Preliminary Study Reflecting The Views And Perceptions On The Regulatory Framework On The Microfinance Sector

Contents

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The Introduction

In the microfinance literature, the concept of "microfinance" refers to providing formal financial services (By entities with governmental mandated) to the poor and low-income (Concerning credit in particular, to those without a fixed income), and others systematically excluded from the financial system, thus, "microfinance" is not limited to a particular credit product, but also covers all the needs of the poor and low-income, whether for business requirements, consumption, social obligations for financing, dealing with emergencies, as well as for savings, funds remittances, and insurance.

This concept was developed to be financially inclusive, meaning that all adults of working-age are allowed credit, savings, fund remittances, and insurance services from formal providers; this procedure includes poor, limit-income, and low-income individuals, as well as micro-businesses and small and medium businesses.

More than two decades after the start of microfinance activities in Jordan in (1997) under the supervision of the Cooperative Charities laws, Jordan Women's Development Corporation (Named later in 2000 Microfund for women), which aims to provide lending services to women using the group loan methodology (Created by Muhammad Yunus and used by the Bank of the Poor in Bangladesh), later, in (1999), a new era began in the microfinance industry, through the establishment of three new institutions operating under the supervision of the Ministry of Industry and Trade (Includes profit and non-profit institutions, local institutions, and foreign institutions).

In (2014), the number of operating institutions became eight institutions, all operating under the supervision and control of the Ministry of Industry and Trade supervision and control. These institutions provided their services to more than (450) thousand clients through more than (200) branches throughout the Kingdom. The vast majority of clients are women, and all these institutions are exempted from sales tax and income taxes, according to the governmental instructions and decisions, till the end of (2014).

At the beginning of the last decade, there were plenty of discussions among microfinance institutions (MFIs) practitioners about whether the industry should be regulated? If this action would bring any added value or advantages to the sector? What is the best regulatory framework to be applied in the event of regulating the Microfinance sector?. Some favored such a scenario, along the lines of international best practices, aiming to diversify the financial services provided by reaching savings mobilization through deposit-taking institutions, expanding their businesses, and becoming public shareholding companies that individuals with limited income can be shareholders/owners. In contrast, some others believed that this option would be costly and force the institutions to reconsider their services.

Such discussions are one of the fundamental matters that shall be taken into account before regulating any financial sector, balancing between costs and benefits so that the cost of complying with regulations should not be higher than the benefits encountered for the stakeholders.

During a panel discussion in (2011), through the conference of the "Arab Microfinance Network - Sanabel", under the title "Regulating the Microfinance Industry", which was moderated by representatives of the Consultative Group to Assist the Poor (CGAP), the Governor of the Central Bank of Jordan opened the session by saying: "What am I doing here? My attendance at a conference for the microfinance industry cannot be justified and explained. There is no room for comparison with the Banking sector as the portfolio of the microfinance sector represents only (2%) out of the market; the

Governor's statement reflects the vision of the potential regulator at that time.

However, in (2014) a new phase was announced entitled "Regulating the Industry under the Supervision of the Central Bank of Jordan" by issuing microfinance bylaws followed by instructions for licensing MFIs, according to which all institutions in the sector (local and foreign, profit and non-profit) operating under the supervision and control of the Central Bank of Jordan, at the time, there was a range of positive and negative expectations, in terms of the nature of this supervision and its related impact on the operation of the microfinance industry, (18) years old thoughts and expectations, for example, legal regulations were expected to protect the industry from the unfair competition with the informal unethical lending practices as well as to regulate the market entry and eliminate unlicensed businesses, furthermore to provide and secure flexible sources of funding (lower cost and longer-term) through direct financing from the central bank to support the efforts of this industry in developing micro, small and medium enterprises (MSMEs) and increasing financial inclusion in Jordan.

The ultimate objectives of the Central Bank of Jordan by regulating the Microfinance industry to protect the clients and make sure that the practices are aligned with the international standards to achieve disciplined financial inclusion, and protecting the stability of the financial system, strengthening institutional governance, and internal controls to enhance the financial position of the financial institutions within the Jordanian economy. This involvement will increase the confidence level of the investors, financiers, and donors towards the microfinance sector and its practices.

Although, The Central Bank of Jordan believes that it is still too early to estimate the impact of the regulation at this stage. As eventually, by the time they will achieve fairness between institutions, reduce the risks of regulatory arbitrage and exploit loopholes in-laws, in addition to preventing the practices of lending that set outside the formal sector, maximize the value for the formal financial industry, and enhance the competitiveness and the confidence of clients.

It is logical and expected that regulating MFIs will increase the client base, especially if they offer savings. Also, the regulations may affect the operational and financial performance of the institutions (the depth of outreach measured by the percentage of poor clients, the average value of the provided loans, and the percentage of women out of the total loans disbursed, profitability...etc.). However, based on the experiences of countries that preceded Jordan, it showed a difference in the performance results of many institutions, as some institutions showed less appetite towards the poorest clients and women segments versus the most wealthy clients to mitigate risks, reduce defaults, increase profits and reduce operational costs.

The study aims to shed light on the microfinance sector employees' perceptions about the legislative framework issued by the Central Bank of Jordan, in addition to the other tax laws and legislations applicable to the sector to clarify the implications of these legislations on the performance of the Microfinance Institutions (MFIs). Also, illustrating the potential cost-benefits associated as a result of the regulation and the extent to which these legislations are compatible with the strategies adopted by the Jordanian Government, especially the strategy of financial inclusion, to come up with recommendations that help those in charge of this industry, the government and the regulators to ensure the progress of the Microfinance Institutions (MFIs) serving the financially marginalized groups and small enterprises.

Conclusions and Recommendations

This study demonstrates the burden of administrative, financial, and operational expenditures on the MFIs due to the cost and impact of taxes and fees (General sales tax, Income tax, Stamp duties, and other types of taxes) compared to neighboring countries and the international best practices. Furthermore, the income tax department does not accept bad debt provisions (that led to increase effective income tax to 45%), and the direct adverse effects on the outreach and inclusion indicators were also evident, as the average outstanding loan balance rose, the average value of loans disbursed increased, and the percentage of females in active loans also decreased.

It should also be noted that at the time of preparing this study, Jordan was going through exceptional economic and epidemiological conditions that undoubtedly had a negative impact on all economic and commercial activities and forced the institutions operating in the sector to exceptionally change their risk management practices, in recent years, the microfinance sector has witnessed slow growth, unlike previous years, due to declining levels of economic growth, in addition to subjecting microfinance institutions to regulation and control, although the legislative and regulatory framework for the microfinance industry has been enacted recently (June 2018) and some of this legislation has not yet come into force, it may be premature to consider the full implications of the legislation, laws, and regulations for several reasons, including that the legislations have just been issued during the past five years, some of which have not yet entered into force, the difficult economic conditions that Jordan has witnessed, and the impact of the COVID-19 pandemic and its repercussions clearly on all commercial and economic sectors, not only in Jordan but worldwide, however, according to the results of the study and the views of the sector's executive departments, which confirmed that the direct repercussions on the performance of microfinance institutions came through increased burdens, which was reflected in the operational performance, as these legislations contributed to accelerating the pace of the development of the technological infrastructure of microfinance institutions, which required re-engineering their internal operations, reconsidering the business model, and developing the services provided by relying on technological development and focusing on serving productive projects, it should be noted here that the microfinance institutions employees have expressed their concerns about the expected additional legislation, including the new implementation law and the Financial Institutions Regulations.

These indicators confirm the industry literature and the experiences of countries and institutions that preceded Jordan by licensing the financial activities (Microfinance), which showed the direct link for additional burdens that force the institutions to increase the average value of loans disbursed (Depth of Outreach) and avoid more poor clients, females, and micro-enterprises in an effort to maintain and improve sustainability to ensure the permanence of the business, as a clear example of the lack of consistency in the ability of institutions to achieve financial inclusion and outreach, or focus on sustainability, financial strength, and regulation[1], whereas several studies have concluded the need to emphasize legislative and regulatory authorities to balance costs and benefits when regulating the microfinance sector and the need to increase the range of permissible services for MFI's such as savings, insurance, and money transfer, in addition granting the sector a set of incentives (Preferential Taxes and subsidized financing by certain conditions), incentivizing commercial banks to lend to the MFIs on preferential terms shall make microfinance sector profitable, helps institutions cover part of the compliance costs, and makes the sector more attractive to investors, in order to achieve the desired development and economic objectives, this represents the challenge facing microfinance regulators in how to balance access to financial services, contribute to achieving levels of financial inclusion, maintain the integrity of the financial sector, and protect the consumers, this complex balancing process requires a continuous analysis of benefits and costs by all financial regulators such as the Ministry of Industry and Trade, the Ministry of Finance, the Income and Sales Tax Department, and relevant consumer protection bodies, therefore, unless there is solid communication and coordination between these regulators, the Microfinance sector will face great challenges to be able to reach new clients or expand the range of services provided.

[1] Microfinance Tradeoffs Regulation, Competition, and Financing, policy research working paper 5086, World Bank ,2009

In Jordan, since the microfinance industry preceded the regulatory framework and its related instructions by at least (15) years (the first microfinance institution started its activities in Jordan in 1996, followed by the establishment of 3 institutions in 1999), it was appropriate for better regulatory environment if the legislations took into consideration the difference in the legal forms of the operating institutions, for-profit or non-profit institutions, in terms of the number of shareholders, or the nature of the services and activities, and the volume of lending, where the directors of the microfinance institutions confirmed that what the legislation came with is not in line with the principles of the industry to stimulate outreach, and they also stressed the need to take into account that the MFIs in their current state are institutions owned by individuals who do not exceed their number in most institutions (3) owners (Private shareholding or Limited liability), not public shareholding, in addition to the fact that the sources of financing are limited to commercial borrowing locally and from abroad, and not from depositors money.

An example of that is what was stated in the corporate governance instructions[2] related to the number of annual board meetings, which are similar to those imposed on Banks, and in some occasions are more conservative, despite the differences between the nature of registration "Public Shareholding Companies" and the services provided "Integrated Bank Services, including accepting deposits", the same applies to consumer protection instructions that did not allow visiting customers or guarantors at their workplace and collect field information except through officially licensed sources[3], as complying with these instructions will force the institutions to reconsider their products, the process of disbursing loans, the target groups and the criteria of selecting clients and limiting the selection criteria to only those who have the ability to re-pay, to improve the quality of the portfolio and reduce the need for follow-up process and procedures for defaulting and late clients, the internal control instructions also came with additional requirements that obligate institutions to add new executive departments such as risk, compliance, and information security, which will increase administrative expenses and the numbers of administrative staff, which will lead to an increase in the complexity of the internal operational management, and the administrative burdens in a way that is not equivalent to the volume of the services and its nature as mentioned earlier, where the instructions did not take into consideration the nature of the financial services provided, nor the nature of the sources of funds used in these institutions, which do not require excessive supervision as long as there are no public funds, whether with capital (shareholders) or within the lending portfolio (depositors' money).

While the officials of the Supervision and Control department at the Central Bank of Jordan emphasized that regulation is usually associated with financial and administrative costs in the short term and will affect the business model of the MFIs (common practices in the MF industry that have been accustomed since many years), nevertheless, the Central Bank of Jordan yet believe that; the future benefits that the sector will gain gradually will be ion the favour of the institutions and will include expanding the range of products and services in which will enhance and strength the financial position of the MFI's and its ability to attract investors and to be enabled to achieve the desired objectives in the medium and long term, they also emphasized that the Central Bank of Jordan follows best practices by reviewing international experience and following the participatory approach in preparing instructions and gradual adoption and application in a manner that takes into account existing institutions and the interests of clients and the balance between benefit and cost, meanwhile, the Central Bank of Jordan indicated that it is in the process of expanding the scope of services for the MFIs and starting to enact instructions that would keep pace with technological developments and allow institutions to use modern technological means in their internal transactions and procedures.

The Central Bank of Jordan considers regulation is not the only step to enhance the robustness and security of the financial system, clients and investors' confidence, and increase competitiveness as they will gradually increase the microfinance institutions products and services that are allowed to offer their clients. The regulations and instructions were developed

[2] Institutional Governance Instructions for Microfinance Institutions No. 10/2020, which enters into force on 6/12/2021, Article 5 / b (the number of meetings shall not be less than six during the year and that no two months elapse without holding a meeting).
[3] Financial Consumer Protection Instructions for the Microfinance Sector that entered into force in 2018, Article 6/b and Article 9/e

and prepared based on international trends and best practices. Additionally, amending the financial institutions' bylaws will reduce competition from the unlicensed financial sector and increase competitiveness.

Among the incentives provided by the Central Bank of Jordan to support and enhance the strength of the microfinance sector, allowing the institutions to apply for direct financing from the Central Bank of Jordan without interest/returns and on flexible terms with a condition to use the funds for MSMEs clients and to reflect pricing on the institutions ' pricing of their products offered to clients, in addition to cooperating with the Jordan Loan Guarantee Corporation (JLGC) by launching a new program aimed to provide (85%) loan guarantee loans for all funds granted by microfinance institutions MSMEs. The Central Bank of Jordan supportive role for the microfinance sector during the previous period, is evident in many vital stations of the industry, including the direct positive impact as a result of organizing the industry, which gave financiers and donors confidence towards institutions and facilitated the access of MFIs to external and internal financing (loans) within more flexible contractual conditions, moreover, the support that is provided by defending the reality of the practices of the MFIs and clarifying the objectives of the social development and the nature of the applied practices, whether through government meetings or media platforms in response to the issue of "AL -Gharimat" that raised during the last period, in addition to the continuous efforts of the Central Bank of Jordan to implement awareness programs specialized in developing the capabilities of the clients and employees of the microfinance sector to enhance financial culture and expand the bases of disciplined financial inclusion.

Furthermore, by analyzing the microfinance sector performance in Jordan, it was clear to confirm results from other studies and international experiences. In terms of outreach(average loans disbursed, average value of outstanding loans, and the proportion of women in funds granted) and profitability; the average loans disbursed and loans outstanding increased, the percentage of women decreased, while profitability and sustainability increased.

By reviewing the performance of institutions for the period after MFIs were subject to taxes and other government levies and complying with regulations and instructions, it was primarily affected by most indicators used to measure the breadth and depth of the outreach. The analysis showed an increase in the average outstanding loan balance from (452) JD in (2012) to (559) JD in (2019), an increase of nearly (24%), records of five institutions showed a rise ranging from (25%) to (92%) while an increase of (13%) for one institution, three institutions showed a decrease ranges between (11%) and (40%). The loans disbursed average size increased by (68%) in years (2021) and (2012), the number of loans less than (1000) JOD decreased. Additionally, the female beneficiaries percentage decreased by (17%) compared to (2012 and 2021) (82% versus 68%, respectively)[4].

Although compliance with laws and regulations comes with an additional cost, as the annual costs increased by (5-8%), and the cost of income tax, sales tax, and stamps fees by (45%) of the net income, however, by reviewing the results of the financial performance of the MFI's (Five institutions operating in the sector) showed that the consequences were positive, as the percentage of financial sustainability was not affected. On the contrary, it maintained the same level during the past eight years with a sustainability rate (124%) and decreased the operating expense ratio.

Accordingly, the study came out with recommendations that we believe will help the industry stakeholders concerned with the sustainability of this vital sector to start working on removing obstacles and smoothing the challenges faced so far during the initial period toward compliance. This intervention will have a significant role in enhancing the ability of the institutions to continue serving financially marginalized clients from financial services to achieve the development, economic and financial inclusion objectives, as stated below:

- Due to the existence of different legal forms, nature of registration, services provided, and ownership structure (even before issuing the regulatory framework), regulators should take into account all various legal forms (for-

[4] At the time of preparing this study, Jordan had gone through exceptional economic and epidemiological conditions that undoubtedly negatively affected all economic and commercial activities and forced the institutions operating in the sector to change their practices to exceptionally manage their risks.

profit and non-profit), nature of registration, the number of shareholders (one or more shareholders), and to consider the nature of provided financial services (accepting deposits or not) before issuing the instructions and its related regulations.

- Unifying the legal and regulatory reference to mediate and coordinate with the other Government authorities to facilitate the communication, such as the Ministry of Industry and Trade, the Ministry of Finance, the Income and Tax Department, and other government authorities whose laws intersect with the activities of the MFIs, this will contribute to eliminating the legislative, regulatory, and procedural obstacles and challenges facing the sector.
- The regulators and government should take legal measures controlling the unlicensed informal lending practices and retailers from engaging in lending activities and individual finance (according to bylaws, these activities are not allowed except for the MFI's already licensed by the Central Bank of Jordan), as it must be regulated or prevented.
- The need to expedite the process of fairness and equality legislative terms of tax treatment in the financial sector (banks and MFIs) allows accepting bad debt provisions and exempting MFIs from the general sales tax.
- Increase the range of services and products to allow MFIs to provide new services and products; savings mobilization, operating electronic wallets, micro-insurance, and revolving credit in addition to providing training and marketing services for both clients and non-clients, which will help to increase outreach and number of clients and thus increase financial inclusion. Accordingly, it would directly impact income and diversify its sources to reduce lending costs and lower interest rates/returns. As well as allowing licensed operating MFI's (according to the proposed new finance companies bylaws) to obtain a micro-leasing license.
- The legislation and instructions issued by the Central Bank of Jordan stipulated the pre-approval condition "obtaining prior approval," especially for procedures related to branching and developing access channels to clients and others. However, to ensure that institutions are motivated to improve the services provided and to increase the outreach, the CBJ should consider the following :

    - Assigning a clear time frame for specific procedures requires pre-approval from the Central Bank of Jordan, including contractual commitments and obligations, relocating branches, hiring new employees, approving a new product, and others, which will help the institutions to have better planning, more efficient costing, and thus better service delivery. Excluding promotion offices(mainly used by the MFIs to promote their services and receive loans applications) from the procedures applied to open or close a branch (License and Presence Instructions Article 20/c).
    - By relying on the widespread use of modern technology by the target groups, and the adoption of modern technological means to inform and communicate with clients in the event of an opening, closing, and transferring the locations of branches presence.
    - Clarify the procedures to be followed in the case of mobile branches to encourage institutions to serve remote areas and increase the outreach.

- Despite the importance of the compliance for MFIs to protect institutions from money laundering and terrorist financing and its adverse effect on existence and continuity, regulators must work out and cooperate with the MFIs to achieve a delicate balance between instructions, sustainability of the institutions and clients. There was an apparent contradiction between the institutions' ability to abide by these instructions and their ability to serve the target segments of the poor, low-income, and financially marginalized.
- Although governments are rushing to implement and encourage the use of technology and the outreach of financial technology services, however, the instructions and regulations emphasized the need for institutions to follow traditional and documented methods of correspondence in their internal operations, therefore, it is necessary to consider technological developments, especially in the financial industry, to draw up instructions for the adoption and acceptance of electronic documents and technological channels for communication, as well as electronic signatures on documents, especially those related to inquiries and the provision of Credit bureau "CRIF"

and funding requests, in addition to setting instructions and taking into account modern technological means of communication, such as the requirement for personal attendance at the meetings of the Boards of Directors and sub-committees (The personal attendance is not less than two-thirds of the members- According to the amending law of the Companies Law of 2021 Law No. 19).

- With the pioneering role of the Jordanian Microfinance Network (Tanmeyah) in supporting Microfinance industry activities, implementing awareness programs, participating in providing an appropriate regulatory environment, and providing reference data for the sector in Jordan, It has become essential to strengthen and activate the position of (Tanmeyah) as an official network of the Jordanian MF industry and provide it a legislative cover to ensure its official representation of the sector in front of the stakeholders.
- Throughout the compliance journey to the instructions and regulations, MFIs practices have mainly been affected by procedures and unfamiliar details. Accordingly led to an increase in the operational costs; therefore, the institutions had to re-engineer their internal processes to comply with the new standards to ensure the quality service delivery, efficiency, effectiveness, and achievement of corporate objectives. This need is also clear, especially when targeting individual financing (retail finance), as the competition increases from banks, the informal sector, retailers, and others, that will also force MFIs to develop their business model and re-assess markets by focusing on small and micro productive projects (MSMEs) only.
- Review the instructions related to combating money laundering and financial consumer protection, especially those that affect the criteria for selecting clients and eligibility conditions for obtaining loans, to ensure that institutions continue to provide financial services to financially marginalized segments and increase the number of those covered financially.
- Due to the specificity of the MF sector and the different nature of the activities, services, and target markets from those of commercial banks which its activities are subject to the supervision and regulation of the Central Bank of Jordan, it is necessary and periodically to hold interactive sessions under the supervision of the Central Bank of Jordan, with the participation of various government authorities. With institutions operating in the sector, to present and clarify instructions and legislation related to the MF sector to enrich experiences and knowledge of the authorities related to the sector, in addition to exchange the experiences of the best practices, this will contribute to creating a balance between benefit and cost, taking into account the nature and specificity of the MFIs activities and the financially marginalized target segments.
- Adopting an incentive scheme in which the CBJ encourages institutions to comply with the instructions, committed and complied institutions enabled to obtain preferential treatment, preferential interest rates/returns, tax deductions, or allowing these institutions to expand their services by adding new services. The Central Bank of Jordan should also stimulate commercial banks to finance MFIs at preferential rates. It's worth mentioning that CBJ recently launched the financing platform as a stimulus methodology within the announced criteria that considers transparency and fairness for all institutions.

The Future Vision

The expected market for the MF industry has not been accurately estimated due to the lack of accurate researches. However, based on a recent study conducted by the International Finance Corporation (IFC) highlighted the potential market volume of between (700 thousand) and (one million) potential clients, with an expected market volume of (450-700 million) Jordanian JOD. Accordingly, it constitutes a financing gap between (185-440 million) JOD during the next five years[5]. Based on this estimate, it is necessary to combine the efforts of all concerns from regulators, government agencies and MFIs, to meet the market needs and increase the financial inclusion of marginalized segments to achieve sustainable economic development objectives.

[5] MICROFINANCE IN JORDAN Developments, Challenges and Future Prospects, IFC, 2021

However, the regulatory and legal developments that the microfinance industry has faced over the past few years have mainly affected the performance of the microfinance industry, particularly concerning outreach and target segments:

- The competition that the MFIs are facing from the unregulated informal financial sector and commercial banks
- The financial and administrative burdens and costs of complying with microfinance regulations and related instructions urge institutions to modify their procedures, policies, and practices.
- The Corona pandemic consequences affect portfolio quality and collection.
- Defense Law implementation and the postponement of installments impacted clients and affected broad sectors.
- The case of "AL -Gharimat" (women who cannot pay their debts) affected MFIs practices and the commitment of the target groups to credit culture.

The Central Bank of Jordan has also recently shared with the microfinance sector the new bylaws of the Financial Institutions for 2020 , the proposed financial institutions by laws are all companies that engage in financing activities, with the exception of banks and payment companies, electronic transfer companies and cooperative societies, the proposed system will regulate the activities of finance companies and all lending practices in the Kingdom to prevent any financing activity for individuals, business or MSMEs unless they are licensed under the new bylaws, thus, to help mitigate the effects of unfair competition from the informal financial sector, it is also worth noting that the proposed bylaws and within the legal form (Article 4) allowed companies involved in the financial services to be either a Public shareholding , Private shareholding or a branch of a foreign company, the proposed bylaws also sets the minimum capital for MFIs at (2 million) JD, specialized finance companies (without real estate financing and/or financial leasing activities) at (5 million) JD, and specialized financing companies that provide real estate financing and financial leasing at an amount of (7 million) JD, while for companies re-mortgaging real estate at (15 million) JD.

The proposed amendments to the finance companies' bylaws will indirectly affect small MFIs, granting a competitive advantage for financial institutions with large capital and a solid financial base to perform all related financial activities. This will have implications for attracting investors in existing MFIs, reducing fair competition, and allowing the banks and well-established financial institutions not necessarily have a social mission to dominate the market. In addition to the microfinance sector's competition with the commercial banks, which have recently begun targeting small business owners with loans ranging between (10-20) thousand JD, the same category is targeted by the MFIs.

Furthermore, the Central Bank of Jordan reviewing new instructions define ceilings for commissions and fees amount charged to clients (such as those for commercial banks) for services such as application fees, Certificate of Commitment, Fees, deferral fees, Penalties, Re-Scheduling, and other commissions, to unify the costs and protect clients from the exaggeration of some institutions in imposing fees and penalties. Likewise, new instructions related to electronic transactions, Know Your Customers (KYC), adoption of electronic signatures for MFIs are in the process. CBJ confirmed that the Studies Department is currently conducting analytical research on the nature of consumer lending activities that MFI's were allowed to carry out in their operation and researching the development of a group of performance indicators related to global social performance standards for MFIs.

Regarding the legal amendments that will negatively affect the microfinance sector mainly, as what is meant hereby, is the proposed amendment to the execution law[6], the modification of which is consistent with international norms and the human rights organization, where the most prominent provision of the proposed amendment is to prevent the imprisonment of the insolvent debtor and/or if the amount of the executed or adjudged debt is less than (5000) JOD, in spite of that the financing institutions rarely resort to the implementation of the imprisonment decision against defaulted clients, which was used as a mean of social pressure in case the client is <u>not willing</u> to pay (Not the client is <u>unable to pay</u>), and since this amendment has a direct impact on the type of collateral that the MFIs will need to manage credit risk in the

[6] The proposed implementation law according to the statements of the Minister of Justice on (14/7/2021) (https://petra.gov.jo/Include/InnerPage.jsp?ID=62343&lang=ar&name=local_news)

absence of an alternative system for imprisonment of a distressed/defaulted debtor, which takes into account the social pressure, which will put the MFI's in front of the following options, either increasing in-kind or cash guarantees (it is known that the target segment of limited-income, owners of small business and the poor do not own it), or stop providing financial services to the poor and financially marginalized segments, and thus will affect the terms of customer choice and limit achieving expanding outreach and financial inclusion and deprives large segments of individuals of their right to have access to the financial services, in contrast to the situation of the past two decades.

All the changes in the sector during the last few years and the expected changes will inevitably affect the industry's activities, services, products, and target segments. This is due to anticipated competition and compliance with relevant regulations and instructions, requiring institutions to reassess the target market's needs, re-design their operations, incorporate costs, and re-evaluate their position in the market and target segments.

Based on the outcomes of the study and its findings, challenges facing the microfinance industry due to complying with legislation and regulations, thus, it is necessary to unite the efforts of all parties involved in the microfinance industry, whether they are donors, sector supporters, regulators, government authorities or financial institutions to overcome obstacles and challenges to ensure the industry continuity and sustainability, this stems from the belief in its essential role in sustainable economic development, driving economic growth and increasing financial inclusion.

Unifying the efforts of the concerned parties is essential to achieve the objectives listed below:

- Treat the microfinance industry differently than the commercial banking industry, MFIs are different in terms of the legal structure, services, products offered, and sources of capital and funds used, the legislation and regulations (Regulations of Governance, money laundering and terrorism, licensing and presence, and control and monitoring systems) should take into account the difference between financial institutions.
- Amend the regulations, instructions, and laws that negatively affected the microfinance industry, especially those related to approving financial allowances for income tax, sales tax, and stamps duties.
- Contribute to the efforts to change the perception of government authorities, the Central Bank of Jordan, and other legislative entities (Parliament), regarding the MF practices that consider global social performance standards and responsible finance.
- Enhance the spreading of financial culture among the current beneficiaries and target segments within a unified program to distinguish between the practices of the formal and licensed MFIs that operate under the supervision and control of the Central Bank of Jordan, compared to the practices of the informal and unlicensed institutions and practices.
- Conduct survey studies to estimate the volume of the demand for micro and small finance and study the needs and desires of the target segments to increase the services and products or modify the products currently offered in line with legislative and competitive changes and technological developments.
- Direct the public opinion, international donor institutions, and beneficiary clients towards the microfinance industry to protect the industry and ensure its sustainability by preserving the microfinance market from unlicensed and informal activities that harm the sector.

Consequently, in the table below, suggestions and proposals can help the microfinance sector achieve the desired objectives by strengthening the competitive and legislative environment towards the sector's sustainability, attracting investors, and increasing financial consumer confidence.

The Objective	Procedures & Activities	Concerned Authorities
Modifying microfinance regulations and instructions that consider the services and products offered, the legal structure, and the sources of capital.	- **<u>Sharing the summary of the study outcome</u>**s with relevant entities such as funders and international donors to clarify the implications for the industry and beneficiary clients. - **<u>Conducting a discussion session</u>** with the Governor of the Central Bank and the Microfinance Unit to discuss the impact of regulation and bylaws on the formal microfinance activities. - **<u>Drafting a proposal</u>** clarifying the instructions required to be amended, drafting the amendment proposal, and sharing it with the concerned entities.	Central Bank Ministry of Finance Income and Sales Tax Dept. Donors and Supporters
Amending the tax legislation related to the inclusion of MFIs under the supervision of the Banks and Financial Institutions Law will exempt the industry from sales tax, and the financial allowances are approved to calculate taxable income in the case of profit institutions (Equal to banking financial institutions)	- **<u>Conducting discussion sessions</u>** aimed at clarifying the impact of taxes, fees, and stamps duties, in addition to the non-acceptance of financial allowances on the microfinance industry and the sector investors. - **<u>Drafting amendment proposal</u>** and sharing it with the concerned entities.	Central Bank Ministry of Finance Income and Sales Tax Dept. Legislatures and Parliament
Demonstrate the impact of unlicensed and informal financial sector practices on the formal microfinance industry.	- **<u>Clarify the impact</u>** of the informal and unlicensed financial sector, particularly concerning over-indebtedness and responsible financing. - **<u>Publish results</u>** of the previous Tanmeyah study about the informal financial sector. - **Conduct an awareness campaign** about the differences between the formal and the informal industry in terms of pricing, responsible financing, and the social dimension. - **<u>Guiding the concerned authorities towards providing protection for the formal industry</u>** from the irresponsible and unprofessional financial practices that occurred by the informal and unlicensed financial sector.	Central Bank. Ministry of Industry and Trade. Parliament. Social & Economic Council. Media
Awareness of the importance of the microfinance industry and its developmental role in serving the financially marginalized	- **<u>Implementation of a media campaign.</u>** Addressing the sector's role in sustainable economic development and providing financial services to the financially unserved segments. - **<u>Clarifying the impact</u>** of the informal and unlicensed financial sector and disseminating the results of the previous "Tanmeyah" study of the informal financial sector. - **<u>Preparing a report on the measures</u>** implemented by MFIs in light of the Corona pandemic in terms of the affected sectors. - Publish and edit small business success stories	Social & Economic Council. Media

The Objective	Procedures & Activities	Concerned Authorities
Sector and MFIs development	- **<u>Direct donors and supporters</u>** to provide funding and funds to support the efforts of operating institutions to cover costs related to compliance with laws and regulations. - **<u>Guiding the Central Bank of Jordan to adopt a motivational methodology</u>** to enhance the efforts of financial institutions to comply with the instructions and regulations, especially the institutions that were operating before the issuance of the regulations and instructions. - **<u>Guiding MFIs</u>** to re-assess the needs of the target segments and small and micro institutions. - **<u>Directing institutions to adopt financial technology</u>** in all their operations activities to keep pace with technological development	MSME Finance Institutions, International donors (GIZ, IFC, EU, KFW……), and The Ministry of Planning and International Cooperation.
Enhancing the Role of the Jordanian Microfinance Network (Tanmeyah)	- **<u>Directing donors and supporters to provide the necessary support</u>** to strengthen the role of (Tanmeyah) in being the official representative of the non-bank financial institutions sector (micro and small finance, individual finance, and microfinance leasing).	International donors (GIZ, IFC, EU, KFW……) Central Bank

<u>The Reality of the Microfinance Industry in Jordan.</u>

Among the past three decades, the MFIs in Jordan has played an important role in promoting the growth of small and micro enterprises, financial inclusion, and promoting sustainable development, as well as improving the quality of life for financially excluded clients by providing financial services to the productive poor, low-income and entrepreneurs. The industry-focused on reaching out to all financially excluded segments of society, including women, youth, and business owners across the Kingdom, the microfinance industry in Jordan started in the mid-1990s. It lasted for (20) years as private companies under the rules of the Companies Law (Ministry of Industry and Trade), all of which provide credit services only.

A report published by " Tanmeyah "[7] (the Microfinance Network) stated that the sector was able, over the past (10) years, to provide financial services to more than (2) million clients, with amounts exceeding (1.5) Billion Dinar, the number of current loan clients (according to the statistics of the fourth quarter of the year (2020)) is about (441) thousand borrowers with a loan portfolio that exceeded (252) million JOD. The number of employees in the microfinance sector (3000), through (202) branches outreach across all governorates of the Kingdom, in the formal microfinance sector (10) institutions are operating, of which only (6) are for-profit institutions (two of which are relatively new and not yet profitable), in addition to the United Nations Lending Program Relief and Works Agency for Palestine Refugees in the Near East (UNRWA).

The Jordanian microfinance industry, since its inception, came in line with the best practices that are globally endorsed, the industry that began in (1976) with dual objective; financial sustainability and social impact dimensions, which explains all the current practices of the sector targeting financially excluded clients by official financial services.

In 1976 the microfinance industry started to provide financial services to those financially marginalized segments (who do not meet the requirements of formal financial institutions) with no collateral. However, only with personal guarantees and using a group guarantee through group lending (group solidarity), later, the group lending methodology evolved and transformed to direct individual financial services using a social guarantee. Reliance on personal and/or social guarantee, in addition to group guarantee, is one of the most important reasons for the widespread that microfinance has achieved

[7] Microfinance Institutions Network - " Tanmeyah ", Report about the Tax Burdens of the Microfinance Sector (2021).

in various countries of the world over the past (45) years, which is considered as the most important global financial achievements that granted small clients, financially marginalized clients and micro-producers the right to obtain financial services like other members of the society ,also, one of the most important features that distinguishes the microfinance industry locally and globally is the time efficiency of the service delivery, which made it satisfactory to the target segments compared to the procedures required by official financial institutions, in addition to the speed of response, keeping the client as the focus of attention; in terms of developing products and services that meet the client's needs, and in terms of achieving wide outreach access to the services provided to all geographical locations that are not covered by any financial services provider.

Globally the microfinance sector has developed in recent years. In many countries, it also provides commercial banking services, such as microfinance institutions in Latin America, India, Cambodia, and other countries; with regards to the Arab world, the legislation and laws in Yemen and Syria have allowed deposits taking, while Yemen has gone further to develop the microfinance sector by including more services such as remittance.[8]

In 2014 Jordan issued a new bylaw which has subjected the MFIs to the supervision of the Central Bank of Jordan to enhance and strengthen the financial position of the MFI's, comply with best practices, align with international financial standards, and ensure that clients are treated with respect and dignity within clear and transparent procedures that are in line with the best practices and the experience of the neighboring countries.

Laws, Regulations, and Instructions Governing the Microfinance Sector in Jordan.

The microfinance industry has been subject to a set of laws and instructions issued by various regulatory and governmental authorities, which can be summarized in two types:

i- Laws and regulations that legalize the commercial, industrial and service sectors in general, including microfinance institutions.

ii- Laws and instructions that legalize the microfinance activity issued by the Central Bank of Jordan.

Laws regulating commercial and service activities in Jordan.

Known as the minimum requirements to run commercial activities and industrial businesses that aim to enhance and support various sectors' competitiveness, enhance the business environment, and regulate internal trade and consumer protection.

The Jordanian Companies Law[9] is the initial legal requirement to which all companies are subject as a prerequisite for obtaining official licenses; for-profit companies are allowed to register under one of the following legal forms: private shareholding companies, limited liability companies, in addition to sole proprietorship, while for non-profit companies, it is subject to the same law referred to, in addition to compliance with the Non-Profit Companies Law No. (73) Of (2010).

Income Tax Law[10], as this law imposed tax burdens on the microfinance sector, especially for the profitable companies, through a nominal income tax (24%) in addition to a national contribution (4%), a study conducted by "Abu-Ghazaleh Group", pointed out that the actual burdens of this law amounted to (45%) in (2019) due to the tax burdens of not recognizing provisions for bad debts as expenses. Thus for tax calculation, the study recommended, from the standpoint

[8] Microfinance in Jordan- Development, challenges and future prospects, IFC 2021
[9] Jordanian Companies Law No. (22) Of (1997) and its amendments - Ministry of Industry and Trade.
[10] The Income Tax Law and its amendments within the scope of the applicable law (2018) and the amended law (2019) - Ministry of Finance.

of tax justice, the need for a legislative amendment to allow the acceptance of the allowance in accordance with International Accounting Standard No. (9)[11].

With regard to the General Sales Tax Law and its amendments, the law subjected the financial services provided by MFI's to a sales tax of (3%) of the total interest income, and these companies may not deduct any taxes on their purchases based on Cabinet Decision dated (06/16/2014) No. (4640).

It also imposed on profit and non-profit institutions, in the event of external borrowing, a sales tax of (16%) in addition to an income tax of (10%), which led to an increase in financing costs, which is the main direct element in pricing the lending products offered by institutions to their clients.

On the other hand, the Stamp Fee Law[12] imposed on MFI's collecting stamp fees on the value of concluded contracts (including interest) according to the following tariff:

Less than (499) Dinar's 1 Dinar Stamp Fee	From (500) to (999) JOD 2 JOD Stamp Fee	More than (1000) JOD 3 JOD each 1000 JOD

The instructions stipulated that those transactions whose value exceeds (2000) JOD should be stamped with an electronic stamp at the Ministry's headquarters, which constituted an additional burden on the institutions and affected the loan disbursement process so that the fees must be paid before the end of the first week of signing the contract; otherwise, a fine starts from (1%) of the value of the fee is imposed. (On 12/1/2021, new instructions were issued regarding facilitating the process of collecting stamp fees by paying in advance lump-sum amounts).

Although MFI's were exempted for a decade from all taxes, fees, stamps, and any treasury revenues, in accordance with decisions issued by the Council of Ministers, before the exemption ceased in (2015) by a decision of the Prime Minister, this exemption included all institutions operating in the microfinance sector, regardless of its legal form and the nature of its registration (profit and non-profit, sole proprietorship, private or limited liability).

A study prepared to show the actual tax burdens on the sector[13]showed that the actual tax rate imposed on MFI's amounted to (31.8%) and (45%) for the period (2015-2018) and (2019) respectively, instead of the announced nominal income tax of (24%), the reason for this discrepancy is that provisions for bad debts are not recognized as expenses and are not accepted for taxes estimation, in addition to the general sales tax and incoming stamp fees to which financing institutions are retroactively subject to, as companies have incurred tax burdens greater than the nominal tax as a result of not recognizing provisions when calculating subject income, the study recommended, based on tax fairness, to amend the legislation in such a way as to allow the acceptance of provisions for non-performing loan losses calculated by MFIs in accordance with international accounting standards.

Subjecting the sector to a general sales tax is neither in line with global practices nor with the recommendations of international institutions[14], "It is usually desirable for enterprises of different types to pay the same transaction tax if they carry out the same activities in order to prevent tax arbitrage regardless of the nature of the enterprise and whether or not it is licensed under prudential regulations", this on the one hand, and contrary to the strategic objectives of financial inclusion, on the other hand, in which, the microfinance axis was mentioned as a primary axis under the title "Providing a supportive environment for achieving sustainable growth for the microfinance sector and enabling it to play its developmental role.[15]", as the Jordanian legislator relied on defining the names of international services and classifications issued by the General Secretariat of the United Nations (i.e. what is known as "**ISIC, International Standard Industrial**

[11] The study carried out by the "Abu-Ghazaleh Group" "Tax Burdens of Microfinance Institutions", (2020).
[12] Stamps and Incomings Law No. (20) of (2001) - Ministry of Finance
[13] Talal Abu-Ghazaleh Group, (2020)
[14] Microfinance Regulation and Supervision Guide, Consultative Group to Assist the Poor, World Bank (2021).
[15] National Financial Inclusion Strategy Document (2018-2020), Central Bank of Jordan

Classification"), according to the table attached to the General Sales Tax Law, the services of "**financial intermediation with the exception of insurance and provision of credits for pensions provided by institutions or companies licensed under the applicable Banking Law**" have been exempted, however, the licensing of MFI's was based on the law of the Central Bank of Jordan, despite the fact that the exempted services schedule issued by the decision of the Council of Ministers on (8/2/2017) exempts financial intermediation services and the services of international and regional financial institutions licensed under the effective Jordanian banking law, but without including microfinance licensed under the Central Bank of Jordan law[16].

The taxes paid by MFI's during the years (2015-2019) exceeded (22 million) JOD, as it was imposed retroactively on all contracts concluded and business results since (2015), which had a direct impact on the financial sustainability of the institutions. Paying this considerable amount from the capital institutions is usually used in lending activities (MFIs could have used this amount to grant nearly (29) thousand new clients). This contradicts with the government strategic objectives and the national strategy for financial inclusion by stimulating the microfinance sector to outreach and reach excluded clients, which prompted institutions in subsequent years and as of (2019) to impose a general sales tax on clients in addition to the stamps fees, which increased borrowing costs.

At the same time, the non-exemption of these enterprises from sales tax created a new situation of imbalance in the market with unfair competition and gave some enterprises a competitive advantage, although all these enterprises perform the same activity as follows:

	Number of Subjected Institutions	Income Tax	Sales Tax	Stamps & Fees	External Borrowing Tax
Profit companies (Individual, limited liability, and Private Public share Companies)	6	Applied	Applied	Applied	Applied
Non-Profit companies	2	Not Applied	Applied	Applied	Applied
Special Law companies	1	Exempted from Taxes, Fees, and All Treasury Returns			

This measure also gave not licensed informal financial institutions a competitive advantage[17].

On the other hand, the percentage of income tax to which institutions are subject in Jordan has reached (24%), which is a high percentage compared to the average rate imposed on the microfinance sector in Arab countries, as is the case in Palestine. (15%), (17%) in Lebanon, (20%) in Yemen, (22.5%) in Egypt and (25%) in Tunisia[18], while in Syria Law No. (8) for the year (2021) "Microfinance has been issued Recently, which exempted MFI's from income tax on the net profits generated from their activities during the first five years of starting a business and subject them to income tax after those five years to (10%) income tax on public shareholding institutions and (14%) private shareholding institutions, the law also exempts microfinance clients from all fees under any designation on any contracts or transactions they conduct with the institution, including mortgage fees and stamp fees.[19]

Regulations and Instructions issued by the Central Bank of Jordan.

To find out what is meant by regulation and supervision of microfinance[20], need to start by knowing that "regulation," which is defined as the set of government rules that apply to microfinance, and "supervision" is the process of applying those rules, where the deposit-taking microfinance providers need prudential regulation and supervision, this type of

[16] Recommendation Paper (Sales Tax on Financial Activities in Jordan) - (2014), by the Lawyer Ala'a Abbas and GIZ
[17] A study showing the informal and unlicensed institutions operating in Jordan indicated that the number has reached to more than (110) institutions registered with the Ministry of Industry and Trade that provide traditional financial services, some of which are in line with the provisions of Islamic Sharia.
[18] Microfinance in Jordan- Development, challenges and future prospects, IFC 2021
[19] Law No. (8) Of (2021) "Microfinance Banks" issued on (2/16/2021) - Central Bank of Syria.
[20] Donor Brief No. (12) - (May 2003)- Consultative Group to Assist the Poor (CGAP)

regulation would protect its financial reputation and prevent it from losing money to small depositors, which would destroy confidence in the financial system, while the practices consider prudential regulation as the regulation that deals with the systemic risks[21] to which a financial institution is exposed, if its failure could easily lead to the failure of other financial institutions, the failure of a single institution that accept deposits can outreach widely to healthy institutions, generating a "rush" as depositors everywhere rush to withdraw their deposits, when a deposit-taking institution goes bankrupt or lacks liquidity, that it cannot pay its depositors, its collapse may destabilize citizens' trust in institutions to the extent that it causes the country's financial system to suffer, and prudential regulation is considered also as a safeguard for depositors who are generally believed to have a poor financial literacy of money management and the potential risks to a deposit taking institution.

As for the "non-prudential" regulations, it is easier to manage because, in this case, the government authorities do not bear responsibility for the financial reputation of the enterprises, where microfinance differs from the banking system, and this is mainly because the assets of microfinance consist of a large number of small unsecured loans, so microfinance must be treated differently from the normal banking system, which imposes the need for regulation and supervision with different rules, that usually require modification of the basic rules used to supervise the banking system, such as limits of unsecured lending, capital adequacy ratios, loan loss allowance rules, and minimum capital.

Non-prudential regulation plays a complementary role[22], dealing primarily with transparency and consumer protection. An important element of transparency is the implementation of recognized accounting standards using qualified external auditors with explicit powers to issue appropriately audited financial statements (for example, accounting standards and external auditing). This is essential for non-depository institutions that need different sources of funding other than depositors' money (for example, government agencies, donors, private sectors). While for the other element of non-prudential regulation deals primarily with consumer protection and the need to consider clear and consistent definitions of the effective interest rate (e.g., which include fees and indicate whether interest is charged to the initial or reducing balance of the loan).

What distinguishes prudential regulation from non-prudential regulation[23]? Prudential regulation is concerned with establishing prudential measures aimed at protecting the entire financial system and ensuring the safety of small deposits in individual institutions. In contrast, non-prudential regulations relate to how financial institutions implement prudential regulations regarding how financial institutions conduct business with their clients, which relate to financial consumer protection, information disclosure, fraud prevention, financial crime, and fair trade practices. Whereas often general supervisory authorities such as central banks in different countries are responsible for supervising prudential regulation, non-prudential regulation can be a prudential regulation imposed or controlled by any other authority or subject to the control of any other authority.

As for the difference in cost for the supervisory and regulatory authorities, or microfinance institutions, non-prudential regulation is usually less complex and less expensive to regulate and supervise than prudential regulation, both for regulators and service providers. However, non-prudential regulation is not free and may not be easy to implement and costly, making it unprofitable for the service provider to provide the service to a particular group of clients. As for prudential regulation, policymakers must be cost-conscious when designing non-prudential measures, always balancing the expected benefits with the cost of regulation and looking for less costly methods.

In (2015), the Central Bank issued Microfinance Companies Regulation No. (5) of (2015)[24] to enhance and develop the role of the microfinance industry, sustainability, and achieve sustainable development goals (part of the execution of the

[21] Microfinance Regulation: Lessons from Bolivia, Peru and the Philippines BY Robert C. Vogel,2012

[22] Microfinance Regulation: Facts from Bolivia, Peru, and the Philippines BY Robert C. Vogel, International Seminar on Microfinance in China and Latin America (Nov,12-2012)

[23] Effect of Regulation on Outreach of Microfinance Institutions in Ghana, Joyce Ma Quartey (Corresponding Author), Department of Accounting and Finance,(February 24, 2019)

[24] Regulation No. (5) of (2015) "Microfinance Companies Law" issued on (12/14/2014).

national strategy for microfinance in Jordan). Creating a legislative framework that includes high standards of professionalism and best practices that protect clients and ensure the availability of sound corporate governance (the existence of efficient management practices with the necessary expertise). The regulations were keen to set the foundations, conditions, and main requirements for applying for a license to engage in a microfinance business[25]. By June-2018, all preexisting operating companies were licensed, after which the Central Bank began issuing more instructions to regulate the microfinance sector gradually.

Subsequently, CBJ issued licensing and presence instructions for microfinance companies, effective on (10th April 2016), and include the following main topics: Microfinance standards, Islamic Sharia-compliant financing, Suitability standards for members of the board of directors and senior executive management, Shariah Supervisory Board, and the local and external presence, although the Central Bank follows best standards and practices and adopts a participatory approach when issuing instructions in consultation with MFI's and Tanmeyah the "Microfinance Development Network", in addition to giving a chance for institutions to rectify their situation, many observations and suggestions were made by the sector collectively on the draft version to the central bank were not taken into account.

In this part, the study will review essential articles of legislation and provisions imposed on the microfinance sector that directly impact microfinance institutions' activities and performance.

The Legal Structure of the Company

The bylaw limits the companies allowed to engage in microfinance activity only to the following forms limited liability companies and private Public shareholding companies (listed companies), with compliance with the Jordanian Companies Law and the Non-Profit Companies Law, and limiting the purposes of providing financing and lending services to micro and small businesses and individuals with limited income and who are not financially served, while the law exempted cooperative and charitable societies that practice microfinance business from complying with the provisions of this bylaw as stipulated in Article (24)

Table 1: Institutions Operating in the Sector by Type of Legal Registration

	Profit Institutions	Non-Profit Institutions	Shariah Compliant Institutions (Profitability)
Limited Liability Companies	Al Ameen & El Ahliah	Tamweelcom	
Private Public share Companies	FINCA & Vitas	Micro fund for Women	Ethmar & & Namothajieh Islamic
Special Law (Private Shareholding)		National Microfinance Bank	

Licensing and Registration Instructions for MFIs Article (2-a)
Micro-company/Enterprise: The company/facility whose total assets or annual sales/revenues are less than (100,000) Jordanian JOD and the number of its employees is less than (5) employees. Enterprise/Small Establishment: The company/establishment whose total assets or annual sales/revenues range between (100,000-1,000,000) Jordanian JOD, and the number of its employees ranges between (5-20) employees.

The instructions also limited the activities of the MFI's to financing small and micro enterprises in which the number of employees is less than (20) and/or their sales volume is less than one million JOD annually. It also specified the upper limit for small and micro projects so that the size of the financing/loan does not exceed (0.2%) of the balance of the existing loan portfolio for the previous month, provided that the amount granted does not exceed (50 thousand) for micro-

[25] Microfinance Companies Law No. (5) Article 4 - A. The company must be licensed: 1) It must be a limited liability company, a private joint stock company, or a branch of a foreign company that engages in microfinance activity in accordance with the conditions and requirements set by the bank for this purpose 2) The minimum Its paid-up capital is two million Jordanian dinars, and the Bank may amend this limit from time to time.

enterprises and (70 thousand) for small enterprises (such limits applies on the first time clients).

It is worth-mentioning regulations did not consider differences among the preexisting institutions; the legal form, whether registered before the issuance of the bylaws, whether it is profit or non-profit, also in terms of the number of shareholders or in terms of the nature of services, or activities and the volume of lending (small or large institution).

Services and Products

The instructions limited the services and activities of financial institutions for granting loans and financing for both conventional and Sharia compliance institutions for individuals with low and limited income and individuals who are not financially included, with no provision for deposit taking services and insurance activities except as an insurance agent, it is noteworthy that the bylaw also defined the services that the microfinance sector was allowed to provide to its clients through disbursing loans and financing (Article 8 / a / b)[26], by performing the activities of the insurance agent and electronic payment agent, but only by making it available to its clients, most MFI's found this limitation not in line with industry principles to stimulate outreach with the variety of products and services offered that could be provided to clients such as training, transfers, electronic payment cards or even deposits, although the bylaw (Article 8 / a / 5) highlights that MFI's that wish to provide additional services are requested to submit an independent application to the Central Bank of Jordan, however, in reality, none of the MFI's had been granted any license or approval to start offer any other services as of the date of this report, despite the fact that some institutions had already submitted formal request to the Central Bank of Jordan to provide additional services.

The regulations set caps to the loan amounts disbursed for individuals to (20,000) JOD for the first time and small and micro enterprises to (70,000) JOD for the first time. However, some institutions specialized in financing small businesses before issuing instructions used to disburse loans in amounts up to (100,000) JOD.

Although the instructions allowed the institutions willing to provide new products or services to clients to apply to the Central Bank of Jordan for approval, most of the applications submitted were not approved, such as revolving credit cards for small clients or training services. Instead, some institutions were requested to stop offering some services and products that are not compatible with the instructions; micro-insurance services, operating electronic wallets to non-clients, and remittances. It was only allowed to provide electronic wallet services to their clients and prevented them from providing even to their employees. Also, the lack of procedural clarity for dealing with institutions' requests to launch new products made this challenge more difficult, as the instructions did not clarify the timeframe for the responses, either accepting or rejecting the requests.

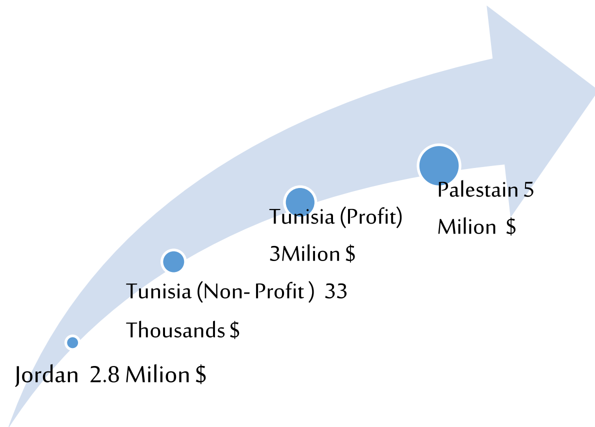
This limitation directly impacted the institution's willingness in creativity and innovation in developing new products, thus limiting the sector's growth, as it contradicts what was characterized by the industry by responding quickly to clients' needs over the past decades.

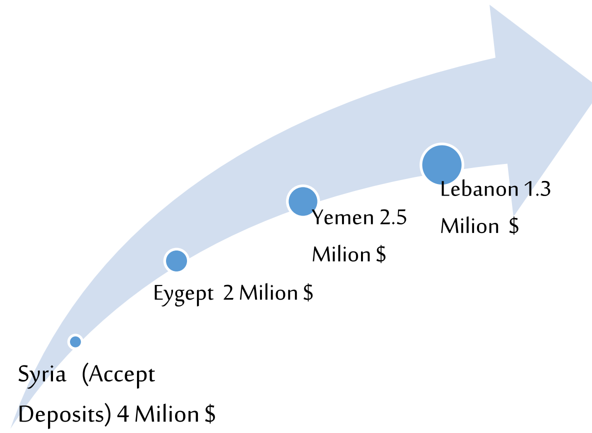
The Minimum Capital

The system set the minimum capital at an amount of (2 million JOD), which is, on average close to the region's countries[27]. In this case, the differences in legal registration between profit and non-profit institutions were taken into account within Article (4/b); the non-profit organizations were allowed to add the surplus retained to the paid-up capital without changing the required amount.

[26] Microfinance Companies Bylaw No. (5) Article 8-a/b, the company, in accordance with its license, exercises any of the following financial activities: Granting loans, granting financing in accordance with Islamic Sharia provisions in accordance with instructions issued by the bank for this purpose, insurance agent business for its clients in accordance with the relevant legislation The work of the agent for its clients to provide services related to payment by mobile phone to its clients in accordance with the relevant legislation, and any other activities or services approved by the bank. The company may not accept deposits of any kind.

[27] Microfinance in Jordan- Development, challenges and future prospects, IFC 2021.





In the meantime, according to the Companies Law, the minimum capital requirement for institutions is (1,000) JOD. Those companies are not licensed by the Central Bank of Jordan but provide financial services and perform microfinance activities (with only a license from the Ministry of Industry and Trade), which has resulted in unfairness and inequality competition with the formal sector to which the provisions of this bylaw apply

Minimum and Maximum Interest Rates and Returns

Neither the bylaw nor the instructions issued until the date of preparing this report stated the maximum or minimum interest rates or returns. However, the bylaw and in Article (19) made it clear that the Central Bank of Jordan has the right to issue instructions that include lower and upper limits for the commissions, interest rates, and returns that's derived from the Central Bank of Jordan agenda not interfering in setting interest rates and returns.

Sharia Supervision

As for the institutions that perform microfinance activities in compliance with the provisions of Islamic Sharia, the instructions stipulated that a Sharia supervisory board must be appointed consisting of at least three members, and the licensing and presence instructions stipulated the appointment of internal auditor concern in Shariah issues[28], with experience in the same field. According to the nature of the MFI's practices, their limited products and services, and the nature of their recurring activities, the appointment of a three-member Shariah supervisory board in addition to an internal Shariah controller will add financial and administrative burdens. Whereas, as per the Islamic banks' institutional governance instructions, the exact requirements were stated in Article (11/2) and Banks Law No. (28) for the year (2000) Article (58/a), provided that the members of the Shariah Board shall not be less than (3) members. Thus, that confirms that the MFI's bylaws did not consider the differences in the investments volume, the nature of the activity, the loans amounts, and the extent of the diversity of financial operations within the Microfinance sector compared to banks.

Institutional Governance and Suitability of Board Members and Executive Management

The institutional governance instructions[29] for the MFI's were issued on (6th Dec 2020) and will be implemented on (5th Dec 2021), giving a grace period that provides an opportunity for the institutions to rectify/amend their positions. These instructions covered the following main topics: Management and board formation, duties and responsibilities of the Shariah Supervisory Board, Audit Committee, Risk Management Committee, Nomination, and Remuneration Committee,

[28] Instructions for Licensing and Presence for Microfinance Companies No. 62/2016 Article 4 /f, financing in accordance with the provisions of Islamic Sharia, which blames the appointment of a resident Sharia observer with the necessary experience and knowledge, and that is with the approval of the Shariah Supervisory Board.
[29] The institutional governance instructions for microfinance companies No. (10/2020) dated (6/12/2020).

General Manager and his suitability, members of the Senior Executive Management, and finally disclosure and transparency.

Noting that these instructions granted the right to branches of foreign institutions operating in Jordan only to implement corporate governance instructions to the extent applicable to the governance policies manual issued by the Mother Company, provided that they do not conflict with the existing legislation and the approval of the Central Bank of Jordan[30].

The licensing and presence instructions, among several articles, clarified the criteria of suitability for the chairman and members of the board of directors and the senior executive departments, and the Shariah Supervisory Board. The suitability of senior executives stipulated that executives should have a bachelor's degree[31] as a minimum in the disciplines related to the positions they occupy, giving the Central Bank of Jordan the right to object to the appointment of any person to a senior position in the executive management.

Comparing the instructions with the institutional governance instructions in commercial banks shows the similarity to those details and conditions that must be met by members of their Board of Directors, and executive departments, as table 1 and table 2 demonstrate the main differences. It is noteworthy that the governance instructions related to the solvency of the Board of Directors and the formation of committees are similar, while in some items, such as the number of board of directors annual meetings, the instruction was more stringent and precautionary than banks situations, Again despite the differences in the nature of the activities, the size, diversity, and the nature of the legal registration of banks (Public Shareholding and Deposit Management). The structure of the Board of Directors of at least (5) members, provided that the number of independent members is not less than (20%), as stated in the instructions, the Board of Directors meets in person at least (6) times annually. However, Article (5/b) at the same time allows attendance through modern means of communication, provided that two-thirds of the members have attended the meeting personally. As for the committees emanating from the board, their number shall not be less than three, and each committee consists of three members; the instructions also stipulated that the members of the audit committee should not be a member of any other committee that has executive authority. Further, the instructions stipulated that the member should not be the head of more than one of the audit committees, either Risk management or nomination and remuneration committees, provided that he is not the chairman of more than two committees of the Board[32].

The instructions did not consider that most preexisting institutions' shareholders do not exceed one shareholder (7 companies with one shareholder out of 9 operating companies). However, the Banking Law dealt with this matter, especially the number of members and independent members, while more precautionary instructions were applied to microfinance institutions, including individual institutions. Also, the banks' executive management requirements that had to fulfill were similar to those for microfinance institutions, despite the massive gap in products and services, the portfolio, volume, and the institutions' size.

For example, the instructions specified the qualifications required and the experience of any person who occupies any position in the senior executive management under Article (11/b) in the licensing and presence instructions and the article (13) of the Institutional Governance Instructions. Also, these instructions did not consider the personnel present before the issuance of this bylaw, as in some cases, the conditions related to (at least two operating institutions) previous experience in the field or the minimum university degrees or specialization related to the position do not apply.

Institutional Governance Instructions state that MFI's must publish annual financial reports and audited financial statements on their websites under the text of Article (16/c) of Disclosure and Transparency, even though the MFI's are limited liability companies or private shareholding companies consisting of one investor in the most cases, it also does not contain any public funds or public shareholders money.

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[30] As stated in Article (1/b) - The institutional governance instructions of Microfinance Companies.
[31] Institutional Governance Instructions for Microfinance Companies Article 11-b
[32] Governance Instructions, Article (9/c, g)

Branching and Opening /Closing branches

The instructions issued by the Central Bank of Jordan stressed the need to take the prior written approval to open, close, or transfer a branch, whether permanently or temporarily, in addition, to providing the Central Bank of Jordan with the expected time frame of execution. The institutions were also required to announce the anticipated date three times in two local daily newspapers. The instructions that were applied to the MFI's were more strict than the instructions applied on banks, especially when opening marketing offices, as the exact instructions for opening and closing branches were applied (License and Presence Instructions - Article 20), this also applies if the location of the branch relocated within the same neighborhood/area, while the banking expansion instructions for banks No. (36/2007) were limited to informing the Central Bank of Jordan without the need to obtain prior written approval.

Simultaneously, complying with the stipulated procedures regarding branching, opening, and closing is costly. It will burden the institutions with additional costs, bearing in mind that most of the local presence of the company's branches is in rented premises with annual contracts, which urge the MFIs to inform the landlord in advance, therefore keeping current, and the new location until obtaining the formal approval has several consequences on the MFIs. Those in charge of the MFI's stressed the cost burdens while waiting for the approval to change the branch location, even if the relocation is within the same area, as it requires pre-approval. Institutions also reported that it took more than (6) months to obtain approval in many cases. These strict procedures, similar to those followed in the banking industry, constitute a complication of the procedures and do not consider the flexibility and nature of the services provided by the Microfinance Institutions.

On the other hand, the instructions did not include clear procedures regarding mobile branches, which were considered one of the best practices that are globally endorsed and the least expensive to increase the outreach and provide services to remote areas with low-income communities.

Financial Consumer Protection

Due to the importance of consumer financial protection, which is one of the basic elements for achieving financial inclusion, the existence of a comprehensive framework for financial consumer protection leads to increased confidence and competitiveness in the financial and banking system, thus improving the quality and efficiency of financial services provided to clients, and also contributes to encouraging individuals and increasing their demand on the use of financial services[33], to comply with international standards for clients protection and responsible financing standards, the Central Bank of Jordan issued instructions to protect the financial clients of the microfinance sector[34], which dealt with an important main axes, including credit policy, the mechanism for identifying target groups, over-indebtedness, disclosure & transparency, responsible pricing and commitment to dealing with clients fairly and respectfully, the mechanism for dealing with complaints from service recipients (Internal Procedures Instructions (1/2017) issued on 28th Aug 2017), the Central Bank of Jordan clarified that the objective of these instructions came in line with the best practices of the global microfinance industry to protect the sector clients from exploitation and abuse, whether when granting or collecting loans, in addition to obtaining appropriate and reliable financial services products.

Apparently, the instructions dealt with many details and detailed procedures that organizations must implement regardless of their size, the number of clients, or the value of their portfolio; meanwhile, and within Article (3/a) of the

[33] The official web page of the Central Bank of Jordan https://www.cbj.gov.jo/Pages/viewpage.aspx?pageID=135
[34] Financial Consumer Protection Instructions for the Microfinance Sector (15/2018) issued (27/6/2018), activated on (1/10/2018)

instructions, the scope of application on the MFI's was clarified to the extent that it does not conflict with their business nature.

Although many provisions of the instructions were in line with the day-to-day practices of institutions operating in the sector and the standards of social performance adopted by the MFIs, some instructions were strict despite the institutions' objections to some articles.

The local and global microfinance industry has been characterized since its inception by relying mainly within the business model on a set of criteria for credit decision-making for the financially excluded and who cannot provide the traditional guarantees required from banks (salary transfer, government employee guarantee, mortgage or bank checks), among these criteria: the client's ability to pay (financial information collected from the clients, clients, suppliers, and dealers) and willingness to pay (the client's reputation, commitment, and honesty) in addition to analyzing the client's personality (Five C's) to estimate the client's willingness to pay, (based on the so-called social guarantee and group guarantees, which has proven successful over the past decades related to the client and his income from more than one source during the field visit to his workplace, project, and residence (this is due to the inability to submit official documents, audited financial statements, or certificates proving sources of income for most small businesses and workers in the informal sector), institutions also need to confirm and infer the place of residence through a field visit (due to the lack of formal lease contracts in most cases, especially in popular and remote areas).

By emphasizing that these procedures are an alternative to requesting the traditional guarantees used by banks and that they are to obtain accurate information and document sources of income from more than one source to facilitate credit decisions to ease the guarantees and facilitate eligibility conditions and replacing them with information collected in the field, however, due to the new instructions that stipulates that it is not permissible to communicate with clients and acquaintances except within certain standards and procedures, the instructions prevented lending officials from inquiring about the client, the guarantor , visiting the client at his workplace, or inquiring about the client in the field to verify financial and personal information about the project, bearing in mind that is in many cases, especially for home-based businesses and operating projects in some areas, perform without any official license (The shadow economy), as the only way to know the correctness of the oral information provided by the client is to inquire in the area about some details related to the business. This affected the client's selection criteria and urged the institutions to change eligibility requirements by increasing the guarantees and sometimes reluctance to provide their services to these financially marginalized groups.

Financial Consumer Protection Instructions for the Microfinance Sector, Article (9/e/1), Article (9/e/5)
The company's employees, especially those responsible for following up on collection, are prohibited from contacting the client or any party or visiting his workplace to request financial information about the clients or guarantor; employees are also prohibited from using inappropriate or abusive means to collect due payments

The instructions within Article (9/e) of the Financial Consumer Protection Instructions, focused on the need not to misuse credit information and preserve the privacy of the clients and were prohibited from making contact with any party related to the clients or visiting his/her workplace, which increased the institutions' risk and affect the actions of social pressure to collect the payments that It is practiced by the MFI's through the field visit, which requires the institutions to change the collection procedures by following up on defaulting clients through phone calls only if possible (insolvent clients and unwilling to pay in most cases change their phone number and sometimes changing the place of residence), this increases the difficulty of collection, which leads institutions to resort to legal procedures because it is impossible to communicate with defaulting clients, and as a result, the rate of default loans increased and bad debt ratios increased, which led to increasing the loan loss provisions that were allocated for bad debts, eventually affecting the amount of the income tax paid (affecting the for-profit institutions only).

While officials of the Consumer Financial Protection Unit at the Central Bank of Jordan believes that adherence to these instructions will lead institutions to redesign their products, review disbursement mechanisms and target groups. This improves the portfolio's service quality, reduces the number of defaulting clients, and reduces the need to exert any pressure on defaulting clients in an arbitrary manner that harms clients without the need to escalate malpractice.

On the other hand, the MFI's executives confirmed that applying the new financial consumer protection instructions negatively affected the disbursement procedures, the mechanism for selecting clients, and the needed guarantees. It also affected the institutions' ability to communicate and achieve financial inclusion by including target groups that are not served by the formal financial system; the ultimate goal is to establish microfinance institutions and push institutions to target the least risky groups or increase the of risk exposure of the clients' selection criteria.

Financial Consumer Protection Instructions for the Microfinance Sector- Article (9/d)
If an incentive system is adopted, it must be based on criteria that take into account the interests of the client and the quality of loans/financings in a way that avoids employees from engaging in any practices that harm clients

As stated in the Consultative Group to Assist the Poor (CGAP) Guide to Regulation and Supervision, it is necessary for central banks in countries wishing to regulate the microfinance industry to take into account "regulations on banking secrecy and general regulations on the use of personal data to protect client's privacy, but it may also hinder the effective credit inquiry of poor clients, which makes it difficult to manage the risk of over-indebtedness."[35]

Although it has been proven over the past decades that organizations have performed this pressure, they have been very careful in a way that maintains the quality of their portfolio while not practice any excessive measures that have abused the clients (although there are some individual practices in this regard), however, most of the MFI's in Jordan adhere, in their daily practices, to international social performance standards and periodically conduct a social audit on their operations by specialized international institutions to show the extent of their commitment to their social mission and the extent of their commitment to applying social performance standards related to treating clients fairly and respectfully, and applying clear procedures for rescheduling and restructuring, instead, institutions offer facilities of free life insurance, and insurance for the cases of partial/total disability to repay the loan amount and have set up a bad debt write-off fund for clients who are proven unable to repay the financing for compelling and documented reasons showing their inability to pay (by distinguishing between the inability to pay and unwillingness to pay), however, the Central Bank's instructions were strict in several areas, which had a fundamental impact in limiting its ability to outreach and reach the target groups, in addition to its effects in disbursement and collection procedures.

Practitioners in the sector also confirmed that there had been many arguments recently about amending the enforcement law and imprisoning the insolvent debtor to prevent the imprisonment of a debtor of less than (5000) JOD (published in the media, as initial version). This increases the difficulty of collection, especially with adherence to the Central Bank of Jordan consumer protection instructions, and will lead to a fundamental change and urge the institutions to reconsider the design of lending products if the law got the royal decree per its initial version.

The instructions within Article (6/b) also stipulates that institutions must, before disbursing credit, investigate the credit status of the clients and the guarantor from reliable sources, including the licensed Credit bureau" CRIF", however, this procedure has positive and other adverse effects according to officials in the sector, it provides institutions with reliable information from all official credit bodies (including banks) about clients indebtedness and credit history, which helps institutions to make the right credit decision, while on the other hand, especially with the competition and acceleration that the industry is facing today from official banks, who started giving small clients and small companies (granting funds for small projects 10-30 thousand JOD), as banks began to rely on the credit history of small clients with the information provided by the Credit information company Credit bureau" CRIF" and offer them facilities at competitive prices that MFI's cannot meet, which threatens unfair competition between banks and institutions operating in the sector.

[35] Guidelines for Organization and Supervision issued by the Consultative Group to Assist the Poor, (2012)

Other obstacles mentioned by the institutions' representatives, which has a negative impact on the performance methodology and the business model followed, that is the institutions must obtain the authorization and obtain approval of the Credit Bureau "CRIF", which requires the client's prior written consent to get the information, in addition to the necessity of obtaining a written acknowledgment from the client before studying the client's request for all his obligations and the burden of covering those obligations, which requires visiting the client before issuing the loan several times, or for the client to visit the branch more than once to obtain the loan in case of approval.

Accordingly, the Central Bank of Jordan stressed the need for institutions to reconsider the target groups of their clients and design products that meet the needs of clients, which also required to review the monthly incentives for employees, which are the main reason for unprofessional behavior by employees, whether in the process of disbursing loans or collection.[36]

To monitor the extent to which institutions are committed to complying with the instructions of financial consumer protection, the Financial Consumer Protection Department has been established in the Central Bank of Jordan, which includes a special section to deal with and follow the complaints of the clients of banks and financial institutions, for the purpose of monitoring the institutions' commitment to implementing the Central Bank's instructions, In addition to strengthening the principles of transparency and fairness in the dealings of financial institutions with their customers through several aspects, including setting credit rules and controls for the retail portfolio, increasing public awareness of banking and financial activities. the Central Bank of Jordan issued instructions clarifying procedures for handling and dealing with clients complaints (2017), and this department issues quarterly and annual reports of complaints against MFI's and banks[37], where the number of complaints submitted during the year (2019) reached approximately (1081) complaints less than the previous year (2018) by (20%), while the complaints submitted during (2020) increased to (2827) (an increase of 260%), as a result of the spreading of the Corona pandemic, the majority of these complaints came to electronic portfolios and electronic payment companies. (Described in Table 3).

While the complaints received and processed by the complaints management units operating in banks and non-bank financial companies amounted to (18,776) complaints in (2019), an increase of (38%) over (2018) (as shown in the table below), complaints increased in (2020) to reach (165,197) complaints, where (82%) of these complaints were against payment, and electronic transfer companies, and only (1.1%) of them were against microfinance companies.

It is worth noting that the Consumer Financial Protection Unit found in (2019) that only (12.1%) of the total complaints claimed against banks, microfinance institutions, and electronic payment in which the clients were right, but this percentage increased in (2020) to reach (52%), due to the Corona impact, the postponement of installments and electronic payment through electronic portfolios.

The complaints reasons submitted by clients focused on employees' behavior and professional transactions, with a percentage of (62%) in (2020) and (42%) in (2019).

It is noted from the data contained in the clients' complaints report regarding the microfinance sector that the number of complaints, whether submitted to the Central Bank or directly to the institutions, did not exceed (2900) complaints in (2020), which constituted less than (0.6 %) of the number of clients served. Complaints did not exceed (2000) in (2019), which is (0.5%) out of (476,000 clients at the end of the year), and this percentage is considered very low compared to other sectors, especially payment and electronic transfer.

The Central Bank of Jordan was also keen on equality among all members of society without any discrimination, intending to deepen the concept of financial inclusion and provide access to all segments of society. CBJ issues instructions to protect

[36] Financial Consumer Protection Instructions for the Microfinance Sector Article 9/d, in the event of adopting an incentive system, it must be based on criteria that take into account the interests of the client and the quality of loans/finances in a way that avoids workers from engaging in any practices that harm clients
[37] The official website of the Central Bank of Jordan / Financial Consumer Protection Unit / Clients Complaint Reports : https://www.cbj.gov.jo/Pages/viewpage.aspx?pageID=368

the financial consumer for clients with disabilities[38] to banks and microfinance institutions. In these instructions, the Central Bank took into account the differences between institutions in applying these instructions to the extent that applies to the nature of their activities and the locations of their branches.

Control and Internal Supervision

Concerning control and supervision systems, the Central Bank issued instructions in this regard to the microfinance institutions No. (11/2020)[39] on (6th Dec 2020), activated one year after its issuance, which dealt with: supervisory tasks assigned to the Board of Directors, executive management, and related departments compliance to the internal audit[40], and risk, where the instructions require the establishment of a department for internal audit, risk management, and compliance management in addition to external audit procedures, the requirements also clarified the financial, accounting, and information management systems and the need to obtain an external report for evaluation risks, and identify strengths and weaknesses for improvement and development periodically.

Although most of the institutions operating in the sector and before the regulation established internal administrative units concerned with internal control in addition to auditing their accounts through the appointment of international external auditors (according to the provisions of the Jordanian Companies Law), however, the control and supervision instructions also added additional requirements that obligated organizations to adjust their organizational structure and create new independent executive departments such as risk and compliance, which increases the administrative burden and increases administrative personnel, and increases the complexity of managing internal operations, as the administrative burdens in a way that is not equivalent to the size and nature of the services, as explained earlier, the officials of the institutions emphasized that the nature of the financial services provided does not require such detailed supervision with separate departments on the one hand, and on the other hand that the nature of the sources of funds used is from the capital or bank loans that do not require excessive supervision as long as there is no public money either in capital (shareholders) or deposits.

Money Laundering and Terrorist Financing

The Central Bank issued instructions regarding combating money laundering and terrorist financing[41] that dealt with several axes, including conducting an annual risk assessment, determining the scope and intensity of risk management depending on the nature and complexity of the company's operations and the risks of money laundering, it also obligated companies to include information technology systems to detect operations suspected of committing money laundering and terrorist financing, implementation of a detailed risk-based classification of clients, clients due diligence measures (detailed identification of the client's identity and legal status), verification of financing repayment sources, for cases of strict due diligence procedures that institutes are obliged to follow in the case of cash payments by others within the framework of an agency (Article 8), the instructions also required the allocation of an independent and qualified staff within the Internal Audit Department whose main task is to monitor compliance with internal policies and controls related to money laundering (Article 10), finally, the Consumer Protection and Money Laundering Directive required a visit to the client to ensure that the funds were used for the purpose for which the financing was requested.

The raised question in this context is, do microfinance operations and activities require to be subject to these instructions? Considering that the average value of the disbursed loans in the industry does not exceed (800) JOD and that these financial institutions do not provide other financial services than small loans, how come that the MFI's and their clients are linked to money laundering and terrorist financing? What is the impact of the costs that organizations will incur to implement such actions? What is the effect of compliance with these instructions on the procedures related to the disbursement of loans? Questions were asked by workers in the sector and those in charge of microfinance institutions

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[38] Financial Consumer Protection Instructions for Clients with Disabilities No. (18/2018) issued on (18/11/2018) activated on (17/11/2019)
[39] Instructions of the internal control and supervision systems for microfinance companies No. (11/2020) issued on (6/12/2020) activated on (27/09/2021)
[40] Instructions for Internal Control and Control Systems for Microfinance Companies Article 3 / A The company shall establish internal control and control systems in proportion to the size of the company and the nature of its operations.
[41] Anti-Money Laundering and Terrorist Financing Instructions No. (8/2020) issued and activated on (28/9/2020).

with undisputable conviction, and they confirmed that these instructions were more stringent to increase the burden on institutions operating in the sector by amending their systems, developing new techniques, and allocating employees for monitoring, auditing and reviewing electronic information systems to increase the financial, administrative and procedural burdens.

Globally, money laundering standards have been applied to all financial institutions, including institutions that deal with the poor and low-income and microfinance institutions and any institution that engages in financial transactions. Financial service providers that deal with low-income clients In many countries, including foundations and non-profit organizations, are also requested to comply to prevent becoming conduits for money laundering or terrorist financing.

All countries have developed systems in line with the requirements and privacy of the target sectors in a way that does not conflict and does not increase the burdens and complications on service providers, the introduction of the new anti-money laundering and terrorist financing system may have unintended and undesirable consequences that affect the ability of institutions to outreach, achieve financial inclusion, and access low-income individuals to formal financial services, in the meantime, it is necessary to commit itself to be protected from money laundering and terrorist financing operations that may affect its existence, therefore, regulators and financial service providers serving low-income clients must work together to strike a delicate balance between regulation, sustainability, and the clients.

To achieve this, a study [42] conducted by the World Bank with the Consultative Group to Assist the Poor (CGAP) recommended and clarified the potential effects of anti-money laundering and terrorist financing standards and regulations in terms of direct costs and procedural burdens faced by MFI's may introduce and propose to countries the following measures mitigate the risks of potential impacts on institutions:

- Gradual implementation of regulations. Financial service providers must coordinate with the supervisory authorities in the country to develop and gradually implement new anti-money laundering and terrorist financing systems to provide institutions with a sufficient period to adjust their internal procedures.
- Adopting a risk-based approach, due to the different risks of financial service providers in terms of institution type and financial services provided, the fifth recommendation of the Financial Action Group stated, "Financial institutions should perform enhanced due diligence for higher-risk segments, in some circumstances where there are low risks, some regulations may decide to apply mitigating or simplified measures.". For example, it can exclude non-depository institutions that offer low-risk financial products that have nothing to do with the payments system.
- Considering flexible requirements for low-risk transaction segments, flexible requirements are developed, considering the specificity of the sector and clients who have financial transactions with small amounts that are less than a specific limit.

[42] AML/CFT Regulation: Implications for Financial Service Providers that Serve Low-income People, The International Bank for Reconstruction and Development/ The World Ban, (2005)
https://documents1.worldbank.org/curated/en/497161468140979952/pdf/361690AML0CFT0regulation01PUBLIC1.pdf

Electronic Information Systems and Information Security Risks

The Central Bank has also issued instructions to adapt to cyber risks[43] and computerization guidelines[44]. The provisions of these instructions apply equally to banks and microfinance companies, and they address several axes, including:

- Assign an information security manager administratively independent of the systems manager Article (10) or Article (11) with the option of contracting with a third party.
- The cost of complying with the instructions on cyber security and cloud information is high, as adherence to the details requires a significant investment in setting up the infrastructure, human resources, and technicians.
- The costs related to the commitment and implementation of the instructions for cyber security and cloud information are costly for institutions. These requirements are unjustifiable as the currently offered services are limited to financing only and do not include any deposits. The imposed procedures restrict companies' operations while the Central Bank indicated that the development of information systems in light of the technological evolution taking place is not an option.

The impact of legislation and laws on the microfinance industry

During the past decades, the microfinance industry has played a vital role in bridging the financing gap (financially excluded individuals and small and micro enterprises), encouraging entrepreneurship, and setting up small businesses. Before launching the microfinance industry in Jordan, the available loan sources were limited and expensive, and difficult to obtain. It is essential to mention that getting loans from outside the circle of family and friends was difficult; the presence of the MFI's came as a substitute for the inability of formal financial institutions to meet these needs.

Official financial institutions and until (2015) (before regulation MFIs under the umbrella of the Central Bank of Jordan) were providing their services to about (25%) of the population of Jordan, as is the case in most developing countries, according to a statistic issued[45] by the Central Bank, the financial inclusion rate increased to (50%) compared to (24%) in (2017), and the gender gap in access to financial services decreased to (29%) instead of approx. (53%). Moreover, Jordan ranked fourth in the Access to Credit Index, ranking (134) in (2019), according to the Doing Business (2020) report issued by the World Bank.

These results come as an outcome of the efforts made by the Central Bank of Jordan to improve the regulatory framework to increase access to financial services and active use by including the microfinance industry under its umbrella, in addition to other instructions that ensured the existence of an effective financial system to protect consumers and empower women to be able to access and use of financial services.

Over the past years, institutions operating in the microfinance sector have been distinguished by their achievements, services, outreach, and diversity of their products locally and globally. The Institutions have been ranked among the best practices institutions in the Arab region and globally and have received international awards for transparency and creativity in product diversification. Some other MFI has been ranked among the top (10) institutions globally with outstanding performance. (According to MIX Market classification for the years 2008 and 2009).

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[43] Instructions for adapting the cyber risks No. (26/1/1/1984) issued on (6/2/2018), activated (5/2/2019).

[44] Cloud Computing Guidelines No. (3/2018)-Central Bank

[45] Financial Inclusion Report 2018-2020 2021 Central Bank of Jordan© Amman, Jordan March, 2021

Despite these achievements in terms of economic development, job creation, striving against poverty and unemployment, and reducing the gender gap in access to financial services, the microfinance industry today has lost many advantages, which for many years was one of the most important elements that have contributed significantly and indirectly to the development of the sector, as the laws, instructions, and decisions exempted MFI's from taxes, fees and any revenues belonging to the treasury, depending on the nature of the registration of these institutions (profitable ,non-profit, individual, private or limited liability), until the exemption was revoked in 2015) a decision of the Prime Minister, under which MFI's were subjected and obligated to pay a package of taxes and fees, these laws did not take into account the legal form of these institutions, and the Central Bank later issued a regulation for microfinance companies and a set of instructions that imposed on institutions to abide by this matter, which placed a heavy financial and administrative burden on them, these burdens will necessarily affect clients and target groups directly or indirectly, and affect the continuity of institutions as well as interest rates.

Some practitioners believe that the introduction of institutions under the umbrella of the central bank had a significant impact on their business and activities. Some considered that the package of instructions and regulations would have negative effects in the future, not only on institutions but also on the ability of potential clients to access microfinance services. At the same time, the Central Bank sees the big future image of the industry and financial stability, which justifies the need for more regulation, control, and supervision to ensure the readiness of institutions and their continuity to provide various services, including deposits and financial technology services in the future.

The Central Bank considers that regulating the industry with a set of instructions is only a step among several other measures aimed at enhancing the strength and integrity of the financial system, enhancing the confidence of beneficiaries, investors, financiers, and donors, and increasing competitiveness as the regulation has been developed and prepared based on global trends and best practices. The Central Bank of Jordan will gradually, over the coming periods, increase the number of services that MFIs are allowed to perform and amend the system of financial institutions, which will increase the competitiveness and limit competition from the unlicensed financial sector. These measures, in the long run, will have a positive impact on the MF industry.

The Central Bank of Jordan has started with providing incentives for MFIs by the initiation of the direct funding platform, which allowed MFI's to obtain direct financing from the Central Bank without interest/returns but conditioned by utilizing the funds to finance micro and small businesses and to reflect the subsidized pricing in their products and interest rates offered to clients. Also, it's worth mentioning that the annual financing needs for the sector are (25-30) million JOD annually, and the financing proposed by the Central Bank represents (10-15%) of the current annual needs (limited amounts have been allocated to institutions at this stage, and the amounts available for lending to institutions will increase gradually over the coming years).

Moreover, although recently Jordan Loan Guarantee Corporation (JLGC) has temporarily suspended the previous agreements offered to the MFIs to guarantee MSEs loans granted to clients, this action followed by a new facility just announced in cooperation with the Central Bank targeting the MFI's benefiting from the funds' facilities according to the following criteria:

- A guarantee of up to (85%) of the defaulted amount, and this includes only home-based and licensed small and micro businesses (MSEs) and start-ups (at least one year has passed since their establishment).

- Guaranteeing the loan portfolio instead of disbursed loans, and thus the procedure has become easier for the MFIs.
- An electronic portal will be launched through which institutions will provide portfolio data instantly and access reports, minimizing paperwork and human involvement to increase efficiency and productivity.

The recently adopted measures, regulations, legislation, and instructions purpose to raise the soundness of the microfinance sector and move it to the next stage of the industry, and gradually build a solid financial sector able to manage funds and loans in a way that ensures clients protection. Additionally, to increase the institutions' capabilities and readiness for managing small deposits once instructions allow MFIs to mobilize in the future.

The Industry Literature

Several international studies have addressed the impact of regulating the microfinance sector and subjecting it to supervision and control by various government regulatory authorities in order to protect clients and financial stability, some of these studies have found that different regulations is the only way that will enable institutions to fully develop into banks or institutions that allow receiving deposits, but at the same time there will be many paradoxes and sacrifices, one example of these studies concluded that “compliance with regulations will be costly and will affect the profitability and sustainability of these companies and their reach, according to an analytical study conducted on (245) of the largest international MFIs, which proved that the direct effect of supervision and control are in increasing the average of loan disbursed and reduce the proportion of the volume of lending operations for women, and although regulation and supervision are not closely related to profitability, it is clear that for-profit MFI’s compensate for the higher cost of supervision by limiting access to market segments that tend to be more expensive per dollar lent, by contrast, the nonprofit MFI’s that depend on non-commercial sources of funding (e.g., donations) and are therefore less profit-oriented, did not adjust the value of loans or reduce women's loans when supervision was applied, while its profitability declined significantly[46] .

The rapid growth, the increase in the number of clients benefiting from MF services, and the entry of new profitable institutions into the market that do not take into account the social dimension (the objective upon which the MFI industry is based) has led to the necessity to organize a sector; however, the costs associated with complying with laws, regulations, and instructions (especially if these are prudential instructions) are costly for the MFIs, a study conducted by the Consultative Group to Assist the Poor (CGAP) concluded that the costs associated with complying with the regulation are high, especially for existing institutions and operating before the issuance of the law, an example of that, in major industrialized nations like the USA, it constitutes (12-13)% of operating expenses (Thornton, 1993; Elliehausen, 1998), whereas in MFI’s it will cost them (5%) of the total assets in the first year and (1%) of the assets in the following years. (Christine, Lehmann & Rosenberg (CLR) (2003)) [47].

A chief financial officer of BancoSol, one of the largest MFIs in Latin America, confirmed that complying with the requirements of compliance and reporting to the Banking Supervision Committee cost an amount equal to about (5%) of the portfolio in the first year, and in the following years, it decreased to (1%)[48] .

Further to the financial costs, there are also significant non-financial costs, since regulation can limit innovation and creativity when issuing instructions that include a set of rules for microfinance, the decision-maker is obligated to abide by these rules in any product development process, whether this development is related to loan methodologies, disbursing procedures or when relying on technology, this commitment will limit creative ideas if these ideas do not comply with the current regulations and laws, many of the products that are now available are considered the secret of

[46] Does Regulatory Supervision Curtail Microfinance Profitability and Outreach, Policy Research Working Paper 4748, WorldBank ,Robert Cull ,Asli Demirgüç-Kunt ,Jonathan Morduch.

[47] Christen, R. P. and Rosenberg, R. (2000) The Rush to Regulate: Legal Frameworks for Microfinance, CGAP Occasional Paper 4 ,2000 , Washington DC.

[48] The Rush to Regulate: Legal Frameworks for Microfinance, Occasional Study (4), (2000), Consultative Group to Assist the Poor (CGAP)

the success of the microfinance sector, such as group lending, group guarantees, and relying on technology to receive loan applications without the need for a field visit.

Generally, some research indicates that regulations do not affect the profitability of the MFI's, despite the higher costs of supervision, and these researchers even came to the conclusion that this type of supervision correlates with the higher average of the value of loans and the fewer loans for women, which confirms reducing service coverage to the costliest segments of the population.

Another working paper based on a statistical methodology published by the University of Cape Coast in (2016)[49] addressed the impact of regulation on the main objectives of the MFIs in sub-Saharan Africa. The paper dealt with outreach and sustainability based on official data for MFI's in (30) African countries. The article concluded that the correlation between regulation and the main objective of MFI's (outreach and sustainability) positively affects the activities of MFI's in sub-Saharan countries in terms of sustainability and outreach. However, regulation has improved the MFI's activities in Sub-Saharan Africa sustainably. The worksheet also revealed that institutions were bound by additional costs, forcing some MFI's to stop serving poorer clients and thus reduce the depth of the outreach. The impact was found to be positive in terms of sustainability and profitability because institutions have excluded many of the poor and the poorest clients (due to costs associated with reaching them) and limited their services to middle- and high-income clients; it was also observed that the profitability of institutions that are allowed to receive and manage deposits have improved; also it is not only the institutions that accept deposits from the poor that are the most sustainable but also tend to serve the marginalized poor.

In a study that captured the clients' perception, awareness, and experience[50] of regulations impact on the services provided by MFIs and their offerings, (44%) of clients reported lower borrowing costs from MFIs, whereas (27%) of clients claimed that borrowing rates remained constant. In which many clients find MFIs loans more affordable than any other source, this is due to two reasons, the first being the interest rate and the second due to changes in repayment schedules by most MFIs, as most MFI have adjusted their repayment schedule from one to two weeks to make it more convenient for clients to accumulate and pay installment amounts. Equally, the regulations focused on consumer protection and the implementation of adequate due diligence measures that resulted in the suitability of the product offered and the quality of services provided by the MFIs. Where the study confirmed that clients consider the overall level of offers from MFIs satisfactory.

Another study [51] was conducted to demonstrate the impact of laws and regulations on outreach (depth and breadth) and sustainability by comparing institutions that were subject to regulatory supervision of the regulatory authority , and other that were not subject to supervision (31) institutions subject to self-supervision, (24) institutions are centrally regulated by an independent authority, and (24) MFI's are regulated by the central bank), the study indicated that the regulation had a positive impact on expanding the scope of outreach (Breadth of Outreach), which led to an increase in the number of clients, as the regulations led to an increase in confidence in MFIs, which enabled the institutions to attract the funds of voluntary depositors and thus enable them to reach more clients and increase their outreach, the study also confirmed the negative impact of laws and legislations on the (depth of outreach), as the absence of a positive relationship between regulations and the average loan size, indeed led to a decrease in the percentage of women clients who are often poor or financially excluded, where compliance with the legislative regulations of the institutions subject to the supervision of the central bank will increase the cost of operations, that will force the MFI's that aim for sustainability to focus on the clients who will pay the cost of the services, as women are among the clients who often request small loans, this represents a deviation from the desired objectives of the MFI's subject to the supervision of the Central Bank. "As regulations ensure

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49 Regulation, Outreach and Sustainability of MFIs in SSA: A Multilevel Analysis, Nyanzu, Frederick and Atta Peprah, James, University of Cape Coast, Department of Economics, Ghana, 2016

50 **Impact of Policies and Regulations on the** Micro finance Sector ,Partha Ghosh, Richa Valechha and Puneet Chopra, MicroSave,2015.

51 Effect of Regulation on Outreach of Microfinance Institutions in Ghana, International Journal of Accounting and Financial Reporting

ISSN 2162-3082, 2019, Vol. 9, No. 1.

the financial sustainability of MFIs, the compliance process forces the formal institutions to provide financial services to middle- and high-income population to reduce lending and clients risks and administrative costs; this is a situation that threatens to deviate from the main objective of the microfinance industry, which is targeting the poor."

The Outreach and Financial Inclusion

The most commonly used terminology to demonstrate the impact of laws, legislation and regulations is "Outreach", the literature on the microfinance industry defines "outreach" as the institutions' ability to provide high-quality financial services to a large number of clients, that is the essential components of the social dimension values, which are supposed to be the ultimate objectives of MFIs. This concept includes six dimensions:

- The Breadth of the Outreach represents the number of clients served, where the outreach is measured by the size of growth in the number of clients and the loan portfolio, such as lending, savings, insurance, training, and other services.
- The Depth of Outreach represents the ability to access services to the marginalized and underserved groups, often the poor and women, to achieve the desired societal value and the added value for the beneficiary. Whereas the average value of the loan disbursed and the average value of the loan due are the most expressive indicators of the "Depth of Outreach" Services, as the lower the average, the more financially marginalized groups will be reached.
- Cost of outreach, which usually represents the costs of institutions to access services, is generally measured by interest rates or returns on its services, which are at the same time the costs incurred by clients to obtain the service as direct costs as well as for the effort, time and transportation expenses incurred by clients as an indirect cost. Usually measured (approximately) by the time the client needs to obtain financing and the proximity of service centers to the client location.
- The worth of Outreach means the value achieved as a result of obtaining financing and whether the clients have benefited from meeting his needs with high quality, which will be reflected in the willingness of clients to pay. It is usually measured using indicators of the client's commitment to payment, quality of loan portfolio, client's retention rate, and withdrawal rate.
- Length of outreach, which means continuous service provision and outreach, so that outreach is not temporary or linked to a specific time frame, usually measured by financial and operational sustainability rates and other indicators that indicate the strength of the financial position of institutions such as return on capital and assets.
- The "Scope of Outreach" is the nature and number of services provided to the target groups, and it is measured by the number and types of services provided, such as lending, savings management, insurance, training, and other services.

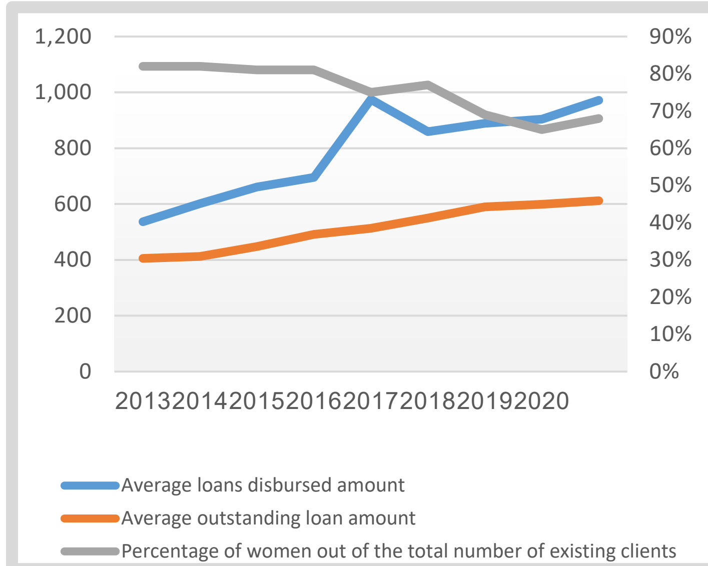
It is known that Outreach is what is meant in modern economies by **financial inclusion,** and due to its importance in achieving economic development objectives, the Jordanian government has adopted it in recent years, where the Central Bank launched the financial inclusion strategy (2018-2020). Accordingly, the CBJ launched a package of legislation, regulations, and instructions to strengthen the sector's financial positions and protect financial consumers.

During the recent years following obtaining the license from the Central Bank, MFI's began their experience towards compliance. As a result of applying and adhering to the instructions and regulations, these institutions faced challenges and contradictions between the objectives set, international best practices, and more than (25) years of experience in the field before the new legislation on the one hand, and the adverse effects that directly affected its performance on the other hand.

According to a recent study conducted by the International Finance Corporation, it concluded that the microfinance sector in recent years has been growing at a slow rate, in contrast to previous years, the study justified this slowdown due to several factors in addition to the economic downturn in the Kingdom; the recent legal framework, taxes, and regulation, the "Ghrimmat" issue, and over-indebtedness due to multiple borrowings among clients from microfinance institutions.

Although the debate about the impact seems early to some, the study review of institutions' performance for the preceding and following the regulations and instructions clarifies that the industry's performance was affected. As the reports issued by the (Jordanian Microfinance Network - Tanmeyah) and the recent report of the World Bank, a decline in the primary indicators used to measure outreach. The study divided the performance in these indicators into three sections: The first period, which is the period before institutions were licensed (2012-2017), the second period (2018-2019), and the third period (2020 - the first quarter of 2021) as demonstrated in table 4.

The analysis showed an increase in the average balance of outstanding loans from (452) JOD in (2012) to (559) JOD in (2019), an increase of nearly (24%), as the records of five institutions showed increases in rates ranging from (25%) to (92%) and an increase of (13%) for one institution, while three institutions showed a decrease ranging from (11%) to (40%).

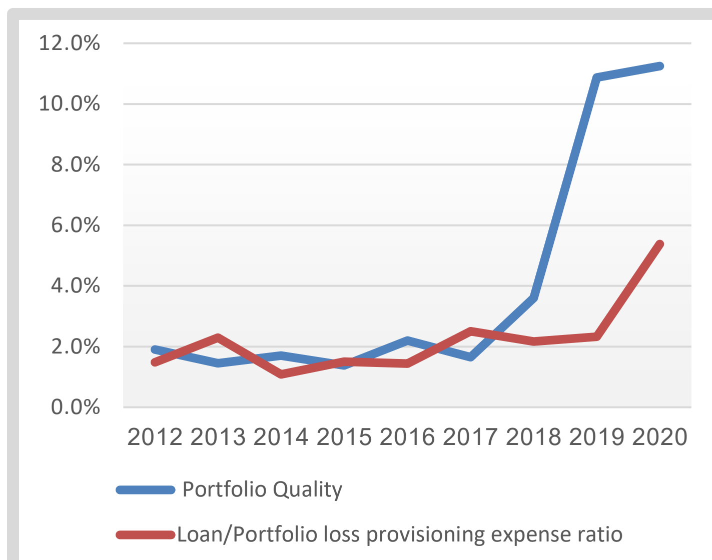


Simultaneously, the average value of large loans disbursed to small projects has increased compared to micro-businesses because servicing small enterprises with larger amounts tempts many MFIs to achieve growth and profit, whereas the average loans amounts disbursed increased by (68%) in (2021) and (2012).

By analyzing the information of the funds disbursed to four institutions (Constituting 75% of the market volume), it is noted that the loans whose amounts are less than (1000) JOD (the micro fund) are decreasing, although they still constitute (73%) in (2019), while loans ranging between (1000-3000) JOD are constantly increasing.

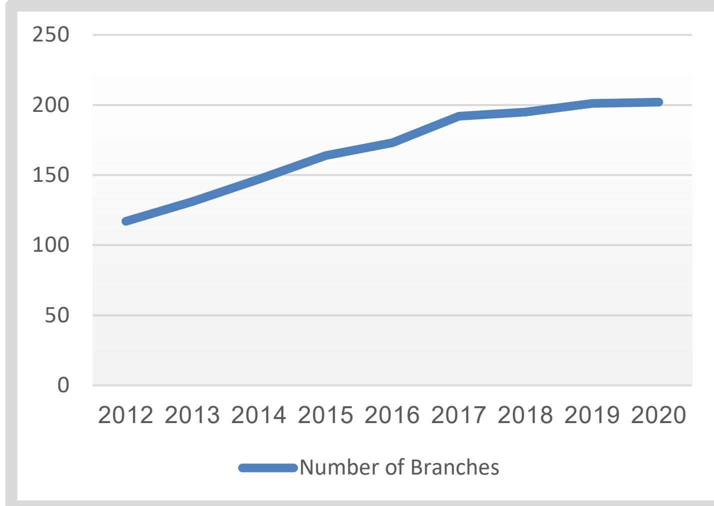
As for the quality of the loan portfolios represented by (30-day risk portfolio), it has doubled dozens of times, as the risk portfolio increased by (53%) during the first period (from 1.7% to 2.6%) and quadrupled during the third period of the Covid pandemic period, which resulted in a doubling of provisions for loan losses and bad loans that are non-taxable.

Similarly, the proportion of women beneficiaries of existing loans also decreased from (17%) compared to the years (2012 and 2019) (82% to 68%, respectively).



Finally, the growth rate in the number of annual branches decreased from (12%) in (2012) to (0%) in (2020).

The above analysis confirms the industry literature and the experiences of countries and institutions that preceded Jordan in regulation and supervision, to emphasize that regulation and supervision are associated with additional costs that push institutions to increase the average size of loans disbursed (depth of outreach), and away from serving the poorest clients and micro-businesses to maintain and improve sustainability to ensure the continuity of the activity.



Sustainability and Profitability

Sustainability refers to the ability of the institution to continue to achieve its objectives and provide financial services to a wide range of clients that the traditional financial institutions exclude; in this case, achieving the main objective is for which these institutions were established; poverty alleviation[52]. Also, sustainability has also been defined as the institutions' ability to cover the costs of operations and build reserves and provisions to face future risks, as sustainability is not the objective in itself, but rather it's a means to achieve the objectives of improving the economic and social well-being of poor communities and individuals with limited income, and thus increasing sustainability rates help institutions increase their clients base and provide their services to new areas to increase their outreach. Within all the different definitions that have been cited in the microfinance industry literature, it seems clear that if sustainability and the ability of institutions to be sustainable are affected, it will negatively and directly affect the ability of institutions to deliver their services to the target segments.

While reviewing the legislation, taxes, and instructions imposed on MFI's, many of these legislations have increased operational and financial expenses in addition to taxes and fees as follows:

- Instructions required MFI's to add new administrative units such as risk management and compliance management.
- The instructions require the creation of new functions for dealing with client's complaints and following up on other tasks to ensure a rapid response to the notes and requirements of the periodic office reports that the Central Bank requires periodically (and as mentioned early, the instructions did not discriminate between institutions, the value of its portfolios, and their legal form).
- Shari'a-compliant MFIs are obligated to appoint a three-member Shari'a supervisory board regardless of the size of the institution and the variety of its products, in addition to appointing at least one Shari'a supervisor.
- MFIs are subject to Income tax on profit at the effective rate of (45%) of the taxable income (nominal tax rate of 24% and 4%).
- The non-acceptance of various financial provisions in taxes, including the allowance for bad debts, has led to a rise in income tax. Despite the passage of five years since the regulation of the industry, but there are still no instructions explaining the acceptable tax provisions and the mechanism for calculating.
- High financing costs for clients, as the laws-imposed stamp fees and sales tax paid by institutions retroactively from (2016), but now institutions began to charge them to clients, which led to an increase in the costs of obtaining the loan and interest rates.

[52] UN Economic and Social Commission for Asia and the Pacific (2006), Microfinance for Poverty Reduction: building inclusive financial sectors in Asia and the Pacific: development papers No. 27, UN Economic and Social Commission for Asia and the Pacific: New York

- Financial Protection Instructions for Clients, anti-money laundering instructions, cyber-risk adaptation instructions that require investment and internal systems revision, and investing in fixed assets, modern systems that require operational and capital expenditures, thus increasing the burden on these institutions.
- Governance instructions that will enter into force by the end of (2021) imposed on institutions to abide by the minimum number of yearly meetings and meetings of the sub-committees and appoint independent members to boards of directors. Bearing in mind that board memberships must not last for more than eight years.
- Instructions for adapting to cyber risks, which were applied to both MFI'sand banks in a way that does not take into account the size of the institution, activities, or services required institutions relatively significant investments compared to the size of its assets, and additional costs related to hiring for new positions such as information security controller or contracting a third party to manage information security.

The institutions operating in the sector assured confidence that once they begin to comply with instructions fully, it will burden the institutions by investing large sums in infrastructure, organizational structure, administrative, and operating expenses. In addition to amending policies, procedures, contracts, training, modifying products, stopping other products, and appointing new employees. So far, investments have also been made in technological infrastructure to comply with adaptive instructions in cybersecurity.

On the other hand, financial institutions are subject to a set of tax laws (income tax, general sales tax, in addition to stamps), the impact on institutions varied due to its different legal forms, the effect and volume varied, as mentioned previously, some institutions are profitable, and some are non-profit. In contrast, other MFIs were exempted from taxes and fees under a special law.

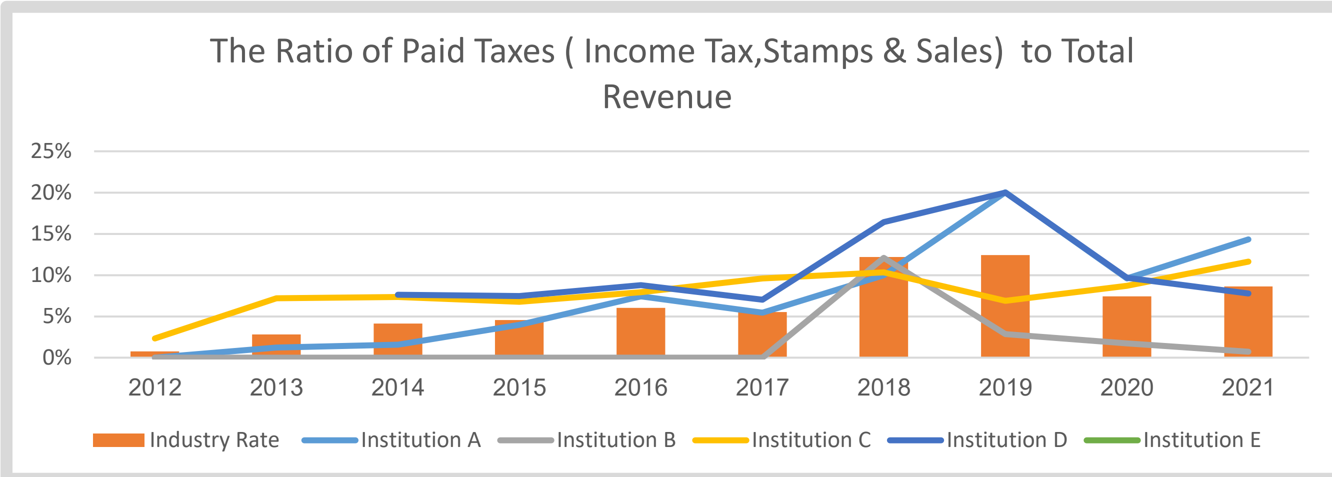
From the point of view of institutions operating in the sector, the cost of complying with laws and regulations costs approximately (5-8%) of the total operating costs (excluding income, sales, and stamp tax, as the effective tax rate for (2019) is (45%) of the total income). For this report, several financial indicators have been used to show the compliance with legislation impact; financial sustainability ratio, operating expense ratios, and return on assets.

The indicator	First Period 2017-2012	Second Period 2019-2018	Third Period 2020- First Quarter 2021
Total Bad Debt Provisions/Total Revenue	5%	7%	10%
Total Paid Taxes (Income Tax, Sales, and Stamps)/Total Revenue	4%	12%	8%
Operating Expenses Ratio to Portfolio	23%	23%	22%
Fixed Assets Ratio to Total Assets	7%	8%	10%
Return on Assets	5%	6%	4%
Financial Sustainability Ratio	123%	129%	130%
Return/Portfolio Ratio	31%	30%	28%
Provision Expense Ratio/ Portfolio	2%	2%	3%

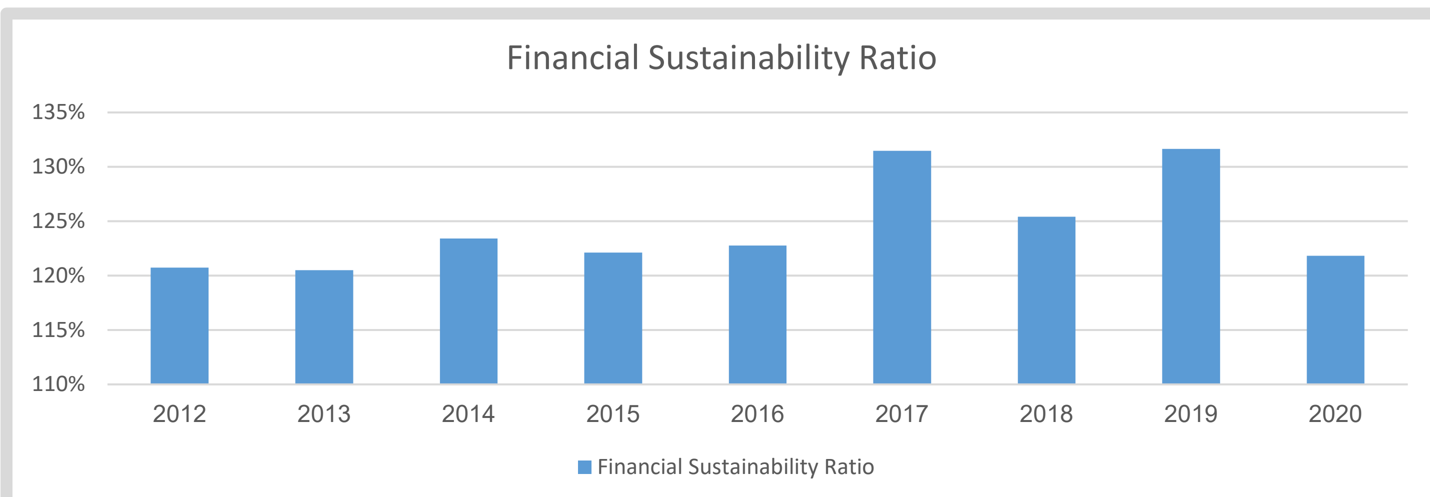
While officials of institutions emphasized that imposing sales tax on financial contracts and imposing stamps law contradicts with the international best practices and financial norms, as well as increasing financial burdens on poor, low-income clients, and small-business owners, the imposition of these taxes and fees will have a significant impact on organizations and clients alike:

- It encourages unfair competition between licensed and unlicensed financial institutions and differentiates between profitable and non-profit MFIs (exempted according to the nature of their legal registration) even though all of these institutions perform the same lending activity.
- Recently, the number of financial institutions that informally provide financial services has increased without control and supervision from regulators. Therefore, they are not subject to financial and administrative burdens imposed on the formal sector due to regulation, which increases the risks of regulatory arbitrage, granting institutions competitive advantages over others and promoting unfair competition between institutions.

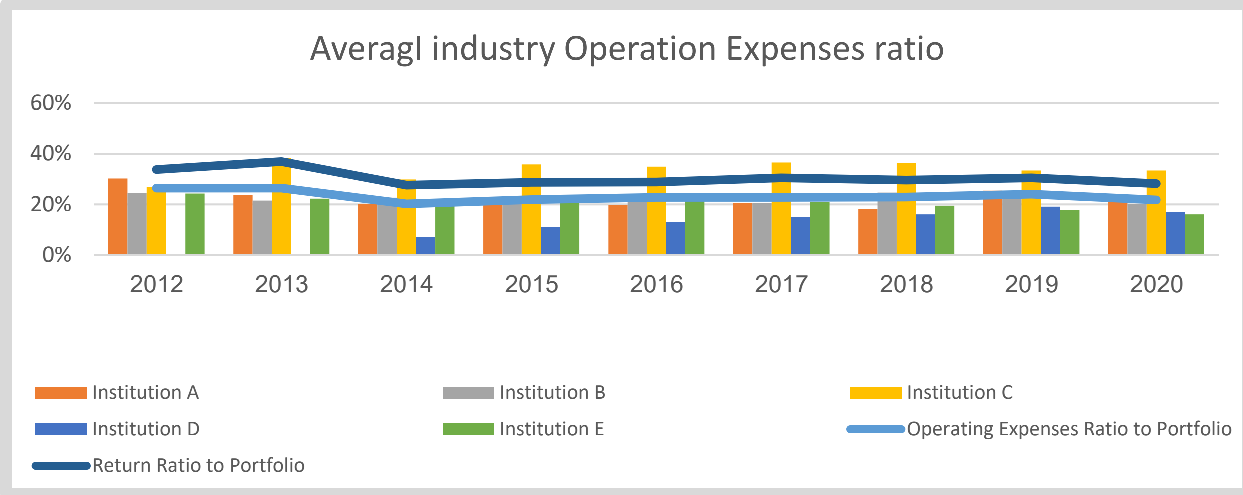
- The obligation to pay taxes, stamps fees contribute to raising operational costs by (5-8%) overpricing, whether borne by the client or the financial institution, in addition to all these costs paid by institutions from its revenues.
- The non-acceptance of the provisions incurred by the institutions as a result of compliance with the International Financial Standards (IFRS) will lead to an increase in the value of the taxable income, and therefore the unfairly paid taxes will lead to a rise in the interest rates on the loans.
- With-holding tax and stamp fees paid to the government in case of international funding, as it is subject to tax (10%) in addition to sales tax on interest and (1%) national tax, this will raise the costs of external borrowing and force institutions to borrow internally with higher interest rates.



By reviewing the MFIs related financial performance results (five institutions operating in the sector), it is noted that the financial performance was positive, as the percentage of financial sustainability maintained at the same level during the past eight years at similar levels, and a sustainability rate (124%), the percentages of operating expenses decreased. However, the percentage of loan losses and taxes paid from the total revenue is high.



Perhaps these results have many impacts, including what has been confirmed by many international impact studies, profitability, and average loan disbursed increased. The direct reflection is that institutions tend to increase the value of the disbursed loans and stay away from serving small clients (with high access costs); the average value of the disbursed loan has increased by (81%), from (537) JOD in (2012) to (972) in (2020), The percentage of loans disbursed for females decreased by (17%), from (82%) in (2012) to (68%) in the year (2020). At the same time, the operating cost ratio and the return on portfolio ratio maintained almost the same level. This confirms the institutions' trend in raising the averages of loans disbursed to maintain the return.



Competition and Market Protection

In this critical context that the microfinance sector suffers from in Jordan, which had an important impact on the microfinance industry, the challenge between regulation, competition, and achieving social objectives has become a tangible reality.

Despite the expected growth in the market size in the coming years, where the potential market size is estimated between (700) thousand and (1) million potential clients, the average outstanding loan balance is expected to grow by (3 to 5) % annually, this growth will create a market size estimated at (450-700) million Jordanian JOD, and a financing gap between (185-440) million JOD[53]. There is no doubt that the costs associated with adhering to the bylaws and taxes negatively affect institutions' profitability. At the same time, institutions strive to achieve their social objectives by reaching poor entrepreneurs and low-income individuals to increase outreach. But the negative impact will be multiplied when complying with privacy and confidentiality instructions that require effort and time to collect and verify client's information during field visits, which will increase operating expenses and force institutions to exclude ultra-poor and micro-businesses due to insufficient documentation and information. It would conclude by increasing the value of loans disbursed, raising interest rates/returns, or imposing commissions to compensate for the decrease in its profitability.

On the other hand, competition increases the challenges facing the MFIs, as it has recently become noticeable that many commercial banks[54] are e downscaling their activities to serve small business owners and startups benefiting from the incentives offered by the Central Bank.

Financial Sector in Jordan legal structure

The Financial Sector	Number of Registered Companies	Quantities
Formal	Licensed Banks and financial institutions and supervised by the Bank	Twenty-four banks, nine microfinance institutions, eight financial leasing institutions, and three bank-owned finance companies.
Simi-Formal	Companies registered under the umbrella of the Ministry of Trade and Industry law and not subject to the supervision and control of the Central Bank. It includes financial companies and financial leasing	11 financial companies, two small and medium-sized companies financing companies, 24 financial leasing companies not owned by banks, in addition to many community institutions that practice lending
Informal	Companies and individuals practice lending services without licenses and are not subject to any laws.	One hundred ten companies and institutions registered for various purposes under the umbrella of the Ministry of Industry and Trade.

[53] MICROFINANCE IN JORDAN Developments, Challenges and Future Prospects, IFC, 2021
[54] According to the annual report of the Central Bank for the year 2020, there are 24 banks (of which 3 are Islamic banks) and 861 branches

The unfair competition between formal sector institutions

Imposing the application of tax laws on MFIs according to the legal structure is unfair even though the interest rates/returns are similar among all institutions operating in the sector, however, cost rules differ between them due to different tax laws and legislation like sales tax, income tax and incoming stamp duty which exempt non-profit institutions while profit institutions are required to pay it, as the Income Tax Law exempted (4) out of (9) institutions operating in the sector from income tax (24% nominal tax) because they are non-profit institutions, which resulted from not affecting its business and giving it more accumulated cash flow, which helps it reduce borrowing and its costs, as for the sales tax and import stamp duties, it gave (1) institution out of (9) a competitive advantage over the rest of the institutions by exempting its clients from paying additional amounts when signing the contract, thus, in the event that non-exempt institutions decide to bear these taxes within the cost of lending and not charge them to the clients, the profit margin will be lower compared to the exempt institutions, as well as the liquidity available for re-lending and therefore they will have to compensate for the difference in liquidity by borrowing, which will increase the loans annual interest costs.

This imbalance and the lack of standardization of legal and tax references created an atmosphere of unfair competition between institutions with similar objectives and target groups and gave a competitive advantage to some institutions over others.

- **The Credit Information System and the Competition of the Official Banks**

Over the past decades, the MFIs have worked provide financial services and include the excluded segments via the formal financial sector including the marginalized groups, and it was able to achieve a credit history for no less than (2) million clients during the past years, which enabled it to maintain the quality of the loan portfolio and manage risks in an effective manner, at present, and within the framework of the Central Bank's instructions, institutions were forced to use the licensed credit information company, in partnership with commercial banks operating in Jordan, in conjunction with the stimulus plan launched by the Central Bank for commercial banks by granting the small and medium-sized companies, which led to an increase in unfair competition with banks, based on the credit history available in Credit bureau" CRIF", officials of MFI's pointed out that the clients withdrawal rate has doubled in recent years in favor of lower costs and various financial services provided by banks, while the Central Bank indicated that this measure is a health indicator and a sound practice, which will prompt institutions to reconsider the pricing of their products, improve their offers and reconsider their costs, which will contribute to reducing the costs paid by clients, these intersections with the target groups of the banks will prompt the MFI's to reconsider their policies around the target groups and focusing on the financially marginalized.

- **The Informal Financial Sector: Fines and Sector Reputation**

The (Jordanian Microfinance Network - Tanmeyah)[55] published a study describing the informal financial sector in Jordan. The study demonstrates that institutions that provide lending and financial services in Jordan are no less than (191) company, of which more than (110) operates in the informal sector, which constitutes (57%) of the total companies operating in the sector (specialize in lending to individuals and owners of MSME). Mostly, informal institutions are not subject to sales tax and income tax.

In addition to hundreds of retail stores sells consumer goods, furniture, household appliances, and small equipment to business owners and individuals. These stores and are not subject to the supervision of the Central Bank (being a financial service provider), do not follow central bank provisions and instructions, and do not fulfill the principles of responsible finance. On the contrary, it imposes high-interest rates, increases client indebtedness.

[55] Market Research on Informal Lending Practices and their effect on the Microfinance Sector, EU and Tanmeyeh,2019.

Another dilemma arose due to retailers' lending practices that created unfair competition and caused damage to the industry's reputation due to irresponsible and unprofessional practices. Recently, much talk has been about “Ghrimmat” (started 2017 and repeated in 2019), thousand of defaulted female borrowers, and thousands of legal cases. Instead, the Microfinance industry blamed and criticized and was subjected to a media campaign and an attack from Parliament members that affected the sector's reputation. Accordingly, MFIs implemented precautionary measures and started refraining from lending to women, although “Ghrimmat” was due to the practices of the informal financial sector and retailers, in particular, MFIs contributed (650,000) JOD to pay off their debts in 2019.

Impact of Laws and Procedures in Dealing with the COVID-19 Pandemic

During the pandemic period, and according to the exceptional circumstances in which the world is suffering in general. The difficult economic conditions that Jordan is going through in particular, and the financial services sector, the Central Bank issued a package of measures and circulars to maintain financial stability and protect clients. The Central Bank has also provided banks with financial windows to support the activities of banks and motivate them to take into account the special circumstances experienced by the economy, many recent Central Bank circulars. The Corona period did not take into account the specificity of the sector, or the microfinance sector was not mentioned, as the conditions and procedures for postponing payments to the affected sectors of MFI’s were not clarified, which led to the failure to apply unified procedures between institutions in dealing with affected clients and those wishing to postpone, which led to market turmoil.

The defense law and the prevention of debtor imprisonment also prompted MFIs to target one category of clients without another (the best and strongest guarantee) to ensure the collection of granted funds in the absence of alternative procedures.

Table 1: MFI's Vs. Banks with regards to governance

	Commercial Banks	Microfinance Institutions
Board of Directors	Not less than (11) members, unless one shareholder owns the Bank	(5) Members at Minimum
Independent Members	Not less than (4) members, unless one shareholder owns the Bank	(20%) of Members or (2) at Minimum
Chairman of the Board	Not acting as a General Manager	Not to be a member of the Senior Executive Management
Suitability Conditions of the Board of Directors	Not less than (25) years old, not be a member of the Board of Directors of another company, not be a lawyer, legal advisor, or auditor, holding a first university degree in economics, finance, and accounting, or any other specialty if related to a similar experience, and his experience in the field must not be less than (5) years.	Not less than 25 years old, not be a member of the Board of Directors of another company, not be a lawyer, legal advisor, or auditor, holding a first university degree in economics, finance, and accounting, or any other specialty if related to a similar experience, and his experience in the field must not be less than (3) years.
Number of Shari'a Supervisory Board members (for institutions that comply with Islamic Shari'a provisions)	(3) Members	(3) Members
Number of Committees Emanating from the Board of Directors	(4) committees Minimum (Governance, Audit, Nominations and Remuneration, Risk Management)	(3) committees Minimum (Audit, Nominations, and Remuneration, Risk Management)
Board Meetings	(6) Meetings at Minimum	(6) Meetings at Minimum, provided that no more than two months pass without holding a meeting.

Table 2: MFI's Vs. Banks about the regulations and instructions issued to ensure oversight of the financial system

Instructions	Microfinance Institutions	Banks
Diversity of Products and Services	Subject to Approval but Not Allowed Yet	Permitted
Minimum Capital	2 Million	100 Million
Sources of Capital	Private Shareholding	Public Shareholding
Deposit Management	Not Permitted	Permitted
Income Tax	24% + 4% National Contribution	35% + 4% National Contribution
Number of Control Units	3	4
Sales Tax	3%	Exempted
Number of Board Members	5	11
Number of the Shariah Committee Members	3	3
Sharia Supervision	1	1
Number of Meetings	6	Unlimited
Emerged Committees	3	4
Branching	Permitted by Prior Approval	Permitted by Prior Approval
Stamp Fees	Clients are Subject to Stamp Duty	Clients are Subject to Stamp Duty
With Holding TAX	Subject to External Borrowing Tax	Exempted
Money Laundering and Terrorism Instructions	Subject to Instructions	Subject to Instructions
Provisions for Bad Debts	Not Accepted in Tax	Taxable
Managing Shareholder Funds	Not Permitted	Permitted
The Average value of the Loans Granted to Clients	700 JD	NA
Annual Report	1	1
Financial Consumer Protection	1	1

Table 3: Complaints Records

	Complaints Submitted to the Central Bank				Complaints Submitted Directly to Institutions Administration			
	Total Complaints of Banks, Financial Institutions, & Electronic Payment.	Bank Complaints	Complaints of non-bank financial institutions	The Clients is Correct in his Complaint	Total Complaints of Banks, Financial Institutions, & Electronic Payment.	Bank Management	MFI's Management	Management of payment and electronic transfer companies
2018	1366	1265	75	38.2%	13591	13591	0	0
2019	1081	994	87	12.1%	18776	16919	1857	0
2020	2827	1699	1128	52%	165197	28830	1857	134510

Table 4: Performance comparison for the main Outreach indicators before and after the regulation.

	First Period 2012-2017	Second Period 2018-2019	Third Period 2020 - the first quarter of 2021
The growth rate in the number of loans disbursed	5%	0%	-49%
The growth rate in the value of loans disbursed	17%	3%	-48%
Portfolio growth rates	16%	6%	-5%
Growth rates in the number of existing loans	9%	1%	-2%
Percentage of women out of the total number of existing clients	80%	73%	71%
Average of loans amounts disbursed	694	874	935
Average of the outstanding loan value	470	594	590
The growth rate in the number of branches	10%	2%	0%
Bad debt ratio	0.68%	0.47%	0.66%
Wallet quality 30 days	1.7%	2.6%	11%

Table: Microfinance Institutions Regulations and Instructions issued by CBJ for

Regulation/ Instruction	Issuing Date	Date of Activation
Regulation No. (5) of 2015, MFI's Law	14/12/2014	Correction Period Two Years
Licensing and Presence Instructions for MFI's No. 62/2016	10/4/2016	10/4/2016
Corporate Governance Instructions for MFI's10/2020	6/12/2020	6/12/2021
Financial Consumer Protection Instructions for the Microfinance Sector 15/2018	27/6/2018	1/10/2018
Financial Consumer Protection Instructions for Clients with Disabilities No. 18/2018	18/11/2018	17/11/2019
Instructions for Internal Control and Control Systems for MFI's No. 11/2020	6/12/2020	5/12/2021
Anti-Money Laundering and Terrorist Financing Instructions No. 8/2020	28/9/2020	27/9/2021
Instructions for internal procedures to deal with clients complaints 1/2017	28/8/2017	28/8/2017
Instructions for adapting to cyber risks 01/26/1984	6/2/2018	5/2019
Guidelines for Cloud Computing 3/2018	N/A	N/A

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