in previously agreed-upon proportions. It cannot, however, be a guaranteed return or a lump sum on investment.
b. The investor shall not suffer losses in excess of his invested capital.
c. The speculator is not liable for financial losses unless they are the result of his own negligence.

Due to the fact that the bank lends to the person who runs the business, mudaraba is seen as a high-risk technique by Islamic banks. An Islamic bank often reduces these risks by taking the appropriate measures to make sure that the suggested business strategy is implemented correctly and that it is taken seriously (Elasrag, 2011).

1. Two-tier Mudaraba

Two types of Mudaraba contracts are the original Islamic banking concept in which the Islamic bank participates. One is from the depositor, and the other is from the person for whom the bank is providing financing. The first is between the bank and the customer who has extra money (the depositor), and the last is between the bank and the customer who is seeking financing. The depositor deposits his money in the bank with no assurance that it will be returned in its entirety or that the bank will make a profit on the investment it makes on his behalf, but he is responsible for all losses and receives a percentage of any gains in accordance with the percentage agreement.

Second-degree speculation occurs between the bank and those who receive bank financing. In this case, the bank is the owner of the funds, while the lender is the speculator. Except in the case of fraudulent activities by the speculator, the bank is responsible for all losses incurred by the business and shares profits with the customer in accordance with previously agreed ratios (Kettell, 2011).

2. Restricted Mudaraba vs Unrestricted Mudaraba

According to El-Tiby (2011), mudaraba contracts are classified into two types: restricted investment accounts and unrestricted investment accounts. Restricted investment account: In this type of mudaraba contract, the depositor (investor) has the right to authorize Islamic banks to invest their money through agency contracts with certain restrictions on where, how, and why their money is invested.

Unrestricted Investment Account: In this case, the depositor does not impose any conditions on Islamic banks when investing their funds. The bank has complete freedom to invest this money in mudaraba or wakala contracts. This is appropriate for banks to pool their funds and invest them in a pooled portfolio.

2.2.2.5 Al-wakala

It is a type of mudaraba contract because the depositor places money with the bank and the customer-bank relation is trustworthy. The bank receives a fixed fee for its services under this contractIt is an agency agreement because one party (the investor) pays a fee to appoint another party (the bank) as an agent (agent). The bank invests in a pre-agreed-upon asset in the best interests of the investor and charges a fee for the profits made from investing the funds, and returns any remaining profits to the investor (the principal).

Agency contracts are classified into several types, including agency in purchase, agency in sale, restricted agency, unrestricted agency, general agency, and private agency. According to Van Greuning & Iqbal (2008), there are two types of agency contracts: unrestricted and unrestricted agency. The bank is not limited in unrestricted agency contracts. It can invest in any asset without restrictions, and the bank only charges a fee to the investor rather than becoming a profit and loss partner (Hassan et al., 2013).

2.2.2.6 Ijara

Ijara is an Islamic method of leasing or hiring in which physical assets are rented. Ijara is a contract in which a customer purchases the right to use an asset for a set period of time. It is, in general, a contract for leasing tangible assets (such as property or goods), but it also refers to the rental of services for a fee.

Ijara is classified into two types: (1) simple ijara and (2) complex ijara (operational ijara). The financier buys the asset and rents it to the customer for a set period of time in this type of ijara. (2) WataqniIjara (Financial Ijara): In this type of ijara, the financier and the customer agree to transfer ownership of the asset at the end of the lease term. The customer is responsible for paying the rent as well as the progressive payment of asset ownership (Van Greuning & Iqbal, 2008). The ijara contract is similar to the Conventional lease agreement of a bank. However, the ijara contract requires the leasing agency to retain ownership of the leased object for the duration of the term. The second distinction is that there is no compound interest if the customer fails to make timely payments in accordance with the terms of the ijara contract (Masood, 2011).

2.2.2.7 Salam

Salam is a contract for the sale of goods in which the seller receives cash in advance and the merchandise is delivered to the customer at a later date. According to Iqbal & Mirakhor (2007), in a salam contract, the quantity and quality of the product are fully determined at the time of the agreement.

It entails purchasing goods and deferring delivery. It functions similarly to Conventional futures contracts but differs in terms of payment agreement. A specific product that has to be supplied at a later time is paid for in full in front. The primary advantage of this contract is that it relieves the buyer of anxiety regarding the future price of the commodity while providing the manufacturer with the full purchase price up front to invest in production (Masood, 2011).

2.2.2.8 Istisna

A set number of products is sold at a predetermined price at a later time under the Islamic financing method known as istisna. It is comparable to salam, however in the case of the istisna contract, the buyer does not pay the whole cost of the goods upfront (Iqbal & Llewellyn, 2002; Vogel & Hayes, 1998).

Iqbal & Mirakhor (2007) outline three requirements for istisna contracts: (1) manufacturing of the underlying asset or product; (2) flexibility in payment and delivery terms; and (3) cancellation of the contract prior to manufacturing.

2.2.2.9 Qard Hassan

According to Siddiqui (2008), this type of financing is available to the poor in society. It is, in essence, interest-free financing. The financier has a negative net present value.

2.2.2.10 Sukuk

It is a bond founded on Islamic values. It is issued as proof of funds received by the recipient (the beneficiary), granting some rights to the assets. Sukuk bonds are a type of asset-backed security.

Sukuk are classified into three types: leased sukuk, sukuk based on shares, and sukuk based on sale. These are similar to bonds in conventional banks, but the difference is that sukuk are asset-backed and refer to the holder's ownership of tangible assets. There are various types of sukuk that rely on complementary instruments. Sharia-compliant terms include Mudaraba, Musharaka, Murabaha, Agency, Ijarah, and Istisna' (Kamil, 2008).

Equity-based sukuk, which are issued in exchange for physical assets and serve as a note or certificate demonstrating ownership of an asset, are the most significant and popular type of sukuk. In order to invest their reserve assets, the central banks of Islamic nations introduced sukuk in the year 2000. Sukuk was employed as a tool for risk management. Awan, 2009; Hassan et al., 2013).

2.3 Unsystematic risk

Banks suffer from several risks due to the nature of their work. Risks are categorized into systemic and unsystematic. Systematic risks are associated with the market and the country's economy and Unsystematic risks are associated with unique assets or a specific company and cannot be reduced through mitigation techniques in a diversified portfolio. Unsystematic risk is another name for diverse risk. There are three general risk mitigation strategies, according to Oldfield and Santomero (1997): risk elimination or avoidance through simple business practices, risk transfer to other participants, and effective bank-wide risk management (risk acceptance).

Uncertainties caused by adverse fluctuations in profits and losses are thus defined as risks. According to the researcher, identifying risks is the first step in the risk management process, and it serves as the starting point for subsequent steps such as risk assessment, risk analysis, and risk control; organizational and risk factors (conditions that increase the chances of loss and profit) and risk (cause of unexpected loss) exposure to resources (things that experience losses and gains). The critical step is identifying risks, and it is necessary to spend time on this activity after identifying risks.

It is necessary to identify the prevailing uncertainties, understand the nature of the market in question, the social, political, and legal environment, and comprehend the risk-related activities. Because the process of identifying risks is complex and not fixed, banks must implement procedures to ensure that all risks faced by the company are captured. There are some concerns about identifying risks. Banks must verify that a single transaction contains numerous risks that must be identified. Banks must also consider the level of risk associated with specific transactions. The bank is also required to assess its business conditions and corporate governance system. Identifying risks is a comprehensive activity that includes determining the sources and causes of risks, as well as whether the risks are caused by internal or external factors. External causes cannot be avoided, but they can be mitigated through careful planning. Oldfield & Santomero (1997). Following the determination of the scope, the potential risks are classified in terms of risk severity and probability in relation to the effect (chance of limits). This informs the bank of its willingness to take on such risks. Risk assessment is a continuous process that involves evaluating the risk response, scope, objectives, and controls. The risk assessment process begins with a qualitative assessment, and then

sufficient data is extracted in a timely manner to aid in risk and resource allocation decisions. The most basic type of assessment is a qualitative assessment, which categorizes potential risks.

Risk assessment is linked to the distinction of primary and secondary risks. The next step is to prioritize the risks after they have been measured. They are compared after receiving and analysing data about the risks. As a result, the bank must determine the level and type of acceptable risks that can be controlled. Furthermore, the bank must clarify the risks that must be transferred to a third party.

2.3.1 Risk in Conventional banks

conventional banking products are classified into two categories: liability products and loan products. Customers can open savings accounts, current accounts, and fixed deposit accounts with liability products, whereas loan products include fixed loans, current financing, and term loans.

2.3.1.1 Credit risk

Credit risk is one of the most visible risks in the banking industry, and it refers to a counterparty's failure to pay debts or meet contractual obligations. Credit risk is an important component of fixed income investment. As a result, rating agencies assess corporate issuers' credit risks.

Credit risk is actually divided into several components (Bessis, 2011). The risk of default occurs when the borrower fails to repay the entire or a portion of the loan amount. There are numerous cases of default, such as loan repayment delays, borrower bankruptcy, and debt restructuring due to the borrower's poor credit standing. The migration risk refers to the direct loss caused by internal and external rating, as well as possible indirect losses caused by credit carry-over, which increases the likelihood of non-payment. Actually, exposure risk is the risk of losing money due to the future value of the money lent. Loss due to default indicates that a portion of the loan amount has not been repaid.

2.3.1.2 Liquidity risk

One of the most significant risks that banks face is liquidity risk. Liquidity risk arises when a bank is unable to pay its obligations due to a mismatch between the maturities of assets and liabilities, as banks with a large number of off-balance-sheet items are more vulnerable to liquidity risk. Finance is all-encompassing, which is why liquidity risk does not appear in the bank on its own, but rather as a result of the consequences of credit risks, market risks, and interest rate risks, to name a few.

Effective liquidity risk management contributes to the development of market confidence and the maintenance of relationships with borrowers by meeting their loan requirements on time and refraining from selling assets at low prices in order to generate funds.

1. Liquidity risk includes the following risks: Financing risk: the risk of substituting net cash flow for unanticipated withdrawals or deposits that have not been replenished by depositors**.**
2. Time risk: the risk of not receiving the expected money flows.
3. Call risk: the risk of obtaining contingent commitments and being unable to obtain useful employment opportunities when needed.

2.3.1.3 Market risk

Market risk is defined as the possibility of incurring losses on and off the balance sheet as a result of market price fluctuations (Ghosh, 2012). They result from changes in the market value of interest rates or exchange rates, as well as price changes in bonds, stocks, and commodities.

Market risk factors include:

1. Interest rate risk

a. It happens as a result of fluctuations and changes in interest rates on assets. For example, when interest rates rise, the value of the bond falls, and when interest rates fall, the price of the bond rises. Banks bear the following types of interest risk.
b. Baseline risks: They occur when the return on assets and the cost of liabilities are calculated at different rates, such as the London interbank rate versus the US main interest rate (Bhattacharya, 2010).

c. Prising risk arises when assets and liabilities are reissued at different times and rates. When the loan has a variable interest rate, the lender may earn more income as the interest rate rises, but it may lose money in the lower price lane. (Vyas & Singh, 2010).

d. Option risk: This risk arises as a result of the variety of assets and liabilities available. option risks arise, for example, in mortgage loans when payments are made early due to interest rate fluctuations, resulting in a loss of income for the lender. This type of risk is challenging to assess and manage. (Vyas & Singh, 2010)

2. Foreign exchange rate risk

Foreign exchange risks, sometimes referred to as currency risks or exchange rate risks, are influenced by exchange rates and manifest as variations in profits as a result of tying revenues and expenses to exchange rates or as changes in the value of assets and liabilities denominated in foreign currencies. This kind of import and export transaction is typical (Vyas & Singh, 2010).

2.3.1.4 Operational risks

They are direct and indirect risks resulting from the failure of internal processes, personnel, and systems, as well as external events. The failure of the information system, reporting system, internal risk control rules, and internal procedures designed to carry out the procedures creates these risks.

Bessis (2011) explains operational risk levels:

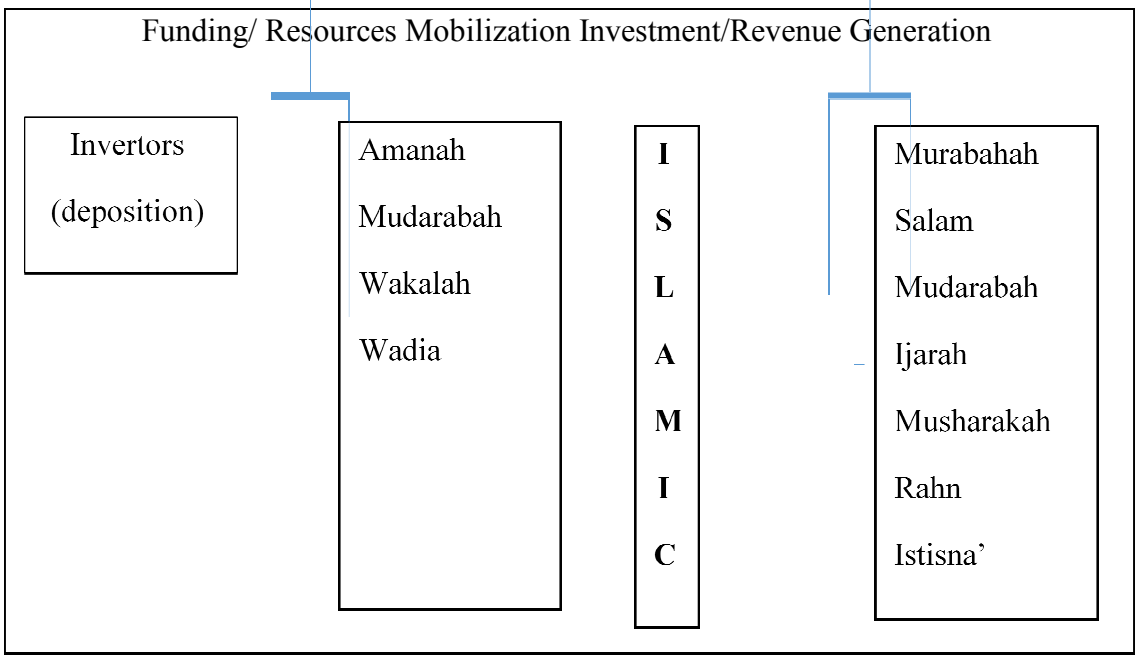
1. Human Errors / Fraud Operations: These include lack of experience, internal or external fraud, and employee practices that may lead to the bank's loss.
2. Processes: They include insufficient procedures and controls for reporting, monitoring, decision-making, organization and management, and inefficiency in technology, which cause losses to the bank.
3. Technical: It includes technical risks and the lack of sufficient instruments to measure the risks in banks.
4. Information Technology: The possibility of loss due to system failure or insufficient information system.

2.3.2 Risk in Islamic bank:

Figure (1) depicts how an Islamic bank is designed to raise funds from depositors and invest it in a variety of sharia-compliant instruments.

Figure 1

Islamic Financial Intermediation



2.3.2.1 Credit risk

Credit risk arises in Islamic financial instruments such as murabaha contracts, which are riskier due to the nature of the contract and its adherence to Islamic Sharia rules and regulations. Credit risk arises when a customer defaults on outstanding duties after receiving assets from the bank. Similarly, in murabaha contracts, the buyer has the right to refuse to deliver the product purchased by the bank, and the bank is also subject to market and price risks as a result of credit risk. The customer defaults for the following reasons, according to Vogel & Hays (1998): the bank did not deliver the goods on time; the goods are of poor quality; and the salam and istisna contracts were not fulfilled. Credit risk arises in the mudaraba contract, according to Hassan & Lewis (2007). Because of the nature of the project, the bank can only act as a financier and cannot manage the mudaraba contract, just as Islamic banks cannot assess and manage credit risk. This situation will increase the credit risk of Islamic banks. However, in the case of

musharaka contracts, Islamic banks will be exposed to credit risk if the customer or entrepreneur fails to pay the bank's profit.

Islamic banks face credit risks that are similar to those faced by conventional banks. As a result, the processes for calculating minimum capital requirements for credit risk exposure are similar to those used by conventional banks. (Kahef, 2005)

2.3.2.2 Liquidity risk

Islamic banks can offer two different types of liquidity: (1) Insufficient resources to access Islamic banks to meet the bank's financial obligations, it might be challenging to turn illiquid assets into liquid ones when there is a lack of liquidity in the financial markets. (ii) The Islamic bank is unable to raise money at a competitive price when the financing market is constricted (Iqbal & Mirakhor, 2007). The primary source of liquidity risk in Islamic instruments is a lack of sufficient liquidity. According to Ariffin et al., converting financial instruments into convertible financial instruments is not acceptable (2009). If you incur a debt, it is transferable, but only at face value.

In Islamic banking, the following factors contribute to liquidity risk:

1. Inadequate legal money market availability
2. The absence of an effective interbank money market as a result of the legal prohibition on interest rate on transactions.
3. A scarcity of secondary markets is also a major source of liquidity risk.
4. Islamic Sharia allows for real estate transactions and borrowing. As a result, tradable asset-backed securities, such as Islamic financial institutions' sukuk bonds, are required.

2.3.2.3 Market risk

Market risk is linked to negative price direction in rate of return, foreign currency rate risk, profit rate risk, equity risk, and commodity price risk, claim (Iqbal&Mirakhor 2007 and Van Greuning & Iqbal 2008). Islamic banks are not exposed to interest rate risk because they do not engage with various governmental and public financial instruments. The erratic nature of the current and prospective asset markets is what generates market risk. Market risk also applies to derivative instruments including options, interest derivatives, currency derivatives, and stock derivatives.

2.3.2.4 Foreign exchange risk

Banks face exchange rate risk as the exchange rate between domestic and foreign currencies fluctuates, according to Van Greuning & Bratanovic (2009). Foreign exchange risk arises in contracts in which an Islamic bank is required to receive payments in another currency and the exchange rate falls over time, or when Islamic banks make payments in foreign currency and the exchange rate rises.

2.3.2.5 Commodity price risk

According to Akkizidis & Khandelwal, (2008) commodity price risk arises when banks own various assets with the intention of selling them in the future. Commodity price risk occurs when an asset's commodity price falls and the bank is forced to deliver that commodity at a low price. Commodity price risk is present in Islamic finance types such as salam, istisna, ijara, mudaraba, and musharaka, according to Hassan & Lewis (2007).

2.3.2.6 Mark-up risk

On the loan that is provided to the customer, Islamic banks impose a fixed rate profit margin. The profit rate is established using LIBOR because Islamic banking does not have any criteria for doing so. If the benchmark rate is greater than the prior rate and there is speculation involved, there is a risk to the profit margin because the bank cannot charge a higher rate to an existing customer. The profit margin is determined once and used during the entire time period, just like in Islamic banking. Similarly, when it comes to participation, Islamic banks use LIBOR as a criterion to calculate the profit-loss ratio. Because the rates were predetermined, the bank cannot enjoy a higher return on previous contracts if the benchmark rate rises (Iqbal & Mirakhor, 2007; Hassan & Lewis, 2007).

2.3.2.7 Equity investment risk

Van Greuning & Iqbal (2008) claim that Islamic banks also participate in equity investments including stock market shares, private equity funds, and involvement in particular projects. Additionally, these investments are vulnerable to market, credit, and liquidity risks. If such risks exist, the bank's financial profits will be volatile, as will the capital invested in those shares. Among the risks associated with stock investing are: improved monitoring is required to reduce informational gaps. Islamic banks must

actively participate in monitoring, financial disclosure, reporting, and project supervision.

To avoid equity losses, proper monitoring and evaluation of mudaraba and musharaka contracts is required. Because the degree of risk in these contracts is high, extra care must be taken to evaluate and select the project in order to minimize future equity losses.

Investing in stocks other than those listed on the stock exchange is risky due to a lack of organized and proper secondary markets, which raises the cost of pre-exit.

2.3.2.8 Operational risks

Operational risks are associated with system failures and issues related to technology and its operation, including weak internal policies, actions, and processes of Islamic banks, which can result in bank losses. Operational risks arise as a result of internal and external operations failing, resulting in direct and indirect losses for Islamic banks (Bassis, 2002; Iqbal & Mirakhor, 2007; Ahmed & Khan, 2007).

Sundararajan (2005) claims that the following issues in internal control systems to handle issues with operational procedures and back office functions, technology risks, potential risks related to the enforcement of Islamic contracts in a complex legal environment, the risk of non-compliance with sharia rules and regulations, and the potential cost of monitoring are the main sources of operational risks in Islamic banks (Van Greuning & Iqbal, 2008).

Legal risks (Archer & Abdullah, 2007; Djogosojito, 2008; Venice, 2007; Khan & Ahmed, 2001; Sundarajan, 2005), Shari'a non-compliance (Islamic Financial Services Board, 2007, Islamic Financial Services. 2005), credit risk (Islamic Financial Services Board, 2005), and reputational risk are all factors to consider (Archer & Abdullah, 2007; Akkizidis & Bouchereau, 2005; Venice, 2007; Standard & Poor, 2008).

For Islamic banks, operational risk is a major concern and one of the most visible threats they face. According to Khan & Ahmed (2001), managers in Islamic banks believe that operational risk is more important than profit risk. According to Khan & Ahmed (2001), operational risks in Islamic finance are higher in salam and istisna

contracts and lower in murabaha and ijara contracts. The instruments' higher risk ranking indicated that banks find it difficult to implement these contracts.

2.3.2.9 Business risks

According to Van Greuning & Iqbal (2008), business risks arise as a result of macroeconomic and policy concerns, legal and regulatory factors, and financial sector infrastructure. Rate of return risk, drawdown risk, liquidity risk, and reputation risk are all examples of business risks.

1. Risk rate of return (ROR)

Because Islamic banks' returns on investments are uncertain, there is a risk of rate of return. In relation to interest rate risk, the rate of return varies. Iqbal & Mirakhor (2007) claim that the way Islamic banks operate differs from non-Islamic banks in that they deal with set rates of interest on securities, which lessens their risk associated with the rate of return on securities.

While the situation differs in Islamic banking, these institutions deal in securities whose yield is disclosed at the end of the holding period. These investment outcomes are unpredictable. As a result, the Islamic bank must wait for the outcome before determining the rate of return for depositors. Depositors' expected returns on investment may differ as a result of this uncertainty. The greater the variance, the higher the bank's risk-return rate (Van Greuning & Iqbal, 2008). Depositors' expected returns on investment may differ as a result of this uncertainty. The greater the variance, the higher the bank's risk-return rate (Van Greuning & Iqbal, 2008).

Rate of return risk is the most significant risk in Islamic banks, according to Khan & Ahmed (2001), when compared to other risks like operational and liquidity risk. In addition, according to How et al. (2005), the risk of rate of return is higher for banks that provide Islamic financing versus those that do not. According to Rosly, (1999), Islamic banks have less investment flexibility (asset side of the balance sheet) than conventional banks because murabaha financing is not affected by market interest rates. All Islamic bank liabilities are exposed to market risk, resulting in negative fund gaps between Islamic banks' assets and liabilities.

2. Withdrawal risks

Withdrawal risk arises as a result of the low rate of return on deposits. If an Islamic bank offers its customers a lower rate of return on their investments, the customer will withdraw their funds and invest them in another bank that offers a higher rate of return. According to Iqbal & Mirakhor, (2007) withdrawal risks arise as a result of competitive pressures faced by purely Islamic banks and Islamic windows for conventional banks.

3. Reputational risk

According to Van Greuning & Iqbal (2008), reputation risk, also known as "key risk," arises as a result of irresponsible management behavior or non-compliance with the system, which harms an Islamic bank's reputation and undermines the trust of its clients.

An Islamic bank's reputation, along with its market share, liquidity, and profitability, can all suffer from negative publicity. Because the Islamic finance sector is new to the market, reputational risk affects all Islamic banking institutions. Therefore, any harm to one company could have a negative effect on the entire industry. (Iqbal & Mirakhor, 2007).

The agreement reached among influential religious scholars and the confirmation of compliance with Islamic Sharia: the foundation of Islamic banking, reduce reputational risk (Shaikh & Jalbani, 2009).

2.3.2.10 Islamic Sharia Non-compliance Risk

Non-compliance with Sharia rules and regulations established by the Sharia Board of the Islamic financial institution or the relevant jurisdiction of an Islamic financial institution is associated with Sharia non-compliance risk (IFSB, 2005). The customer (depositor) and the banker have a principal and agent relationship. In this regard, Islamic banking services differ from conventional banking services in that the investor trusts that his money will be handled in accordance with Islamic Sharia. If a bank violates a customer's trust and engages in illegal compliance, the bank risks losing the trust and confidence of the investor or depositor. Some scholars believe that any income derived from Sharia violations should not be distributed to investors and depositors.

2.3.2.11 Risks Specific to Islamic Banking

1. Displaced business risks

Substitute commercial risk is defined by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) as the danger that develops when an Islamic bank is forced to offer depositors and investors a return that is higher than what would be provided under the "real" terms of an investment contract. This may occur if a bank has a history of poor performance and is unable to produce sufficient earnings to pay out to account holders (Islamic Financial Services Board, 2005). To mitigate commercial risk, Islamic banks may choose to forgo a percentage of their revenues in order to stop depositors from withdrawing money. Among Islamic banks, this voluntary practice is widely accepted. Islamic financial institutions should follow best practices and be transparent with applicants about how they operate and what rights investors have with respect to their reserves.

2. Transparency risk

In order to effectively analyze a bank's position, financial performance, business operations, risk profile, and risk management procedures, users must be provided with accurate and timely information. When there is a lack of transparency, there is a higher chance of losing money as a result of making bad judgments based on incomplete or incorrect information. (BCBS, 1998).

3. Governance Risk

These risks arise as a result of management failures, negligence in contract performance, and companies' compliance with the institution's low internal and external environment, including legal risks as banks fail to implement their contracts (Van Greuning & Iqbal, 2008).

4. Fiduciary Risk

Fiduciary risk arises from the institution's failure to meet explicit and implicit fiduciary standards (Islamic Financial Services Board, 2005). These risks include the possibility of litigation (legal action) if the bank's agents fail to fulfill their obligations to depositors and shareholders. Islamic banks are expected to act in the best interests of

their investors, depositors, and shareholders as fiduciaries. When investors' and shareholders' goals diverge from the bank's, the bank is held liable under fiduciary duty.

Additionally, the reputation of the bank will suffer from negligence or misconduct in Sharia compliance (Hamidi, 2006; Izhar, 2010). Even financially stable institutions that encounter these dangers may lose the confidence of prospective depositors or investors, which will lead to a decline in deposits. Due to the fact that they are entitled to a portion of the investment's returns, shareholders and depositors are also at risk of suffering financial losses due to fiduciary risk.

The following are the effects of credit risk that have been discussed in the literature: Depositors' withdrawal of funds due to mistrust of the Islamic financial institution is referred to as withdrawal risk. Other withdrawal risks include legal risks in the event of carelessness or misappropriation of investors' (depositors') funds, reputational risk in the event that the bank disregards Sharia-compliant rules of conduct, and bankruptcy risk. (Iqbal & Merkhor, 2007; Van Griening & Iqbal, 2008; El-Tiby, 2011).

2.4 Palestine and Jordan economy and banking sector:

2.4.1 Israel, Jordan and Palestine economy:

Israel economy: In 2019, the Israel economy maintained a comparative stability in the growth trend compared to the weakness of global growth, especially in the developed countries. It recorded a growth of 3.5%, compared to 3.4% in the previous year, in addition to keeping the inflation rate stable at 0.8% for the second year in a row benefiting from the decline in commodity prices and the appreciation of the shekel exchange rate. While the unemployment rate decreased from 4.0% to 3.8% during the comparison period. in addition to the Palestinian market's dependence on the Israel market as a main trading partner, which still accounts for approximately 80% of Palestinian exports and 60% of imports (PMA, 2020).

Jordan's economy: The Jordanian economy recorded a growth of 2.0% in 2019, compared to 1.9% in the previous year. These developments come against the backdrop of a noticeable improvement in mining activity and services provided by the government, in contrast to a slowdown in other activities and a further decline in construction. This performance has resulted in an increase in unemployment rates from

18.6% to 19.0% in 2019 and the inflation trend has slowed down from 4.5% to 0.8% during 2019. The Jordanian economy ranks second (after the Israel economy) in terms of effect on financial and economic stability in Palestine, due to the land occupied by Jordanian banks operating in Palestine, or the weight that the Jordanian currency occupies in the composition of the assets and liabilities of the Palestinian banking department. The assets of Jordanian banks represent about 42.0% of the total assets of the Palestinian banking department. They account for 36.7% of the total credit granted in the Palestinian market, and about 43.0% of the total public deposits. The share of the Jordanian dinar was about 22.1% of the total Palestinian banking department deposits, and 14.9% of the total credit portfolio. These percentages reflect the extent of the Palestinian banking department's exposure to any potential shocks to its Jordanian counterpart (PMA, 2020; CBJ, 2019).

Palestine economy: In fact, 2019 witnessed a further slowdown in of economic activity in Palestine, with the gross domestic product (GDP) registering a growth that did not exceed 0.9%, compared to 1.2% in the previous year, after the shadows of the Palestinian government financial crisis and the irregular payment of public employees' salaries loomed over the economic scene during 2019. This simple growth reflects the sluggishness of economic activity in the West Bank, which achieved a complete stagnation of growth, with 2.3% in the previous year, an increase of 1.2%, compared to the Gaza Strip, after a contraction of about 3.5% in the previous year. The growth in consumer prices in Palestine increased by 1.6% in 2019, compared to a contraction of 0.2% in the previous year, in conjunction with the escalation of inflation in the West Bank from 0.4% to 1.8%; its renewed growth in the Gaza Strip by 0.4%, compared to its decline by 3.1 n the other hand, the weak economic performance did not prevent unemployment rates from declining in Palestine from 26.2% to 25.3%, according to their decline in the West Bank from 17.3% to 14.6%; it continued to rise in the Gaza Strip from 43.1% to 45.1 %. Perhaps the steady rise in the number of workers in Israel and the settlements was a key factor in the decline in unemployment rates in the West Bank, which constitutes the only source of these workers in light of the continued prevention of workers from the Gaza Strip from entering the Israeli market, as their numbers reached about 133,7 thousand workers in 2019. This constitutes 13.2% of the total Palestinian workers, and 17.8% of the workers in the West Bank. The continuous growth in the rates of their daily wages also constitutes a positive development in terms

of the role of these wages in moving private demand and supplying the local market with liquidity. However, the above statistics shows, on the other hand, the extent of the exposure that the Palestinian economy faces compared its Israeli counterpart due to the leakage of these large numbers of workers outside the domestic market. Consequently, the sensitivity of labour market conditions and income flows to economic and political shocks experienced or caused by the Israeli side. Consequently, the increasing number of these workers and the absence of suitable employment opportunities for them in the local market would undermine the economic and financial stability in Palestine in the medium and long terms. Domestic debt (borrowing from the banking department) accounted for approximately 56% of the total government public debt, or the equivalent of $6.1 billion (5.5 billion shekels). This level of domestic borrowing shows the extent of the close relation between government finance developments and the banking department and the size of the risks that may affect the stability of this sector due to the performance of government finances (PMA, 2020).

2.4.2 Banking sector

2.4.2.1 Palestinian banking sector

As a result of the political conditions and changes that Palestine experienced, the historical development of the banking system in Palestine was initially characterized by weakness and distortion in its structure and activity.

The stages of development of the Palestinian banking sector may be divided into four stages:

- The first stage: The period before 1948

Many banks and financial institutions were working during that period, the most prominent of which was the Arab Bank, which was established in 1930 in Jerusalem and its branches spread in many Palestinian cities, but in the 1967 war all branches of the Arab Bank were closed in Palestine and moved to work in Jordan.

- The second stage: The period 1948-1967

After Israel occupied part of the Palestinian territories, the West Bank region joined the East Bank in what became called the Hashemite Kingdom of Jordan, while Gaza was

subject to the administration of the Egyptian government. The Palestine Council dissolved for criticism and stopped issuing the Palestinian pound, but the currency remained in circulation in Jordan and the West Bank until Jordan began issuing the dinar in July 1950. On September 30, 1951, Jordan stopped dealing with the Palestinian pound, while Egypt replaced the Palestinian currency with the Egyptian pound in Gaza in 1951. During this period, 8 banks worked and had 32 branches in the West Bank: Arab Bank, Arab Real Estate Bank, Cairo Amman Bank, Ottoman Bank (Grindlays), Bank of Jordan, Jordan Ahli Bank, Intra (Mashreq) and British Bank for the Middle East. In addition, there were 6 banks with 7 branches in Gaza: Bank of Palestine, founded in 1960, Arab Bank, Alexandria Bank, Nation Bank, and Agricultural Credit Company. (Osama, 2008).

- The third stage: The period 1967-1993

Israel did not wait long after occupying the West Bank and Gaza Strip to impose its laws, as banks operating in the West Bank and Gaza Strip closed their doors and transferred their balances, which were estimated at about $2.3 million, to bank accounts in Israel bank. Actually, 6 Israeli banks and 39 branches opened in the West Bank and Gaza, and the Israeli occupation authorities issued a decision to impose its currency (the Israeli lira at the time) as a legal currency while allowing dealing with the Jordanian dinar and abolished dealing with the Egyptian pound and other currencies. This led to the emergence of a black market through a network; a wide range of money changers to settle foreign payments and these payments were made illegally, which led to a high cost. This situation continued until 1981 when the Bank of Palestine Limited won a case before the Israeli courts to reopen its branches in Gaza. Then the Cairo Amman Bank branch in Nablus was reopened in 1986 under an unfair agreement. Strict restrictions were imposed on the two banks' dealings in foreign currencies and they were not allowed to open documentary credits, except through Israeli banks, which used to impose large commissions, in addition to delaying the implementation of transactions. However, during the first intifada in 1987, Israeli banks were forced to close their branches in the West Bank and Gaza, with the exception of the Mercantile Discount Bank in Bethlehem, which continued to operate until December 2000. (Osama, 2008).

In 1991-1993, there happened a noticeable increase in the number of banks. However, the nature of the work of these banks in that period was restricted and unable to act as a mediator between savers and investors, as their work was limited to the task of facilitating commercial operations and keeping deposits only.

- Fourth stage: The period after the establishment of the Palestinian Authority and the signing of the Paris Agreement

This period witnessed the birth of a Palestinian banking system that operates according to laws and instructions issued by the Palestinian Monetary Authority. The Paris Agreement (29/4/1994) came to draw the general framework governing the banking system, as it stipulated the complete exit of Israeli banks from the Palestinian territories except for Jerusalem and the establishment of the Palestinian Monetary Authority. It shall have the duties and powers of applying monetary policies in Palestine. Its establishment was announced on 12/1/1994.) (Osama, 2008).

As the number of banks operating in Palestine increased to 8 banks with 34 branches distributed between (2) national banks with (9) branches and (6) foreign banks with (25) branches.

Now, there are 14 operating banks in Palestine, including 7 local banks, 7 foreign banks, 6 Jordanian banks and 1 Egyptian. The number of their branches and offices is (422); the number of ATMs is (854); and the number of employees is (8,587) as of 31/12/2019.

The deposits of Palestinian banks all together reached $13.4 billion, total assets are $16.9 billion, and net direct credit facilities are $7.8 billion up to the year 2020.

Table3

Name, type, registration, No. of employees, No. of ATMs and No, of branches& office in Palestine at the end 2019

Name	By type	By Registration	No. of Employees	No. of ATMs	No. of Branches & Offices
Bank of Palestine	Conventional	Local	2,326	222	98
Arab Bank	Conventional	Foreign	923	111	32
The National Bank	Conventional	Local	1,296	119	73
Quds Bank	Conventional	Local	741	70	39
Palestine Islamic Bank	Islamic	Local	664	82	45
Arab Islamic Bank	Islamic	Local	595	57	25
Cairo Amman Bank	Conventional	Foreign	514	49	22
The Housing Bank for Trade & Finance	Conventional	Foreign	279	33	15
Bank of Jordan	Conventional	Foreign	344	45	20
Palestine Investment Bank	Conventional	Local	272	25	20
Jordan Ahli Bank	Conventional	Foreign	218	17	10
Jordan Commercial Bank	Conventional	Foreign	138	7	7
Safa Bank	Islamic	Local	127	9	9
Egyptian Arab Land Bank	Conventional	Foreign	150	8	7
Total			8,587	854	422

Source: Association of Banks in Palestine

2.4.2.2 Jordanian banking sector:

The Jordanian government established the Central Bank of Jordan in 1964 as an independent legal entity with fully owned capital. The Central Bank is in charge of many functions, the most visible of which are the issuance of bank notes and sukuk in the Kingdom, the maintenance of monetary stability, the provision of required liquidity to banks, and the management of bank reserves. It also aims to improve the integrity of financial institutions through various control methods. The central banks are also in charge of managing the Kingdom's gold and other foreign currency reserves. Jordan's Central Bank works to achieve three national goals: ensuring monetary and financial stability, achieving economic and social development, and providing an appealing investment environment.

Jordan's licensed banking sector expanded from 21 to 25 banks by the end of October 2010. Jordan had 16 banks, three of which were Islamic and nine of which were foreign (6 Arab banks and 3 foreign banks). The rise in bank numbers was the result of the rise in bank numbers. After the Central Bank of Jordan granted licenses to these foreign banks, namely BLOM Bank, Audi Bank, and the National Bank of Kuwait, the number of foreign banks operating in Jordan increased from five in 2000 to eight in 2004. On January 12, 2005, the number of local banks fell from 16 to 15 due to the merger of Philadelphia Bank with Bank of Philadelphia Al Ahli of Jordan, and then increased again at the end of 2009, after the Islamic Bank of Jordan Dubai and the National Bank of Abu Dhabi obtained licenses from the Central Bank (ABJ) (2010).

Now, there are 24 operating banks in Jordan, including 16 local banks, 8 foreign banks. The number of their branches and offices (862), the number of ATMs (2,038) and the number of employees (21,192) as of 2019. Table (4) lists the banks operating in Jordan and their general characteristics.

Total assets of Jordanian banks all together reached 51.09 billion dinars, total deposits 41.79 billion dinars, and net direct credit facilities 25.19 billion dinars at the end of 2019.

Table 4

Name, type, registration, No. of employees, No. of ATMs and No, of branches& office in Jordan at the end 2019

Name	By type	By Registration	No. of Employees	No. of ATMs	No. of Branches & Offices
Arab Bank	Conventional	Local	3,236	205	81
The Housing Bank for Trade and Finance	Conventional	Local	2358	226	115
Al-Etihad Bank	Conventional	Local	1,142	118	48
Jordan Kuwait Bank	Conventional	Local	1239	102	64
Jordan Ahli Bank	Conventional	Local	1186	111	52
Bank of Jordan	Conventional	Local	1547	158	77
Cairo Amman Bank	Conventional	Local	1535	246	78
Arab Jordan Investment Bank	Conventional	Local	755	66	19
Jordan Capital Bank	Conventional	Local	583	53	14
Societe Generale Bank	Conventional	Local	316	27	19
Jordan Commercial Bank	Conventional	Local	729	67	34
ABC Bank	Conventional	Local	520	56	26
Investment Bank	Conventional	Local	407	45	12
Jordan Islamic Bank	Islamic	Local	2440	256	80
Al-Rabi Islamic International Bank	Islamic	Local	980	101	45
Safwa Islamic Bank	Islamic	Local	612	76	36
Al-Rajhi Bank	Islamic	Foreign	309	50	10
BLOM Bank	Conventional	Foreign	400	22	16
Bank Audi	Conventional	Foreign	239	25	14
Egyptian Real Estate Bank	Conventional	Foreign	384	18	14
Standard Chartered Bank	Conventional	Foreign	134	5	3
Citibank	Conventional	Foreign	57	0	2
National bank of Kuwait	Conventional	Foreign	55	5	1
Rafidain Bank	Conventional	Foreign	29	0	2
Total			21,192	2,038	862

Source: Association of Banks in Jordan

2.4.3 The relation between banking and economy

The relation between banking finance and development is explain by identifying the channels that link the banking and real sector, as financial intermediation services affect indirectly or through these channels as follows:

- The first channel: The channel of money supply and the provision of liquidity

Economic theory has established that the effect of the money supply on the variables of the economy and on economic growth. The Central Bank continues to issue money and determine the quantity of its supply, reflecting the importance of the banking department because banks are the main channels through which financial policy is implemented and the necessary liquidity is pumped to achieve financial stability and ensure the efficient flow of economic and commercial transactions. One of the main conventional channels for transmitting the effect of monetary policy on the volume of economic activity and its effect on economic growth is credit granted. In theory and practice, the control of the money supply is carried out through several tools, the most important of which is the issuance of new cash, interest rate and credit banking (Department of Studies, Association of Banks in Jordan, 2020).

- The second channel: The channel for mobilizing savings (deposits)

The primary process of financial intermediation is the mobilization and accumulation of savings from various segments of society. Without the success of banks in attracting deposits, they will fail in their economic role, which is based primarily on granting credit and providing the necessary liquidity to the economy's financial deficit units. Banks are economically significant in the field of mobilizing deposits from savers because they achieve a balance between the money supply in the economy (the supply of savings) and the demand for money (the demand for investment and consumption), which has a positive effect on economic growth and income levels. Saving will become unproductive hoarding in the absence of banks (Department of Studies, Association of Banks in Jordan, 2020).

- The third Channel: Channels of Link and Influence between the Banking Sector and the Stock Exchange

It represents the main difference between the banking department and the stock exchange in that the former contributes to encouraging investment and economic activity in an indirect way, as it plays the role of a financial intermediary between savers and investors. While the stock exchange allows the saver to be a direct investor, the importance of the economic effect of the banking department's relation with the financial market stems from the fact that banking activity is positively reflected on the financial market. The banking system is important to economic growth because of its ability to collect and attract deposits from savers; its role in providing loans to encourage investment and production; its ability to bring about economic expansion in most economic sectors, such as agriculture, industry, and trade; and its role as a financial intermediary between savers and borrowers. Without banks and other financial service providers will not be able to start new businesses that drive innovation and economic growth unless they generate capital that is rich or accumulated over time (Abusharbeh, 2017). While the stock exchange allows savers to become direct investors, banks play a variety of critical roles in the economy. They serve as important sources of credit for households, small and medium-sized businesses, corporations, and governments, as well as safe havens for depositors. Diversification, derivatives, and other on and off-balance-sheet activities help banks manage credit, solvency, interest rate, foreign exchange rate, liquidity, and other risks (Berger, Molyneux&Wilson, 2020). In addition to what is known as the leading supply hypothesis, lending to businesses increases company competition and supports innovative business activities. The banking department contributes to growth because innovative businesses are critical to economic growth (Bayar, Borozan&Gavriletea, 2021). Investments rely on conventional bank loans; banks are the backbone of financial stability and the overall stability of the economy (Popovska, 2014).

The banking department facilitates economic growth by: I providing advanced information on potential investments and capital provision; (ii) monitoring investments and applying corporate governance after credit is extended; (iii) trade facilitation, risk diversification, and risk management; (iv) deposit mobilization and consolidation; and (v) facilitating the exchange of goods and services (Bayar et al., 2021).

Financial stability may be jeopardized by operations in the financial sector, which may result in the emergence of vulnerabilities as a result of severe shocks. Such shocks can be caused by external shocks, domestic macroeconomic developments, the positions of major debtors and creditors of financial institutions, economic policies, or changes in the institutional environment. Any interaction of vulnerabilities and shocks has the potential to result in the failure of major financial institutions and the disruption of financial system functions such as financial intermediation and payments. In the worst-case scenario, this could trigger a financial crisis with serious economic consequences. The recent financial crisis demonstrated the importance of banks in the economy, which began in part due to irresponsible management of banks, investments in high-risk financial instruments, and "adjustment" in financial reporting and bonuses when regulation was relaxed. There was a lack of strict internal and external control commensurate with financial innovations. In the field of banking, many authors emphasize the importance of the banking system and its critical role in economic growth (Popovska, 2014).

2.5 Literature review

Given the importance of the concept of stability banks and consequently financial stability and the extent of its effect on the economy, the following literature attempt to verify the stability of the banking department in several countries and the factors affecting it. A study by Djebali&Zaghdoudi (2020) indicated that the bank should improve economic performance and work to eliminate imbalances resulting from undesirable internal factors as a result of banking risks. Amara&Mabrouk (2019) point out that banking activities through excessive investment, weak credit and mismanagement of both internal and external factors dependent on the economy are all factors that threaten banking stability. Therefore, the system of banks needs to identify sources of banking fragility in order to control them. According to the financial intermediation, it clarifies that the most important activities for banks are the process of accepting deposits and giving loans, meaning that the structure of assets and liabilities is linked to each other for the bank, so both credit risk and liquidity risk are linked to each other according to the classical theory of microeconomics (Ghenimi et al., 2017). As risk of default increases liquidity risk due to lower cash flows, and more liquidity facilitates the transfer of risks from the bank and increases profits. Through empirical

evidence, Ghenimi et al., (2017) explained that banks have a weak liquidity structure and rely heavily on financial leverage before the global financial crisis were more likely to go bankrupt during the crisis. Hassan, et al., (2019) explained that Islamic banks enjoy high liquidity compared with conventional banks due to the scarcity of available investment opportunities. Consequently, liquidity risk negatively influences stability of conventional banks whilst positively affecting Islamic banks stability. Nevertheless, the stability of conventional banks is higher than of Islamic banks. stability of Islamic banks depends hugely on the amount of risk management. It is a result consistent with Korbi&Bougatef (2017) who explained that Islamic banks are better capitalized, but less stability than conventional banks. They found credit and liquidity risk have a negative relation with stability, but do not have a significant effect on Islamic banks. Zaghdoudi (2019) showed that liquidity positively affects the stability of conventional banks, while credit risk negatively affects the stability of conventional banks. A result that contradicts Rupeika-Apoga et al. (2020) who found that credit risk has a positive relation with stability and a negative relation between liquidity and stability risks. However, a study by Amara&Mabrouki, (2019) clarified that there is no effect between liquidity and credit risk on stability, but it helps the management to understood stability of the bank and that its stability depends on the control and risk management, based on the various results reached by the researchers as it is not possible to determine the effect of both liquidity risk and risks credit on stability. Djebali&Zaghdoudi (2020) The Tunisian study studied the impact of liquidity and credit risks in the countries of the MENA explained that the direction of the relationship cannot be determined permanently, so they determined the optimal limit to use these risks, as they discovered that credit and liquidity risk become harmful to conventional bank stability at (13.16%) for credit because the increase in credits increases payment defaulted. Money is being wasted rather than allocated to more productive activities, risk, and (19.03%) for liquidity risk. While Smaoui et al., (2020) explained that an increase in liquidity risk indicates an increase in bankruptcy risks in all types of banks, Islamic banks are more cautious in bearing risks. As a result, risk behavior differs between the two sectors. It was also stated that size plays a role. They also found a positive relation between the global financial crisis and stability, as laws during crises are more stringent, in addition to some banks taking advantage of the opportunities available during the crisis in order to compensate for losses during the recession. Ferhi (2018) analysed the credit risk of

the Islamic and conventional sectors to verify the relation between capital and credit risk; it was expressed by the variable ratio of loss reserves to total loans and the ratio of loan loss provisions to the average total loans. The results show that conventional banks have a higher credit risk than Islamic banks. The larger the size of Islamic banks is, the greater the credit risk of Islamic banks. The increase in credit risk leads to a decline in the capital in the two sectors. The negative effect of credit risk on capital is higher in conventional banks. Odeduntan et al., (2016) measured the stability of the Malaysian Islamic banking department through many variables (Z-score, NPL, loan to deposit ratio). It was found that the Islamic sector is stable, but suffers a high rate in (loan to deposit ratio) due to the excessive dependence on financing. Thus it may threaten its stability, as the future, therefore, needs good management of the finances it provides. Therefore, Albaity et al. (2019) explained that competition can affect stability, because competition for deposits leads to the fragility of banks. In addition to the fact that Islamic banks rely on equity financing, they suffer from the volatility of returns more than conventional banks. It was also explained that large banks increase competition. Consequently, smaller banks tend to take additional risks in order to be able to compete. Banks with less competition have fewer bankruptcy risks and revel higher profitability, as it was found that Islamic banks have less competition ability than conventional banks. Phan et al. (2019) worked on studying the effects of competition and efficiency on stability using a sample of conventional banks in East Asian countries, through a sample of 99 banks divided into 25 from China, 23 from Hong Kong, 22 from Malaysia and 29 from Vietnam. They reached the following results regarding stability. It was found that Vietnam has a less stability banking system, followed by China. Banks in Malaysia are more stable when using (Z-score(ROA), while according to (Z-score (ROE) shows that Hong Kong is more stable. They found positive relation between credit risk and stability, and negative relation with liquidity, as it was clarified that listed banks are less stable than unlisted banks. Beck et al. (2013) illustrates, in general, the increase in competition is linked to a greater rise in the fragility of banks in countries that imposed restrictions on the effect of stricter activity, less systemic fragility, better developed financial markets, and more generous insurance on deposit and more effective systems for exchanging credit information. They also found a positive relation between market strength and the bank's safety and stability. They explained that increased competition leads to eroding the bank's pricing ability and

increases risks, as it harms stability. They added that troubled banks have more incentives to exploit competition in order to take more severe risks, meaning that there is a positive relation between troubled banks and competition. Al-Shboul et al. (2020) examined the effect of political risks on the risks of banks in the countries of the Middle East and North Africa, where the risks of banks were expressed by five risks, namely, insolvency, credit, liquidity, portfolio risk, and leverage risk. It was concluded that policy risks have an important negative effect on the stability of banks, as it increases the bank's risks that have been used. The results support the hypothesis of financial fragility. It was also found that the effect of political risks has a less detrimental effect on Islamic banks compared to conventional ones. It also shows that Islamic banks in the MENA suffer from a higher risk of bankruptcy than conventional banks, but they are exposed to less credit risk compared to conventional banks, and the liquidity risk of Islamic banks is higher than that of conventional banks. Salah&Fedhila (2012) summarize that the credit risk of American banks increase when securitizing their loans, and it was also shown that there is a positive relation between securitization and banking stability. They also added that the different types of securitized assets lead to different effects on risks and thus on stability, as they clarified that mortgage securitization (risks are not fully transferred to the investor, but are retained by the bank transferring securities in its off-balance sheet commitments) has a positive effect on stability, while non-real estate securitization (in which all risks are transferred to the investor and is riskier) has a negative effect. Therefore, the effect of securitization depends on the stability of the banks, the portfolio structure and the credit support provided by the bank. They also explained that there is a negative relation between liquidity and credit risk, and a negative relation between liquidity with stability. Köhler (2015) clarified that business models differ significantly across bank types, savings and cooperative banks are more retail-oriented, commercial and investment banks towards investment. He indicates that this difference has an important effect on the way in which non-interest income and non-deposit financing affect stability and profitability, as investment-oriented banks are riskier and less profitable, while retail-oriented banks are more stability and profitable. He explains that the banks directed to individuals will be less stability, as their share of un-deposited funds increases, while investment banks are more stability. It was also shown that there is a positive relation between liquidity with stability, but it is not significant.

Our thesis came to try to determine the relationship between liquidity risk, credit risk and banking stability using a non-linear model withConsider the business type model

Based on the current research, the following main hypotheses can be formulated:

H1: Unsystematic risks affect the stability of both Islamic and conventional banks.

H2: The banking business model type affect banking stability.

Chapter Three

Methodology

3.1 Data

This thesis examines the effect of liquidity and credit risks on the stability of Palestinian and Jordanian banks, as well as whether the banking business model type represented by Islamic and conventional banks affects banking stability, using a sample of 28 conventional banks and 7 Islamic banks from 2008 to 2019.Table 1 shows conventional and Islamic banks number per country. Z-score(ROA) will be used as a dependent variable and (CR, LR) as transition variables, in addition, to control bank-specific variables (size, CAR and ROA). Data will be collected through the financial statements of the banks published on the Palestinian Banks Association and Amman Stock Exchange and Jordanian foreign banks through the consolidated financial statements from the bank's website while the macroeconomic control variables (FIN, GDP and political stability) are obtained from the World Bank group and the Global economy. Table 2 describes the study variables and definitions. Econometric techniques will be relied on to estimate nonlinear relations, namely the Panel Smooth Threshold Regression (PSTR) model developed by (Gonzalez et al. 2005).

Table 5

Conventional and Islamic banks number per country

Countries	commercial banks	Islamic banks
Palestine	11	3
Jordan	17	4
Total	28	7

3.2 The PSTR model

(PSTR) the technique is applied to the data because this technique has a dual application that can be considered a heterogeneous linear model with the coefficients that change with different countries over time, thus allowing the heterogeneity to assume that these transactions are related to continuous functions that can be observed through a limited function referred to as the transition function of such variable and changes between extreme states. It can be considered a homogeneous non-linear model. It is a fixed-effect model with external regressors and overcomes the problem of heterogeneity in the nonlinear model. In additional, it takes into account the different time dimensions

and cross-sectional of the panel (T and N) and the effect of cross-sectional heteroscedasticity on the size and power of the tests. It also behaves well in small sample (Gonzalez, et al., 2005; González, et al., 2004; Raza et al., 2020).

We use the non-linear relation between risk and stability polynomial specification panel data models, which are traditionally used to check nonlinearities. They have some flaws that smooth panel transition model can solve. The model imposes arbitrary quadratic polynomial regression for polynomial functions and the nature of the relation between variables. Observations are divided into homogeneous groups or systems according to the threshold value. Companies can move between groups over time depending on changes in this variable. Multiple transactions differ between companies and also the time that deals with company heterogeneity and instability time for transactions, compared to multinomial warning models and regression multiple definitions (PSTR) model gives more flexibility and consistency because it determines the threshold level of credit risk and liquidity risk and examines their effect on stability above and below the threshold level. The model offers other advantages. First, it allows the parameters to vary efficiently as a function of the threshold variable and avoids sudden changes through systems as in the panel regression model (PTR). Second, the temporal variance of the parameters in the model allows us to deal with homogeneity problems (Boussaada, Hakimi,&Karmani, 2022; Gharbi&Othmani, 2022).

Theoretical form as follows:

$$y\square\square = \mu\square + + \beta 0X\square\square + \beta 1X\square\square\ g(q\square\square, \gamma, c) + \varepsilon\blacksquare\blacksquare \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

where: i: cross-section of the panel; t: time dimensions; μ▪ : constant; + β^0: parameter vectors of linear; β^1: parameter vectors of non-linear; y▪ ▪ : dependent variable; X▪ ▪ : explanatory variables; g(q▪ ▪ , γ, c)the q▪ ▪ : is a function of transition which depends on the transition variable, γ: the transition parameter and c: the parameter of threshold; ε▪ ▪ : error term.

For this transitional function g (q▪ ▪ , γ, c) to be operational, each of Granger&Teräsvirta (1993); Teräsvirta (1994); Jansen & Teräsvirta, (1996); Gonzalez et al. (2005) suggested the following logistic form of order m:

$$g\ (q\blacksquare\blacksquare\ , \gamma, c) = (1+\exp\ (-\gamma \prod_{j=1}^{m}(\ q - c))^{-1} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

This function has the advantage of allowing a system to transfer from one system to another, as it takes values between 1 and 0. When $\gamma \rightarrow 0$ the PSTR model becomes a homogenous linear panel with a fixed effect, but when $\gamma \rightarrow +\infty$, this function tends to indicator function g (q‧ ‧ , c‧) which takes 1 if q‧ ‧ , > c‧ .

We examined the effect of credit and liquidity using annual data from 35 banks in two countries from 2008 to 2019.risks on bank stability by using the PSTR model, can be written as follows:

$$STAB‧ ‧ = \mu‧ + \beta 0X‧ ‧ + \beta 1X‧ ‧ \ g(q‧ ‧ , \gamma, c) + \varepsilon‧ ‧ \ldots\ldots\ldots\ldots\ldots\ldots(3)$$

The threshold effect of two variables (credit risk (CR) and liquidity risk) is investigated (LR). so, the

g(CR‧ ‧ , γ, c) and g(LR‧ ‧ , γ, c) are transition functions, can be divided into two equations:

$$STAB‧ ‧ = \mu‧ + \beta 0X‧ ‧ + \beta 1X‧ ‧ \ g(CR‧ ‧ , \gamma, c) + \varepsilon‧ ‧ \ldots\ldots\ldots\ldots\ldots\ldots (3\text{-}1)$$

$$STAB‧ ‧ = \mu‧ + \beta 0X‧ ‧ + \beta 1X‧ ‧ \ g(LR‧ ‧ , \gamma, c) + \varepsilon‧ ‧ \ldots\ldots\ldots\ldots\ldots\ldots(3\text{-}2)$$

In Eq. (3-1), the variable transition is credit risk (CR), in Eq. (3-2), the variable transition is liquidity risk (LR), then t is the time period in years (t = 2008-2019), and I refers to banks I = 1, 2, 3,....,35).

We included the same bank-specific control variables (Bank Size (SIZE), Capital Adequacy Ratio (CAP), and Bank Performance (ROA) in both equations, as well as the same macroeconomic control variables (Economic Growth (GDP), Inflation Rate (INF), and Political Stability (PS)) (POLSTAB). We obtain the experimental model for estimation, which is provided as follows:

$$\begin{aligned} STAB‧ ‧ = {} & \mu‧ + \beta_0{}^0 CR‧ ‧ + \beta_1{}^0 LR‧ ‧ + \beta_2{}^0 SIZE‧ ‧ + \beta_3{}^0 CAR‧ ‧ + \beta_4{}^0 ROA‧ ‧ \\ & + \beta_5{}^0 GDP‧ ‧ + \beta_6{}^0 INF‧ ‧ + \beta_7{}^0 POLSTAB‧ ‧ + \beta_8{}^0 Typebank‧ ‧ + \beta_9{}^0 country‧ ‧ + \\ & [\beta_0{}^1 CR‧ ‧ + \beta_1{}^1 LR‧ ‧ + \beta_2{}^1 SIZE‧ ‧ + \beta_3{}^1 CAP‧ ‧ + \beta_4{}^1 ROA‧ ‧ + \\ & \beta_5{}^1 GDP‧ ‧ + \beta_6{}^1 INF‧ ‧ + \beta_7{}^1 POLSTAB‧ ‧ + \beta_8{}^1 Typebank‧ ‧ + \beta_9{}^1 country‧] \\ & g(CR‧ ‧ , \gamma, c) + \varepsilon‧ ‧ \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots(4) \end{aligned}$$

$$STAB_{\square\square} = \mu_{\square} + \beta_0^{\,0} CR_{\square\square} + \beta_1^{\,0} LR_{\square\square} + \beta_2^{\,0} SIZE_{\square\square} + \beta_3^{\,0} CAR_{\square\square} + \beta_4^{\,0} ROA_{\square\square} + \beta_5^{\,0} GDP_{\square\square} + \beta_6^{\,0} INF_{\square\square} + \beta_7^{\,0} POLSTAB_{\square\square} + \beta_8^{\,0} Typebank_{\square\square} + \beta_9^{\,0} country_{\square\square} + [\beta_0^{\,1} CR_{\square\square} + \beta_1^{\,1} LR_{\square\square} + \beta_2^{\,1} SIZE_{\square\square} + \beta_3^{\,1} CAP_{\square\square} + \beta_4^{\,1} ROA_{\square\square} + \beta_5^{\,1} GDP_{\square\square} + \beta_6^{\,1} INF_{\square\square} + \beta_7^{\,1} POLSTAB_{\square\square} + \beta_8^{\,1} Typebank_{\square\square} + \beta_9^{\,1} country_{\square}] g(LR_{\square\square}, \gamma, c) + \varepsilon_{\square\square} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (5)$$

Table 6

Definitions, measures variable

variable	Definitions	Measures
STAB	Stability.	Z-Score(ROA) =[E(ROA) +CAP]/σ(ROA).
CR	Credit risk.	Nonperforming loans/total loans.
LR	Liquidity risk.	Liquid assets/total assets.
SIZE	Bank size.	ln(total assets).
CAR	Capital adequacy ratio.	Total equity/total assets.
ROA	Bank performance.	Net income/total assets.
GDP	Economic Growth.	GDP growth rate (%).
LNF	Inflation rate.	Consumer price index.
POLSTAB	Political stability.	Variable that takes values between −2.5 and +2.5.
Typebank	Type of bank, Measured as dummy variable's	0= Islamic banks; 1= conventional banks.
Country	Country Type, Measured as dummy variable's	0= Jordan; 1= Palestine.

3.3 Definition of variables

3.3.1 Dependent variable

Z-Score =((U+K))/σ: It represents the probability of default of the banking system. (U) denotes the return on assets; (K) the ratio of equity to assets; it indicates the standard deviation of a return on assets, as return and capitalization are compared to the variability of returns (Amara & Mabrouki, 2019; Hassan et al., 2019). It is used as a proxy for bank stability.

3.3.2 Transition variables

Credit risk: represents the non-performing loans on total loans, as it indicates the amount that the bank allocates to cover loans expected to be uncollectible. Through this ratio, the weight of doubtful loans is evaluated from the total loans (Ghenimi, et al., 2017).

Liquidity risk: refers to the bank's ability to fulfil its financial duties in a timely and effective manner. Liquidity represents the life and blood of banks, especially commercial banks. We use the following ratios to measure liquidity: the ratio of liquid assets to total assets (Djebali & Zaghdoudi, 2020).

3.3.3 Bank-specific control variables

The Size of the bank, represented by the logarithm of total assets, represents the bank's ownership of assets (Rupeika-Apoga et al., 2018). Capital adequacy ratio (CAR) is the ratio of total equity to total assets. It represents the extent of share ownership in the bank and protects against the risk of borrowing. The bank's performance (ROA) is expressed through the return on assets, which is calculated by dividing net income by total assets; it indicates how profitable a company is in relation to its total assets. ROA can be used by corporate management, analysts, and investors to determine how effectively a company uses its assets to generate a profit (Amara & Mabrouki, 2019).

3.3.4 Macroeconomic control variables

Inflation (INF) is used, which is the change in the consumer price index, indicating that there is an increase in the price level. Economic Growth (GDP) shows the monetary value of total goods and services in the country during a specific period of time (Imbierowicz & Rauch, 2014; Čihák & Hesse, 2010). Political stability (POLSTAB) measures the potential for political instability, ranging from-2.5 (indicating weak political stability) to 2.5 (indicating strong political stability) (Zaghdoudi, 2019).

Chapter Four

Result and Discussion

4.1 Introduction

Chapter Four begins with a descriptive statistics of the data, then presents the correlation matrix, linearity test and threshold test, followed by the empirical results obtained from estimating the effect of unsystematic risks on the stability of Islamic and conventional banks in Palestine and Jordan using (PSTR) as shown in Chapter Three. The obtained results will also be discussed and compared with previous studies mentioned in Chapter Two. The dependent variable is stability, and we used one proxy for it, that is (Z-score) (ROA). Liquidity risk and credit risk are transition variables, as are bank-specific control variables such as size, profitability, capital adequacy, macroeconomic control variables, inflation, and political risks.

4.2 Descriptive statistics

Descriptive statistics provide the first impression and useful information for further interpretation of the data that was used to include 420 observations for the period 2008-2019 in Palestine and Jordan. For each variable, the mean (mean), standard deviation (S.D.), median (p50), minimum (min) and maximum values (Maximum) are shown.

Table 7

Description of quantitative variables

	Mean	SD	Min	Max	Med
STAB	35.32375	23.06698	.4266565	119.6509	30.92441
CR	.0258609	.252902	-1.566667	3.446667	.0067642
LR	.3358904	.3875622	.0415227	7.365009	.2954604
SIZE	20.15028	1.84364	12.98326	24.4919	20.49498
CAR	.1509009	.0950269	.001	.9609177	.1329452
PERF	.0118532	.022404	-.1545404	.3608625	.0112961
GDP	3.7505	2.544315	-0.158	9.601	2.61
INF	109.2688	9.071779	93.803	125.604	110.747
POLSTAB	-1.053333	.7297169	-2.16	-.31	-.575

Table (7) is discussed by comparing the results of the mean of the factors, together with previous studies on MENA and GCC countries mentioned in Chapter Two.

The mean of the stability of banks, found in this study, has increased compared to the study of Miah & Uddin, (2017). They found a mean of (21.501), which has decreased compared to the study by (Kabir, et al., 2015). who found a mean of (52.74), and Paltrinieri, Dreassi, Rossi & Khan, (2021) who found a mean of (32.534). The results illustrate the mean of (35.32375). A credit risk mean (0.0258) compared to Djebali & Zaghdoudi (2020); they found a mean of (0.087). Liquidity risk has a mean value of (0.33) compared to (0.262) and (0.155) by (Djebali & Zaghdoudi, 2020;Hassan, Khan, & Paltrinieri, 2019) respectively. The capital adequacy mean is (0.1509) against (0.116) by (Djebali & Zaghdoudi, 2020). A probability has a mean value of (0.0118532) compared to (0.016) by (Djebali & Zaghdoudi, 2020), and (0.02) by (Kabir, et al., 2015). The mean size of the banks (20.150), found in this study, has increased compared to the studies of (Zaghdoudi, 2019;Amara&Mabrouki, 2019;Paltrinieri, Dreassi, Rossi & Khan, 2021; Abuzayed, Al-Fayoumi & Molyneux, 2018). They found a mean of (14.00), (15.0042), (15.478) and (15.2430) respectively. The mean of Macroeconomic control is less in inflation and higher in political stability in the previous studies.

In this study, I found mean inflation of (109.2688). This value is higher compared to the previous studies. It is almost the same mean value of GDP (3.7505) and the political stability mean (-1.053) compared to (−0.358) by (Djebali & Zaghdoudi, 2020), and (-0.29) for (Zaghdoudi, 2019). This means that Palestinian and Jordanian banks suffer from more instability.

4.3 Correlation matrix

In order to quantify this relation between the quantitative variables, we usually employ the Pearson correlation coefficient. This indicator is a measure of the linear association between two variables and describes the type and degree of the relation. It has a value between -1 (perfectly negative linear correlation between two variables) and 1 (perfectly positive linear correlation between two variables). So the correlation matrix shows the correlation coefficients between (the independent variables with the dependent variable) and (the independent variables together). As shown in the Table 2, STAB is stability banks; CR is credit risk; LR is liquidity risk; CAR is capital adequacy; ROA is

profitability; GDP is growth of GPD; INF is the country inflation; POL-STAB is political stability; and conventional is the type bank, which is dummy variables.

The results indicate that CR, LR ROA and INF are negatively correlated with stability by -0.0265, -0.0521, -0.011, -0.0174 respectively; it is a similar result found by (Zaghdoudi, 2019; Amara & Mabrouki, 2019). While SIZE, CAR, GDP, POL-STAB and bank type are positively correlated with stability. This means that the banks are large in size and have capital, in addition to countries where there is political stability: their stability is higher than others. A similar result is found by (Djebali & Zaghdoudi, 2020; Zaghdoudi, 2019; Amara & Mabrouki, 2019).

The results showed that the strongest correlation was between stability and the type of bank refers to conventional bank (28.5%), and then followed by the correlation of capital with stability (22%). Thus, we find that both the bank type (Conventional bank) and the bank capital ratio are significantly positively correlated with the bank stability, in other words, the choice of the banking business model and the capital adequacy affects the banks stability, thus investors should be careful about their choices of the banking system type, and banks should be careful in terms of their capital adequacy.

The results also show a weak correlation between all variables, except for the correlation between liquidity risk and profitability by 67%. (Gujarati, 2003) explained that the multiple linear relation s are expected to be severe and harmful when the correlation coefficient between the two variables exceeds the inputs (80%). In this case, rejecting the existence of the multi-collinearity problem[1].

[1] The country was omitted due to a negative strong correlation with political stability, to avoid the multi-collinearity problem.

Table 8

The correlation coefficients between the independent variables with the dependent variable and the independent variables together

	Correlation									
Probability	**BSTAB**	**CR**	**LR**	**SIZE**	**CAR**	**PERF**	**INF**	**GDP**	**POLSTAB**	**Typebank**
STAB	1.000									

CR	-0.0265	1.000								
	0.6096	-----								
LR	-0.0521	-0.0434	1.000							
	0.295	0.4037	-----							
SIZE	0.1725	0.0282	0.004	1.000						
	0.0005	0.5877	0.936	-----						
CAR	0.2237	0.0021	0.0296	-0.1583	1.000					
	0.000	0.9685	0.5527	0.0014	-----					
PERF	-0.011	-0.0124	0.6765	0.0261	-0.153	1.000				
	0.8251	0.8113	0.000	0.6001	0.002	-----				
INF	-0.0174	0.0255	-0.1732	0.0569	-0.1463	0.0511	1.000			
	0.7264	0.6235	0.0005	0.2529	0.0031	0.3039	-----			
GDP	-0.0094	-0.0269	0.1873	-0.0693	0.127	-0.0223	-0.6019	1.000		
	0.8500	0.6041	0.0001	0.1633	0.0104	0.6535	0.000	-----		
POLSTAB	0.0983	0.0401	-0.2433	0.0178	-0.2278	0.1349	0.2736	-0.3652	1.000	
	0.0478	0.4401	0.000	0.7209	0.000	0.0065	0.000	0.000	-----	
typebank	0.2853	-0.0748	-0.0483	-0.0450	-0.086	-0.0761	0.0086	-0.0103	0.0288	1.000
	0.000	0.1496	0.3314	0.3660	0.0834	0.1259	0.8599	0.8331	0.5557	-----

4.4 Econometric findings

We can use a linearity test based on two hypotheses to determine the linearity/non-linearity of credit risk (CR), liquidity risk (LR), and bank stability (STAB).

H0: $\beta 1 = 0$ versus H1: $\beta 1 \neq 0$

According to our econometric model, the null hypothesis (H0) of linearity test becomes as follows:

$$H_0: \beta_1^{1*} = \beta_1^{1*} = \ldots = \beta_1^{7*} = 0 \text{ versus } H_1: \beta_1^{j*} \neq 0 \; ; \; \exists \, j = 1, 2, \ldots, 10$$

Hence, to test this null hypothesis, we use three tests: Wald test (LMW), Fisher test (LMF) and likelihood ratio test (LRT).

Table 9

Linearity tests

	STAB	**CR**	**STAB**	**LR**
	Statistics	**P-value**	**Statistics**	**P-value**
LMW	37.120	0.000	27.625	0.000
LMF	25.231	0.000	15.729	0.000
LRT	51.198	0.000	44.712	0.000

Table 10

Tests for the number of regimes

	STAB	**CR**	**STAB**	**LR**
	Statistics	**P-value**	**Statistics**	**P-value**
LMW	143.819	0.000	115.211	0.000
LRT	11.911	0.000	7.987	0.000

Source: Author's manipulations

Table (10) shows that the null hypothesis (linear model) is rejected at the 1% level of significance for the three tests: Wald test (LMW), Fisher test (LMF), and likelihood ratio test (LRT). As a result, the relationship between bank stability (STAB) and credit risk (CR) and bank stability (BSTAB) and liquidity risk (LR) is non-linear (p0.001).

4.5 Regression results

We used a PSTR model to estimate the relation s between bank stability and credit risk, bank stability and liquidity risk for 35 conventional and Islamic banks through the non-linear least squares technique. The results of the PSTR model estimates are presented in Table (11):

Table 11

PSTR models estimations

Varibales	Model 1		Model 2	
	Coeff	**prob**	**coeff**	**Prob**
CR	131.22	0.123	0.812	0.131
SIZE	6561.05***	0.000	3.276***	0.000
CAR	1887.36***	0.000	2.046***	0.000
PERF	2434.211	0.232	-2.7769	0.321
LR	1988.88	0.342	-2.379*	0.067
INF	0.205	0.431	-0.166	0.543
GDP	-0.134	0.735	-0.143	0.923
POLSTAB	0.0311***	0.000	1.545***	0.000
COUNTRY	-16.821	0.183	-18.823	0.192
TYPBANK	22.562**	0.042	25.361**	0.039
CR * g(qit, γ, c)	-1530.877	0.514	-1.2875	0.532
SIZE * g(qit, γ, c)	-3436.65**	0.041	-8.126***	0.000
CAR * g(qit, γ, c)	-3877.3***	0.000	3.765***	0.000
PERF * g(qit, γ, c)	-2731.32	0.514	-5.763	0.348
LR * g(qit, γ, c)	-1619.619	0.752	-2.202*	0.061
Γ	0.525***	0.000	3.212***	0.000
C	**0.1141**		**0.2015**	
AIC	−1.498		−1.497	
Obs	373		373	

Note: ***, ** and * indicate level of significance respectively at 1%, 5% and 10%.

This section presents the interpretation of the findings from econometric analyses. It should be noted that the Panel Smooth Threshold Regression coefficients are interpreted in the similar manner to OLS regression coefficients (McDonald and Moffitt, 1980).

According to our regression, the p-value (Prob ≥ F) of our Panel Smooth Threshold Regression model is equal to 0.000. It is lower than the level of 5 percent. That means, we have to reject the null hypothesis that assume that the coefficients of the parameters in our regression is equal to zero. It means a statistically significant relation could exist between our dependent variables and the block of the explanatory variables.

Furthermore, as the coefficient R-squared revealed the amount of variance of the endogenous variable explained by the exogenous variables. In our model, it explained 68% of the variance the dependent factor. At the microeconomic level, this rate is very acceptable. It means a strong relation may be existed between endogenous and exogenous variables. It also should be noticed that the mostly of our exogenous variables are statistically significant at the criteria value of 5 percent ($p<0.05$). Furthermore, the results of our econometric model revealed a non-linear relationship between credit risk, liquidity risk, and bank stability over the chosen time period. At the 5% level, this result was statistically highly significant. It follows that the traditional approach, such as ordinary least squares (OLS), fixed effect, and random effect models, cannot be used to approximate our phenomena.

The results of the PSTR model estimation about the relationship between bank stability and credit risk are shown in Table 8, and the presence of a threshold effect characterizes the relationship between bank stability and liquidity risk. The optimal credit risk threshold is 11.41%, and the optimal liquidity risk threshold is 20.15%.

The equation (4) results show that credit risk and liquidity risk have a positive, but not significant, effect on bank stability below the threshold of 11.41%, and a negative, but not significant, effect above this optimal limit. The results of equation (5) show that less than 20.15% credit risk has a positive but non-significant effect on bank stability in Palestine and Jordan, whereas liquidity risk has a negative and significant effect at the 10% level. Above this optimum limit of 20.15%, the credit risk has an insignificant negative effect during the selected period 2008-2019, while the liquidity risk has a significant negative effect at 10%. This outcome is in agreement with (Djebali & Zaghdoudi, 2020;Hassan et al., 2019;Ghenimi et al., 2017; Amara & Mabrouki, 2019; Zaghdoudi, 2019; Amara & Mabrouki, 2019; Matey, 2021).

Due to nature of banks' work in financial intermediation, liquidity and credit are critical for each bank. However, there is a limit, as the results show that after the optimum, credit and liquidity risks become detrimental to bank stability. Non-performing loans exceed 11.41% of total loans, according to equation (4). becomes harmful to the bank. Higher credit risk leads to a higher probability of bank failure; as credit risk increases, stability decreases. This result may be due to the fact that higher loan rates are the result of higher demand for credit risk by consumers; as banks offer different types of credit (such as loans, consumer loans, housing loans, etc.) to its customers, who are mainly

individuals, professionals and companies (Ghenimi, Chaibi & Omri, 2017). It becomes more difficult to recover its credit that should have been invested in more productive activities. Moreover, above the threshold, liquidity risk becomes a negative effect on stability, as when liquidity increases, banks are pushed to provide more credit; the probability of return is low, and therefore these risks threaten the stability of the bank. When the bank maintains high liquidity, it is deprived of the returns of the investable assets, which leads to a deterioration in the profitability situation and thus affects the stability.

In both equations, it is clear that credit risk has a positive effect before the threshold and then becomes negative, as loans are beneficial and generate interest that enhances the net income of banks, but to a certain extent; after that, it becomes harmful to the stability of the bank.

In both equations, there is a negative impact of liquidity risk due to the Palestinian economy suffering from the lack of a national currency and therefore depends on three main currencies, which are the Israeli shekel, the US dollar, and the Jordanian dinar. However, Palestinian banks suffer from the accumulation of surplus shekels from several sources, the most important of which are Palestinian workers who work in the occupied interior and receive their wages in cash, or Palestinians in the occupied interior shop in the markets of the West Bank, which constitutes great difficulty in the Palestinian market absorb this liquidity, and the difference is great between depositing and disbursing the shekel, and thus the banks accumulate losses because the deposited shekel is not invested in the Palestinian market.

This thesis has the advantage of demonstrating that the effects of other variables on stability are dependent on the optimal credit risk and liquidity risk thresholds of 11.41% and 20.15%, respectively, destabilizing the bank during the specified period.

The relationship between stability and return on assets as a proxy for profitability is negative and non-significant in both equations. This result agrees with (Hassan et al., 2019; Amara & Mabrouki, 2019). The average return on assets is 1.1%, which is considered low. Bank profits are primarily derived from the mediation of their balance sheets (granting loans, collecting deposits and managing payment methods). Amara & Mabrouki (2019) discovered that the return on assets does not always contribute positively to the bank's stability. If managers' primary concern is profit, they will take

more risks, resulting in higher volatility than the return on assets and lower stability. As a result, Palestinian financial institutions and Jordan are encouraged to develop new businesses and provide products, especially online for their clients (Djebali & Zaghdoudi, 2020).

The transformation variable influences the effect of capital adequacy (CAR) on bank stability. However, at the credit risk limit of 11.41%, this variable is detrimental to bank stability. A lack of capital can explain the negative and destabilizing effect. As equity accounts for an average of 15% of total assets, banks require more equity capital than this to protect their stability, according to research (Djebali & Zaghdoudi, 2020).

However, above the liquidity risk threshold of 20.15%, this variable has a significant positive effect at 1% on bank stability, as explained by (Hakimi, Zaghdoudi, Zaghdoudi & Djebali, 2017) that banks with sufficient capital can manage their risks well and avoid financial crises in the future. Capital increases reduce the level of banking risk. Concerning the Basel III agreements, there was a call to strengthen the type and quantity of capital because it was the best way to cover the risks that the bank faced, as banks with high capital ratios tend to face lower financing costs due to the lower cost of bankruptcy. This outcome is consistent with (Ghenimi et al., 2017;Amara & Mabrouki, 2019; Matey, 2021).

Even if equity is insufficient, both liquidity and CAR reassure bank customers and shareholders; bank liquidity serves as a supplement; it indicates a good financial situation.

The size before the threshold had a significant positive relationship at 1%; however, after the threshold, it has a significant negative effect on bank stability at both thresholds of 11.41% for credit risk and 20.15% for liquidity risk. This is due to the fact that the majority of banks in Palestine and Jordan are small in size; small banks contribute to stability.According to (Zaghdoudi 2019), the quality of managers who lack the culture and competence required to manage large banks. The effect is positive in the short term, but it can lead to bank failure in the future if large foreign and local banks compete. As a result of their small size, banks are unable to recover non-performing loans because they find it difficult to implement new credit risk management techniques, such as securitization and the abandonment of credit risk in new financial markets. As a result, their small size restricts and threatens their stability. As a result,

banks must carry out appropriate bank re-ownership operations in order to improve and increase their market share. and not only to be able to attribute new financial markets. This result is in agreement with (Ghenimi et al., 2017; Djebali & Zaghdoudi, 2020).

Likewise, Srairi, (2013) added that large banks have the ability to diversify risk across product lines and are more adept at managing risk than smaller banks because they have more opportunities to pursue a wider range of loans, investments, and other activities.

Banks operate in a macroeconomic environment, so macroeconomic conditions are an important component of banking performance and stability. Actually, GDP is used to measure the general health of the economy, however, inflation is used to measure macroeconomic stability. An economic slowdown can lead to a deterioration in the quality of loans and an increase in non-performing loans and provisions, thus reducing profitability. It limits stability (Hakimi et al., 2017).

For macroeconomic control variables, the experimental results show that non-significant negative relation between GDP and stability, which helps reduce the risk of banking failure, is in agreement with (Hakimi et al., 2017;Ghenimi et al., 2017). A non-significant positive relation between inflation and stability exists; this result is in line with (Ghenimi et al., 2017; Djebali & Zaghdoudi, 2020). Inflation affects the costs of products and services, therefore, a high level of inflation leads to an increase in costs. This may lead to an increase in the bank's income and an increase in the bank's repayment of bank advances or financing; in addition to the fact that high inflation can enhance the ability to repay loans, which leads to reducing the percentage of non-performing loans. This leads to increased stability (Hakimi et al., 2017; Srairi, 2013).On the other hand, we found a positive and significant effect at 1% between political stability and banking stability. Therefore, the government should form and implement strategies to maintain security and political stability in the region, which has a significant effect on the work and stability of banks. This result is in accord with (Djebali & Zaghdoudi, 2020;Zaghdoudi, 2019). The experimental results also show thatconventional banks are more stable than Islamic banks according to the dummy variable (conventional), positive at 5%. This result is in agreement with (Hassan et al., 2019).

Chapter Five

Conclusions

5.1 Conclusion

This thesis contributes significantly to various areas and provides varying information about the nature of Islamic and conventional bank work and the risks to which they are exposed. Thus, it helps managers to understand the working mechanism to improve management capabilities and develop financial products that meet the needs of customers and maintain their stability. It contributes to the existing literature by investigating the effect of unsystematic risks on stability, as the study area is a comparatively marginalized region and has a slightly different political situation from the rest of the developing countries. In addition, it adds the moderating variable to capture the effect of bank type on stability.

The results show that the relationship between the bank's stability, credit risk, and liquidity risk is non-linear, with two thresholds equal to 11.41% for credit risk and 20.15% for liquidity risk. Credit risk and liquidity risk were not significant to stability below and above the threshold in the model (1). In model (2), credit risk remained insignificant, whereas we discovered the negative relationship between liquidity risk and stability. Its negative impact can be explained by multiple forms of competition and redundant bank liquidity, which can push banks to take more risks and extend more credit to their customers without considering their ability to repay. This risk raises non-performing loans, reduces profitability, and jeopardizes stability.

The results for bank-specific variables show that the effect of the capital adequacy ratio (CAR) on the stability of the bank is dependent on the transformation variable above the two ideal thresholds. This variable, along with the credit risk threshold is detrimental to bank stability. This negative and destabilizing effect can be explained by a lack of capital in the selected banks, where stocks account for on average 15% of total assets from 2008 to 2019, and this lack of capital, combined with their low profitability, contributes to the banking department's destabilization. This variable (CAR) is in favor of bank stability above the liquidity risk threshold. Bank liquidity serves the same purpose as a customer and shareholder assurance. Even if equity is insufficient, bank liquidity supplements equity and demonstrates the bank's strong financial position.

When the variable size exceeds the credit risk limit and the liquidity risk limit, the bank's stability suffers. This negative impact is caused by the small size of the majority of Palestinian and Jordanian banks, which prevents them from recovering non-performing loans.

As a result, banks in Palestine and Jordan must undertake appropriate banking restructuring operations in order to compete with large foreign banks that can be established in the region under signed agreements. In terms of macroeconomic variables, empirical findings revealed that only political stability (POLSTAB) has a positive and significant effect on bank stability in Palestine and Jordan, indicating the importance of political stability for banking and financial stability. As a result, both countries are encouraged to maintain political stability while combating violence and terrorism. In addition to the dummy variable, the type of bank chosen affects banking stability, with conventional banks showing a positive significance. This can be explained by the Islamic system's recent entry and managers' lack of understanding and application of the nature of the Islamic system's work.

5.2 Recommendations.

The following are the recommendations for stakeholders that are based on the results of the thesis:

1. In this examination, we find that Size has a positive effect before the two thresholds and then became negative. Therefore, banks need an appropriate restructuring to try to increase their size in order to be able to survive in the markets and compete. This can be done by conducting a merger between banks and reducing the number of banks operating in Palestine and Jordan. So that it becomes more efficient with a smaller number.
2. As for the capital, it is the main element that supports the bank in unexpected cases and reassures customers in addition to liquidity. Therefore, banks need to increase their capital by issuing new shares to existing shareholders or adding new shareholders.
3. Giving courses and lectures to bank employees, especially Islamic banks, to get acquainted with the nature of the work of Islamic banks and practice Islamic transactions accurately

4. This study examined the banking and macroeconomic determinants of stability in Islamic and conventional banks in Palestine and Jordan using secondary data for selected variables. Hence, future research is recommended to extend this scope to substantiate and support secondary data through primary data, such as interviews and questionnaires.

5.3 Limitation

Some of the challenges we faced in the thesis were the difficulty of accessing the necessary data easily, the lack of sufficient years for all the sample, in addition to the use of some traditional measurements to measure some variables due to the lack of previous studies using the same analysis model to be able to compare the results more effectively, because of time was excluded Years could have affected the results due to events that greatly affected the world economy, such as Covid-19.

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الملخص

تناولت هذه الدراسة استقرار القطاع المصرفي من وجهة نظر المخاطر غير النظامية حيث تركز على مخاطر الائتمان ومخاطر السيولة وذلك لاعتبارها من أهم المخاطر التي يتعرض لها القطاع المصرفي بسبب نشاطه الأساسي في تحويل الإيداعات قصيرة الأجل الى قروض طويلة الاجل، يكون الهدف الأساسي من هذه الدراسة هو التحقق من العلاقة بين مخاطر الائتمان ومخاطر السيولة على استقرار البنوك لمجموعة بيانات من 35 بنكاً تقليدياً واسلامياً تنتمي إلى فلسطين والاردن- بالتوزيع التالي (11) بنك تقليدي و(3) بنوك إسلامية في فلسطين و(17) بنك تقليدي و(4)بنوك إسلامية في الأردن-، تمت ملاحظتها خلال 2008-2019. من خلال تنفيذنموذج انحدار عتبة اللوحة السلسلة حيث تم استخدام هذا النموذج لأنه يأخذ بعين الاعتبار العلاقة الخطية وغير الخطية، ثم استخدام Z-score(ROA) كمتغير تابع للدراسة والقروض غير العاملة من القروض، ونسبة الموجودات السائلة من الموجودات تعبر عن مخاطر الائتمان ومخاطر السيولة على التوالي وتشير الى متغيرات الانتقال، بالإضافة إلى مجموعة من متغيرات التحكم المرتبطة في خصائص البنك و الاقتصاد الكلي.

تظهر النتائج ان العلاقة بين استقرار البنك ومخاطر الائتمان، واستقرار البنك ومخاطر السيولة هي علاقة غير خطية، وتتميز بوجود عتبتين مثليتين تساويان 11.41% لمخاطر الائتمان و 20.15% لمخاطر السيولة.اظهرت النتائج بأن مخاطر الائتمان لا تؤثر على استقرار البنوك، بينما مخاطر السيولة تؤثر بشكل سلبي على الاستقرار.

بالنسبة لمتغيرات التحكم المرتبطة في خصائص البنك توضح النتائج بأن كلاً من الحجـــم وكفايـــة رأس المال لهما تأثير ايجابي جوهري على الاستقرار قبل العتبه المُثلى ثم تصبح سلبية بعد العتبة،بينما فيمـــا يتعلق بمتغيرات الاقتصاد الكلي وجد بأن الاستقرار السياسي له تأثير قوي على استقرار البنـــوك، كمـــا وجد بان نوع البنك يؤثر على الاستقرار حيث ان البنوك التقليدية اكثر استقراراً من البنوك الاســـلامية في فلسطين والاردن.

بالتالي لضمان استقرار البنوك توصي الدراسة البنوك باختيار اعادة الهيكليه المناسبة للتخفيف من صغر حجمها، وتعزيز رأس المال، بالاضافة الى ايجاد طريقة للتخفيف من مخاطر السيولة، اما بالنسبة للدول المختارة، يتعين عليها إجراء إصلاحات لانظمتها المالية وتطـــوير تقنيـــات جديـــدة لإدارة المخـــاطر المصرفية وتعزيز استقرارها السياسي لإعتباره عاملاً أساسياً للاستقرار المصرفي.

توصي الدراسة بإجراء المزيد من البحث باستخدام المزيد من التفاصيل في قياس الاستقرار والتوسع في المخاطر غير النظامية من خلال استخدام نماذج مختلفة.

الكلمات المفتاحية: مخاطر الائتمان، مخاطر السيولة، استقرار البنك، نموذج PSTR، البنوك التقليديـــة، البنوك الاسلامية.