منتدى الاستراتيجيات الأردني

JORDAN STRATEGY FORUM

Financial Services Sector

Jordan's Economic Vision Roadmap

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The Jordan Strategy Forum (JSF) is a not-for-profit organization, which represents a group of Jordanian private sector companies that are active in corporate and social responsibility (CSR) and in promoting Jordan's economic growth. JSF's members are active private sector institutions, who demonstrate a genuine will to be part of a dialogue on economic and social issues that concern Jordanian citizens. The Jordan Strategy Forum promotes a strong Jordanian private sector that is profitable, employs Jordanians, pays taxes and supports comprehensive economic growth in Jordan.

The JSF also offers a rare opportunity and space for the private sector to have an evidence-based debate with the public sector and decision-makers with the aim to increase awareness, strengthening the future of the Jordanian economy and applying best practices.

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#JSFJo
@JSFJordan
/JordanStrategyForumJSF
Jordan Strategy Forum

Amman, Jordan
T: +962 6 566 6476
F: +962 6 566 6376

This is an expert opinion report based on discussions and focus group meetings held by the Jordan Strategy Forum (JSF). The overall objective of this effort is to analyze different sectors (14) of the Jordanian economy and their respective challenges, and come-up with practical solutions and initiatives to enhance their competitiveness. Throughout this exercise, the JSF facilitated the focus group meetings, and supported the work-stream managers with any needed research and logistics.

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Work Stream Manager:

1. Dr. Ghassan Omet

Work Stream Members: (In Alphabetical Order)

2. Dr. Ali Wazani
3. Dr. Ahmad Al Hussein
4. Mr. Amjad Al Sayeh
5. Mr. Laith Qasem
6. Dr. Maher Mahrouq
7. H.E. Muhannad Shehadeh
8. Mr. Nebal Freihat
9. H.E Omar Malhas
10. Dr. Radwan Shaaban
11. Mr. Samer Al Tamimi
12. Ms. Taghreed Nafisi
13. Mr. Talal Tabbaa

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1. Introduction

The role of banks, insurance firms, and stock markets in economic growth and development has been a topic of interest to researchers, as well as to international organizations. Indeed, the World Bank outlines five key financial functions of these institutions.

Banks, Insurance Firms, & Stock Markets:

1. Produce information about investment projects, and allocate capital based on assessments.
2. Monitor borrowers and exert corporate governance after allocating capital.
3. Mobilize and pool savings.
4. Facilitate trading, diversification, and management of risk.
5. Ease the exchange of goods, services, and financial instruments.

Finance is too important to ignore. A large body of evidence shows that economies with better-developed financial systems / services tend to realize higher growth rates. Indeed, better-developed financial systems reduce inequality and poverty.

"Countries with better-developed financial systems tend to grow faster over long periods of time, and a large body of evidence suggests that this effect is causal: financial development is not simply an outcome of economic growth; it contributes to this growth" (World Bank).

Financial development "reduces poverty and inequality by broadening access to finance to the poor and vulnerable groups, facilitating risk management by reducing their vulnerability to shocks, and increasing investment and productivity that result in higher income generation" (World Bank).

Given the socio-economic importance of finance, it is useful to note, from the outset, that the International Monetary Fund (IMF) has been publishing what is called the **"Financial Development Index**" for 183 countries since 1980. The Index ranks countries' financial development based on how developed their financial institutions (banks and insurance companies) and financial markets (stock market) are in terms of three sub-pillars and these are **Depth, Access, and Efficiency.**

The purpose of this effort, organized by the Jordan Strategy Forum (JSF), is to conduct Strengths, Weaknesses, Opportunities, and Threats (SWOT) Analysis of the "financial services" sector in Jordan. Naturally, the objective of this exercise is to determine few strategic objectives for the sector, and outline a number of initiatives, whose objective is to develop the sector further during the next 8 to 10 years.

To realize the objectives of this exercise, naturally, the JSF needs the opinion of experts, whose sector-specific knowledge and experience are valuable. This is why the Forum has organized focus group meetings to discuss the overall objectives and plan for the exercise, fill the SWOT matrix results, agree on the overall objectives, and to recommend few initiatives.

The rest of this document is organized as follows. In section 2, we outline a number of observations about licensed banks in Jordan, finance companies, and the Amman Securities Exchanges (ASE). In section 3, we outline where Jordan stands on the IMF's financial development index. In section 4, we present the SWOT results and main objectives. In section 5, we present the initiatives. Finally, in section 6, we conclude the report.

Licensed Banks, Insurance Firms, and the Amman Stock Exchange

In almost all countries across the globe, financial systems are composed of two main pillars and these are financial institutions and financial markets.

Financial institutions include banks, insurance, exchange companies, and others.

Financial markets are a marketplace where financial securities, such as stocks, corporate bonds, government bonds, and derivatives, are traded.

In Jordan, financial institutions consist of banks, insurance companies, exchange companies, micro finance institutions (MFIs), financial leasing companies, financial intermediation and financial services companies. The Central Bank of Jordan (CBJ) oversights and supervises banks, exchange companies, and the MFIs. In addition, and since 16 May 2021, the CBJ has been in charge of overseeing and supervising the insurance sector as well.

In Jordan, the financial market pillar is composed of three institutions and these are the Jordan Securities Commission (JSC), Securities Depository Center (SDC), and the Amman Stock Exchange (ASE).

1. The JSC, established in 1997, is a public institution that develops, regulates and monitors the ASE "to maintain a sound investment environment and protect investors".

2. The SDC, established in 1997, is a public institution whose responsibilities are to register and deposit financial securities, transfer securities' ownership, and to clear and settle securities' transactions.

3. The ASE, established in 1978, and registered in 2017 as a public shareholding company owned by the government, provides an "organized, fair, transparent, and efficient market for trading securities in Jordan, and secure a safe environment for trading securities to deepen trust in the stock market therefore to serve the national economy".

Jordan's financial institutions are large relative to the size of the national economy. In 2020, for example, the total assets of this sector (JD 56.2 billion) are equivalent to about 190% of nominal Gross Domestic Product (GDP). Licensed banks account for 96.2% of the sector's total assets. Insurance companies are the second largest. They account for about 2% of the financial institutions assets.

The ASE boasts some of the largest in the country. Arab Bank, Jordan Islamic Bank, Jordan Electric Power, Jordan Petroleum Refinery, The Arab Potash, Jordan Phosphate Mines, and others, are listed on the capital market. These companies, and others, are the jewels of the Jordanian economy.

1. In terms of assets, deposits, and credit facilities, licensed banks in Jordan are large, relative to the size of the national economy (Gross Domestic Product / GDP). Their accounting performance, in terms of return on assets (ROE) is positive, albeit relatively low. In addition, licensed Jordanian banks are relatively well capitalized.

In addition, licensed banks lend to all sectors of the economy. Banks are significant contributors to public revenues (taxes) and to shareholders (cash dividends). Finally, licensed banks employ a total of 21,003 (35.23% of these individuals are females). This number, whilst small, is much higher than the 2,442 individual (30% of whom are females) employed by the insurance companies.

Table 1: Licensed Banks in Jordan: Assets, Deposits & Credit (% of GDP) & Performance

Year	Assets	Deposits	Credit	ROE	Capital Adequacy Ratio
2016	170.8%	68.0%	69.6%	8.9%	18.5%
2017	167.0%	67.6%	74.5%	9.1%	17.8%
2018	167.0%	66.5%	77.1%	9.6%	16.9%
2019	169.8%	65.8%	76.7%	9.4%	18.3%
2020	183.8%	64.5%	77.8%	5.1%	18.3%

2. The insurance sector in Jordan is relatively small. In 2020, for example, this sector collected a total of JD 594 million in premiums, and paid a total of JD 411.1 million in claims. In terms of insurance type, it is also useful to note that motor vehicle dominate

this sector's activities. In 2019 and 2020, the written insurance for motor vehicle constituted 38.1% and 36.0% of the total written premiums respectively. Similarly, in 2020, claims paid for motor insurance accounted for 45.5% of total claims.

Table 2: Insurance Companies: Relative Importance of Written Premiums & Paid Claims

	Written Premiums		Paid Claims	
Insurance Type	2019	2020	2019	2020
Motor Vehicle	38.1%	36.0%	47.8%	45.5%
Medical	30.8%	30.0%	33.0%	36.6%
Life	13.9%	15.5%	11.0%	8.6%
Accident	3.5%	3.2%	1.0%	1.4%
Maritime	2.6%	2.7%	1.6%	1.4%
Fire	11.1%	12.6%	5.6%	6.5%

3. The performance of the ASE has been poor in all important measures. For example, the number of listed firms has decreased from 277 companies in 2010 to 179 in 2020. The return on the market has been, for so long, persistently negative. The trading volume on the secondary market has been falling as well. Finally, the market capitalization of the ASE to GDP ratio has fallen significantly.

Table 3: The Performance of the ASE

Measure	2010	2012	2014	2016	2018	2020
No. of Listed Firms	277	243	236	224	195	179
Return (Market Index)	-3.8%	-1.2%	-2.3%	-3.9%	-5.6%	-15.2%
Trading Volume/Capitalization	30.6%	10.3%	12.5%	13.4%	14.4%	8.1%
Market Capitalization to GDP	113.5%	85.2%	69.1%	61.2%	52.9%	41.6%

Where is Jordan on the IMF's Financial Development Index?

As stated in the introduction, the IMF's **"Financial Development Index"** ranks the financial development of 183 based on how developed their **"financial institutions"** and **"financial markets"** are in terms of **Depth, Access, and Efficiency.**

The Financial Institutions Index is an aggregate of three Sub-Pillars.

1. **Depth:** Bank credit to the private sector in percent of GDP, pension fund assets to GDP ratio, mutual fund assets to GDP ratio, and insurance premiums to GDP ratio.

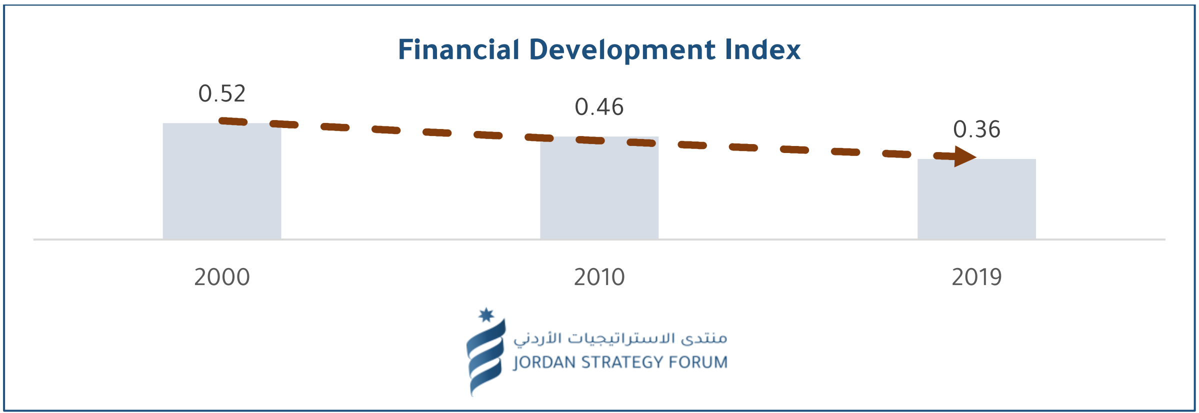
2. **Access**: Bank branches per 100,000 adults and ATMs per 100,000 adults.
3. **Efficiency:** Banking sector net interest margin, lending-deposits spread, non-interest income to total income, overhead costs to total assets, return on assets, and return on equity.

The Financial Markets Index is an aggregate of three Sub-Pillars.

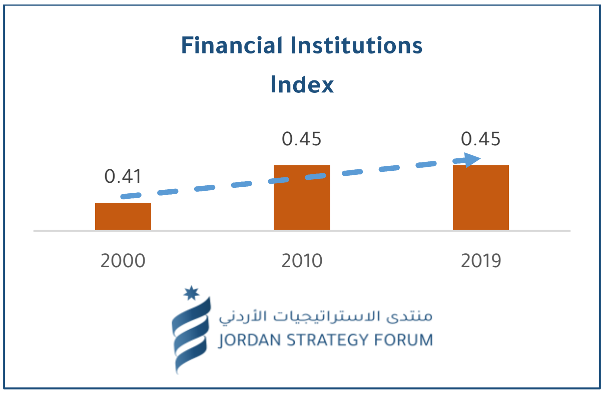
1. **Depth:** Stock market capitalization to GDP ratio, stocks traded to GDP ratio, international debt securities of government to GDP ratio, and total debt securities of financial and non-financial corporations to GDP ratio.
2. **Access:** Percent of market capitalization of outside of top 10 largest companies and total number of issuers of debt (domestic and external, non-financial and financial corporations) per 100,000 adults.
3. **Efficiency:** Stock market turnover ratio (stocks traded to capitalization).

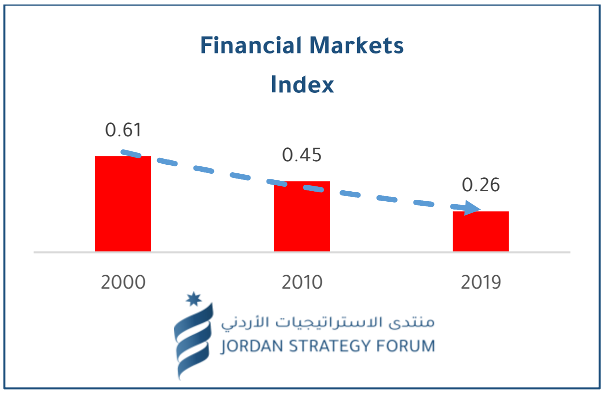
Based on the updated IMF's database, we outline below, a number of observations about where Jordan stands on the IMF's index.

A. It is unfortunate to note that over time, Jordan's financial development index has decreased from 0.52 (2000) to 0.46 (2010), and to 0.36 (2019).

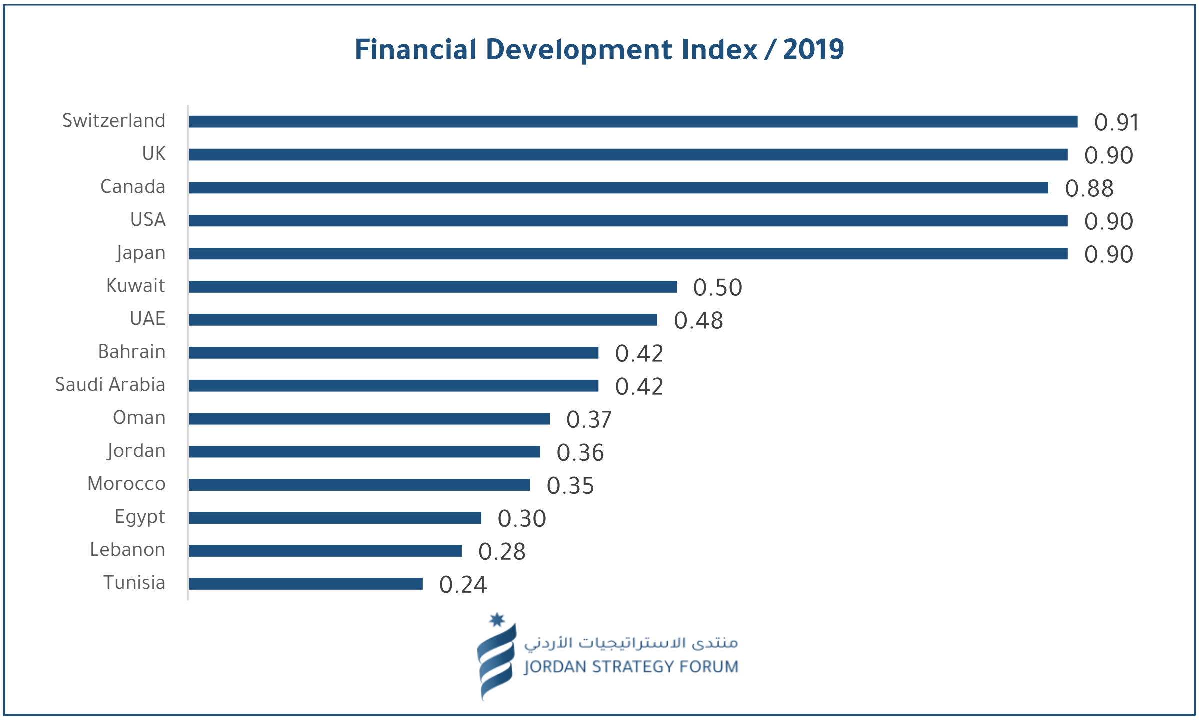


B. The significant deterioration is the result of the more significant deterioration in the financial markets' side of the index. Indeed, this index has fallen from 0.61 in 2000 to 0.45 in 2010 and to 0.26 in 2019.

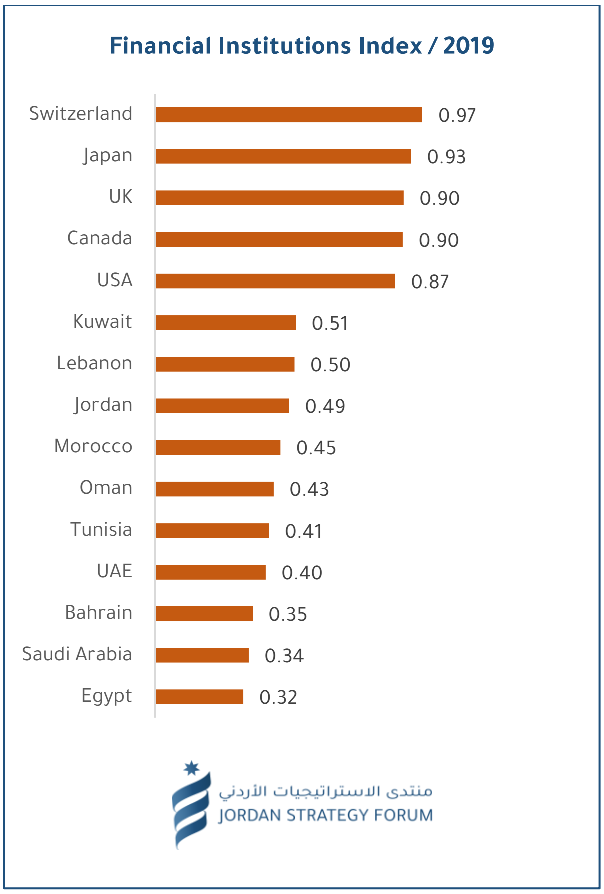


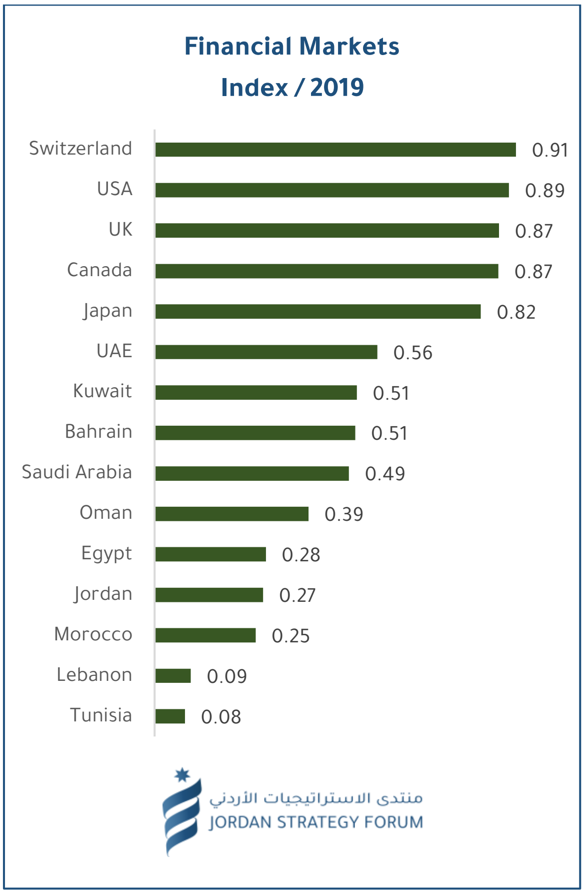


C. While Switzerland boasts a much higher index value (0.91), it is again unfortunate to note that the scores of Kuwait, UAE, Bahrain, Saudi Arabia, and Oman are above that of Jordan.



D. In terms of the financial institutions index, Jordan ranks below Kuwait and Lebanon only. However, in the financial markets index, Jordan's scores is lower than the UAE, Kuwait, Bahrain, Saudi Arabia, Oman, and Egypt.





Based on the above-mentioned four observations, it is clear that the deterioration in Jordan's financial development index is due to the financial markets pillar, and not the financial institutions pillar.

All relevant stakeholders should take the issue of financial development a lot more seriously. Indeed, this is based on the fact that banks, insurance companies, and stock markets are three institutions, should complement each other, in the growth and development process of Jordan.

In particular, relevant stakeholders should look into the cost of financial intermediation (net interest margin), banks' return on equity, low written insurance premiums, market capitalization to GDP ratio, stock market trading volume to market capitalization / turnover ratio, and the absence of trading on the secondary market in corporate and government bonds to improve Jordan's standing on the IMF's index.

2. Strengths, Weaknesses, Opportunities, & Threats (SWOT) Analysis

In terms of the strengths, weaknesses, opportunities, and threats of the financial services sector in Jordan, the team members see the followings:

Strengths	Weaknesses
1. The banking sector is well capitalized, and liquid, with good asset quality. 2. The banking and insurance sectors enjoy a competent workforce. This is also the case in the ASE. 3. The availability of diverse operating banks (Islamic, Commercial and Foreign). 4. Efficient and effective regulatory and supervisory functions. 5. Highly adaptive to technological innovations.	1. Heavy use of cash-based and check-based culture. 2. Banks are highly exposed to government debt. While government bonds are "risk-free", lending to the government might well crowd-out the private sector from the credit market. In addition, tax rate imposed on the sector is high. 3. Access to finance is a major constraint for private investment. 4. Weak financial awareness of individuals and companies (SMEs) in financial services. 5. Financial services are mainly driven by bank financing. Insurance written premiums are small, and the size of re-insurance is large (about 500 million US Dollars). The ASE has limited role.
Opportunities	**Threats**
1. The banking sector can be instrumental in financing infrastructure projects with employment impact. Similarly, the role of insurance can be enhanced. 2. Deepen financial inclusion, particularly for SMEs, and deepen financial literacy in national education programs. 3. Move further towards a cashless society (digital banking). 4. Enhance and strengthen the role of the ASE. 5. Stakeholders should look more into Eco-investing or green financing.	1. Potential regional security threats would impact growth, and consumer and business confidence. 2. Financial services are mainly driven by bank financing. 3. Lengthy and complex judicial proceedings in resolving financial disputes. 4. Increases in digitalization increases cybersecurity threats, if not well-managed properly. 5. Regulatory processes and the government's policy orientations are unpredictable.

3. Strategic Objectives

Based on the results of the SWOT analysis, the team members envisage the following objectives:

Strategic Objectives
1. Realize healthy increases in the number of listed firms, size of primary market issues, and in trading volume. In addition, develop government and corporate bonds market (issues and trading volume).
2. Promote bank and insurance competition and efficiency. The known measure of competition is what is called the H-Statistic. The efficiency measure is net interest margin which is equal to [(Interest Received - Interest Paid) / Interest Bearing Assets].
3. Realize a reduction in the cost of intermediation (net interest margin), improve banks' return on equity, and increase written insurance premiums.
4. Realize more increases in financial inclusion (individuals and SMEs).
5. Maintain and promote innovation, adaptation, and dynamism / digitalization.

4. The Initiatives

Based on the SWOT analysis, the team members see the following initiatives worth pursuing:

Initiative Name: Develop a More Efficient Trading Platform.
Short Description: The ASE should look into reducing the minimum tick from multiples of one pence to, for example, half of one pence. Reconsider capital gains tax and brokers' commission rate. In addition, the ASE should look into licensing market makers who are obliged by Law to continuously quote their two prices, and hence, provide liquidity. The government should look into "activating" trading in its issued securities to observe the yield curve.
Expected Outcome: Listed firms may increase. The trading volume would also increase. The cost of trading in shares (spread) would decrease. The corporate bond market may develop. Fiscal discipline on public finance.
Initiative Owner: Ministry of Finance, Central Bank of Jordan, and Jordan Securities Commission.
Enabler: Amman Stock Exchange.

Appendix A examines the technical issues behind the ASE's weakness, and the recommendation.

Initiative Name: Cash Dividends / Capital Gains Tax, & Commission
Short Description: The ASE should look into allowing listed firms to distribute cash dividends on a semi-annual, if not on a quarterly basis. In addition, why not scrap capital gains tax, and reduce brokers' commission rate?
Expected Outcome: Number of shareholders, especially small ones, might increase. Trading volume on the secondary market might also increase.
Initiative Owner: Jordan Securities Commission.
Enabler: Amman Stock Exchange.

Initiative Name: Bank Competition & Insurance Competition & Efficiency
Short Description: The degree of competitiveness in the banking sector and the insurance sector should be measured over time. The CBJ should look into the required minimum reserve ratio, and if possible reduce it. In addition, the CBJ should look into reducing the deposit insurance premium. Also, the issue of third-party insurance premium on motor vehicle (fixed) should be re-examined. Finally, the issue of re-insurance should be examined, and if possible, reduce this foreign exchange outflow from the Jordanian economy.
Expected Outcome: Good remedial measures to improve competitiveness. Cost of financial intermediation (net interest margin) would narrow, and insurance premiums on third-party motor vehicle would reflect reality of subscribers.
Initiative Owner: Association of Banks in Jordan.
Enabler: The Central Bank of Jordan.

Initiative Name: Governance
Short Description: The ASE should look into enforcing corporate governance principles in a more active manner.
Expected Outcome: Listed firms might increase. Trading volume would also increase.
Initiative Owner: Jordan Securities Commission.
Enabler: Amman Stock Exchange.

Initiative Name: Financial Literacy & Inclusion: SME & Individuals
Short Description: Financial literacy and inclusion, as well as awareness of fin-tech services are important. Inclusion enhances the role of monetary policy. Higher levels of inclusion enhances the transmission mechanism of monetary policy. Literacy and inclusion allow individuals to gain the knowledge regarding effective management of money and debt. In addition, support the growth of startups and provide finance to non-bankable clients. Within this context, it is useful to note that the "Financial Inclusion Strategy" was launched back in2017. In addition, in 2015, the "Financial Inclusion Education Program" at schools was launched. These initiative should have indeed resulted in some significant improvement in inclusion and literacy.
Expected Outcome: Ability to make better financial decisions such as saving for retirement, investing, managing debt, selecting insurance and purchasing home and car.
Initiative Owner: Ministry of Higher Education, Ministry of Finance, and Ministry of Planning.
Enabler: The Central Bank of Jordan and Universities and training centers.

Initiative Name: Innovative Financial Infrastructure & Digital Banks
Short Description: It is a shortcut for the use of digital technologies, ranging from web-based applications to digital process, as well as big data analysis. Nonbanks are financial technologies companies that offer products and services with no physical branches.
Expected Outcome: Open financial services to new types of players, reduce costs and increase revenues, increase efficiency and customer services and greater convenience. Increase competition, and stimulate innovation.
Initiative Owner: Ministry of Finance and Ministry of digital Economy and Entrepreneurship.
Enabler: Central Bank of Jordan and Telecommunications Regulatory Commission.

5. Summary and Conclusions

1. In any economy, the role of banks, insurance firms, and stock markets should not be underestimated. Indeed, these institutions provide their respective economies with a myriad of financial services conducive to economic growth and development. Within this context, the JSF has carried-out a SWOT analysis for the financial services in Jordan. Based on this effort, a number of conclusions have been raised.

2. The performance of the ASE, to say the least, is weak. The Market needs several reform measures. At the forefront of these measures is the trading mechanism itself. Relevant stakeholders should look into licensing market makers to provide liquidity (trading volume in the secondary market). Naturally, such a reform would entail changing the legal and regulatory framework surrounding the capital market. Indeed, this is what has recently happened in the Dubai, Abu Dhabi, and in the Saudi capital markets.

3. The absence of secondary market trading in the issued government securities is rather disappointing. The government should apply the same principle to its issued bills and bonds (allow trading in treasury bills and bonds on the secondary market / with market makers), so that all investors observe the "Yield Curve".

4. Before embarking on such a move, however, the government must have enough "fiscal space". Naturally, any government can create fiscal space by raising revenues, securing outside grants, cutting lower priority expenditure, and borrowing. However, it must do this without compromising macroeconomic stability and fiscal sustainability. If the government succeeds, and by time, public finance would become a lot more "fiscally disciplined". After all, the financial securities, issued by the government, are being traded on the secondary market. In addition, developing the government bonds market would also develop the corporate bond market as well.

5. It is interesting to note that in "2015 Joint IFI Needs Assessment on Local Capital Market Development / Egypt - Jordan - Morocco - Tunisia" the European Bank for Reconstruction and Development and the Arab Monetary Fund called for developing corporate and government bonds market. Similarly, in their "Capital Market Development Strategy and Roadmap for Jordan" the European Bank for Reconstruction and Development together with the Jordan Securities Commission, called for the introduction of market makers. They even called for the introduction of short selling.

6. If the ASE succeeds in introducing market makers, and the government succeeds in allowing its issued securities to be traded on the secondary market, banks themselves would also benefit. Their stock prices, as well as other listed companies' prices, would be more accurately priced. In addition, banks can also establish new lines of services

such as investment funds / mutual funds, risk management (options, forwards, and futures), securitization, and even licensed market makers. This is the only way to make the ASE and licensed bank real partners in the process of growth and development of Jordan.

7. Finally, it is probably accurate to state that COVID-19 has forced banks into dramatic, technology-focused changes. Indeed, customer-facing digital channels and remote working platforms are enhanced or introduced. This is why, banks in Jordan should continue to adopt digital modernization and transformation, at pace and scale. However, banks should also stay on top of the resultant risks. This is why, "risk management functions need to be involved as early as possible in the development of new products and services. Risk teams need to evolve and upskill to meet banks' shifting needs, with an emphasis on increasing agility".

6. Appendix

A. The ASE's Trading Mechanism

This initiative rests on the poor performance of the ASE. The ASE suffers from one major disadvantage, and is lack of Immediacy. This problem can be highlighted using only four simple scenarios:

First Scenario: Someone could come into the market to buy 1000 shares at JD10.0 each. What happens if no counter sell order is forthcoming (Table A)?

TABLE A: ORDER-DRIVEN MARKET			
Buy Orders		Sell Orders	
Shares	Price	Shares	Price
1000	JD 10.0		

Second Scenario: Someone could come into the market to sell 1000 shares at JD10.0 each. What happens if no counter buy order is forthcoming (Table B)?

TABLE B: ORDER-DRIVEN MARKET			
Buy Orders		Sell Orders	
Shares	Price	Shares	Price
		1000	JD10.0

Third Scenario: Someone could come into the market to sell 1000 shares at JD10.0 each. What happens if the existing counter buy order is at JD9.6 (Table C)?

TABLE C: ORDER-DRIVEN MARKET			
Buy Orders		Sell Orders	
Shares	Price	Shares	Price
1000	JD9.6	1000	JD10.0

Fourth Scenario: A "desperate" investor, for liquidity purposes, comes in the market to sell 1,000 shares at JD 10.0 each. The absence of a counter buy order makes him / her reduce the selling price to JD 9.8, to JD 9.6, and to even JD 9.2. At this price, a counter buy arrives.

TABLE D: ORDER-DRIVEN MARKET

Buy Orders		Sell Orders	
Shares	**Price**	**Shares**	**Price**
1000	JD9.2	1000	JD10.0
		1000	JD9.8
		1000	JD9.6
		1000	JD9.2

Relative to the fourth scenario, one can ask what is the reason behind the fall in the price from JD 10.0 to JD 9.2? In addition, one can ask can the stockbroker buy these shares (conflict of interest)? Finally, one can also ask, if the same "desperate" investor wanted to buy, would his / her price increases reflect the same proportion (i.e. from JD 10.0 to JD 10.80?). In other words, are increases and decreases symmetrical in magnitude?

To summarize, investors cannot get their orders executed at any moment they choose, regardless of what the price is. The ASE suffers from lack of liquidity. Liquidity is the ability to trade "immediately", and at the "right prices", (difference between available buy and sell prices is minimal).

Stakeholders should look into licensing "market makers" to provide liquidity. These private sector companies, once licensed, are "obliged by law" to provide liquidity by continuously quoting their bid (buy) and ask (sell) prices. Any investor who wants to buy (sell), can buy (sell) at the quoted ask (bid) of the market maker. This is the only way to provide liquidity, and result in a lot more, trading volume. Price increases and decreases would become more symmetrical in magnitude, and encourage, over time, price increases.

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