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Insurance Regulation in Jordan New Rules - Old System

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Abstract

The Jordanian insurance market has been free from extensive state ownership and pervasive premium, product, investment and reinsurance controls. However, these positive features have been marred by the licensing of a large number of private companies, often on political rather than professional criteria, and the resulting fragmentation of the sector. Various policies have perpetuated the fragmentation of the sector, while regulatory forbearance has allowed the continuing operation of several weak companies.

Despite the avoidance of pervasive controls and extensive state ownership and the presence of a large number of private companies, the insurance industry is not well developed. This mainly reflects the underdevelopment of life insurance. In contrast, the level of general insurance is comparable to several other developing countries in the region and elsewhere.

A major modernization effort has been undertaken in recent years. This has included the enactment of a new insurance law and the creation of a new Insurance Commission. The latter has made considerable progress in expanding its staff, undertaking a wide-ranging training program to upgrade skills, and implementing a multi-year action plan aiming at modernizing the regulatory framework and enhancing the efficiency of the sector.

The new rules entail the use of sound licensing and financial solvency criteria, while reducing the role of political favoritism and regulatory forbearance in deciding the fate of ailing companies. However, several of the modern rules are difficult to implement because of the predominance of family-based companies, the shortage of experienced non-executive directors, the dearth of specialized professionals such as actuaries and auditors, the absence of comprehensive statistical databases, and the lack of liquidity of asset markets.

To overcome these difficulties, the Insurance Commission needs to strengthen its proactive approach to insurance supervision, complement the role of company directors, and even develop asset valuation models. Its success requires a change of traditional attitudes and acceptance of the rigors of a sound regulatory framework as well as strong political backing for early remedial intervention of weak companies.

Another major challenge is the development of life insurance. In addition to strong fiscal incentives, this would also require a robust regulatory framework to protect the interests of policy holders.

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I. Introduction and Main Findings

Jordan is remarkable among Arab countries on the Mediterranean coast in that its insurance sector has been free of state ownership in both the primary insurance and reinsurance markets and has been spared the pervasive premium, product, investment and reinsurance controls that have bedeviled the insurance markets of so many developing countries around the world. This approach has also been reflected in the banking sector, which has been characterized by the absence of dominant state-owned banks and by the limited use of directed credit programs, interest rate controls and credit ceilings.

The avoidance of extensive state ownership and government direction of the economy have contributed to the achievement of reasonable economic growth with financial stability. This success has also been reflected in an effort to build efficient and viable private sector institutions in both banking and insurance.

These positive features of the Jordanian financial system have been marred, at least in the case of the insurance industry, by the licensing of a large number of private companies, often on political rather than professional criteria, and the resulting fragmentation of the sector. The latter has been perpetuated by the operation of a market control mechanism that allocates compulsory motor insurance business on a rotational basis and by the dependence of many companies on regulatory forbearance for their survival and continuing operation. The negative public image and weak marketing effort of many insurance companies, especially in life insurance, have contributed to the limited growth of the sector.

Despite the avoidance of pervasive controls and extensive state ownership and the presence of a large number of private companies, the insurance industry is not well developed. This mainly reflects the underdevelopment of life insurance, which has annual premiums of only 0.28 percent of GDP. A level of well over 2 percent of GDP would represent a satisfactory state of development. In contrast, the level of general insurance (annual gross premiums of 1.65 percent of GDP) is comparable to several other developing countries in the region and elsewhere.

General insurance represents 85 percent of total business. Motor insurance is the largest branch with 50 percent of general premiums, followed by medical insurance at 20 percent. These two lines generally suffer from negative technical results (except for 2002 when an increase in premiums resulted in technical profits). Some companies specialize in motor and/or medical insurance and tend to face financial difficulties with inadequate reserves, large holdings of illiquid assets and large volumes of accounts receivable.

The fire, marine and general accident branches, which collectively account for 30 percent of general premiums, are highly profitable. They make extensive use of international reinsurance (over 80 percent) and benefit from large commission income from reinsurers.

Expense ratios are generally low at 14 percent of gross premiums. There is little difference in expense ratios between large and small companies, mainly because motor insurance is allocated on a rotational basis by the Unified Motor Insurance Bureau, which is operated by the Federation of Insurance Companies.

Total insurance assets amount to 3.9 percent of GDP. Their low level reflects the preponderance of general insurance business. Liquid assets represent 30 percent of total assets, securities (mostly company shares) 27 percent, real estate 11 percent, and other assets 32 percent.

Most companies have strong equity positions with an average across all companies of 35 percent of total assets. However, the equity of several companies is likely to be overstated. There are three reasons for this: first, insurance reserves may be understated; second, the value of some illiquid assets, both company shares and real estate, may be overstated; and third, provisions for overdue accounts receivables may be inadequate. Thus, while several companies appear to have strong capital, adequate reserves, appropriate reinsurance arrangements, and low retention ratios, there are other companies that report low solvency margins and/or low reserves. Some of these companies also report large amounts of accounts receivable and large holdings of illiquid assets.

In line with most developing countries around the world, Jordan has undertaken a massive modernization of its financial regulation framework over the past decade. In the area of insurance, the modernization effort has included a new insurance law, enacted in 1999 and extensively amended in 2002, the creation of a new autonomous Insurance Commission, the issuance of numerous new regulations, and a strengthening of insurance supervision.

The new Commission has made considerable progress in its short life in expanding its staff, undertaking a wide-ranging training program to upgrade skills, and implementing a multi-year action plan aiming at modernizing the regulatory framework and enhancing the efficiency of the sector. Its basic developmental objectives are to expand the contribution of the insurance industry to the economy and increase the public's awareness of the benefits of both life and general insurance.

The new rules entail the use of sound licensing and financial solvency criteria, while reducing the role of political favoritism and regulatory forbearance in deciding the fate of ailing companies. They rely on modern concepts of risk-based capital and solvency margin, reserving policies and reinsurance cover, as well as settlement procedures and market conduct. The new rules also emphasize the importance of proactive, risk-based supervision.

However, there is some tension between the new approach and the current functioning of the insurance industry in Jordan. The main areas of difficulty, which are shared by most developing countries, include: the observance of modern principles of corporate governance in countries where family control is still dominant and where there

is a shortage of non-executive directors with insurance expertise; the requirement of actuarial certification of general insurance business in view of the dearth of qualified actuaries; the determination of sound reserving policies given the absence of a comprehensive statistical databases on mortality, lapse and surrender rates as well as on loss experience, driving records, and other important aspects of insurance business; and the implementation of fair value accounting rules in countries where asset markets are highly illiquid.

These difficulties should not, however, imply a rejection of modern regulatory principles. On the contrary, they imply a greater reliance on an effective and proactive supervisory agency, which should focus on risk-based supervision, emphasize the importance of internal control systems, complement the corporate governance role of non-executive directors, play an active part in developing comprehensive databases, develop objective and uniform valuation models for illiquid assets, and commission special audits of companies with weak financial structures (low reserves and solvency margins and/or large exposure to illiquid assets and accounts receivable). The success of the new regulatory and supervisory approach would require a change of traditional attitudes and acceptance of the rigors of a sound regulatory framework.

The insurance sector will be called upon to play a major role in meeting two important challenges of the Jordanian economy in the future: the mobilization of long-term financial resources for a more stable financing of economic growth; and the financing of the growing retirement needs of an aging population. Even if no major systemic reform of the pension system is undertaken in the immediate future, stimulating the development of life insurance would provide a major impetus to the mobilization of long-term financial savings. This would require the introduction of tax incentives favoring life policies that generate long-term savings and a strengthening of the regulatory framework covering life insurance. A strong regulatory framework offering adequate consumer protection would contribute to building greater public trust in life insurance companies and their intermediaries.

In addition to tax incentives and a strong regulatory framework, the growth of life insurance would also require a positive public image for the whole sector. A negative experience in one part of the insurance market would affect the development prospects of other parts. Every effort would need to be made to complete the ongoing modernization process by eliminating the remaining shortcomings and contradictions of the regulatory framework.

This paper examines the structure and performance of the insurance industry in Jordan.[1] It highlights the positive achievements of the Jordanian insurance industry, but

[1] Similar analyses have been undertaken for the US insurance industry (Wright 1992, Grace and Barth 1993), for Tunisia (Vittas 1995) and for Mauritius (Vittas 2003). World bank staff has contributed a score of insurance sector studies in financial sector reports of developing countries over the years. These have included Argentina, Brazil, China, Czech Republic, Hungary, Mexico, Slovenia, South Africa and Sri Lanka, while the recent Financial Sector Assessment Program (FSAP) reports have included more or less detailed studies of insurance sectors in most of the countries covered by the program.

also notes some important areas where problems persist. The paper summarizes the new rules that aim to modernize the regulatory framework, discusses the areas of tension between the new rules and traditional attitudes, underscores the importance of strengthening the proactive role of the Insurance Commission, and stresses the need for political backing for more effective supervision and earlier remedial intervention of weak insurance companies.

The paper is organized as follows. Section II reviews the structure and performance of the industry. It is divided into sub-sections offering in turn an international comparison of market development, a brief historical survey of institutional structure, a review of asset and liability structure, and an assessment of the performance of general insurance as a whole as well as of the motor, medical and other nonlife insurance branches and of the life insurance sector. The section concludes with an evaluation of insurance solvency.

Section III examines the regulatory and supervisory framework, drawing attention to the coverage and objectives of new rules. The section covers in turn the status of the new regulatory authority, the licensing criteria, rules on corporate governance and internal control systems, underwriting policies and the calculation of technical provisions, rules on asset segregation, diversification and valuation, the new risk-based capital approach to solvency, controls on reinsurance, an acceptable code of market conduct, the effectiveness of off-site surveillance and on-site inspections, the utilization of sanctions and ladder of compliance, the role of compensation funds and the growing emphasis on proactive supervision. The last section covers continuing policy issues and future prospects.

II. Structure and Performance

This section presents an analysis of the structure of the insurance industry in Jordan and an assessment of its performance. The section relies on traditional indicators of market penetration, loss ratios and expense levels. However, the section underscores the difficulty of assessing the adequacy of reserve levels and the appropriateness of asset valuation techniques.

The activities of most insurance companies are highly complex and cover multiple lines of business that have distinct operational characteristics. There are important differences not only between life and general insurance, but also among sub-branches in each of these lines of business. These differences are reflected in the use of reinsurance, the importance of acquisition costs, the processing of claims, the level of reserving, and the accumulation of assets.

A discussion of the policy implications of the operational characteristics of different lines of insurance business is beyond the scope of this paper. However, the complexity of insurance operations and the need to minimize the extent of cross-subsidization across lines and better protect the interests of policyholders strongly support the separation of life and general insurance. They also suggest that insurance companies will be well advised to focus their operations on their main field of activity, which presents major managerial challenges, and avoid expanding into other unrelated or more specialized fields.

A. Comparative Development

Despite the presence of a large number of companies, the insurance industry is not well developed. This mainly reflects the underdevelopment of life insurance. In contrast, the level of general insurance is comparable to several other developing countries in the region and elsewhere (Table 1).

General premiums are higher, relative to national income, than in Malaysia, Mauritius or Chile. In the Arab world, only Lebanon and Morocco among the countries listed in the table have a higher development of general insurance. Moreover, the gap between Jordan and high income countries is not very large. A norm of between 3 and 4 percent of GDP for general insurance premiums prevails in most OECD countries.

In sharp contrast, the development of life insurance is lagging considerably behind. Malaysia and Morocco show that Islamic countries can have reasonably well developed life insurance sectors, while Mauritius is a small island economy where life insurance is thriving. Thus, cultural factors and the smallness of the economy cannot account fully for the underdevelopment of the life sector.

In several countries, including in particular South Africa, Chile, Denmark. Ireland and Mauritius among the countries listed in Table 1, life business has benefited from the high level of development of pension funds on the one hand and housing finance on the

other (Vittas 2003). Generous tax incentives, often linked to the offer of private pension plans, have played a major role in most of these countries. Fiscal incentives have a greater impact in countries where marginal rates of personal income tax are very high. High real investment returns in an environment of low inflation with economic and political stability have also been an important factor.

Table 1: Insurance Premiums, 2001 (percent of GDP)

	Total	Life	General	% Life
Jordan	1.92	0.28	1.65	15
South Africa	17.97	15.19	2.78	85
Ireland	9.14	6.30	2.84	69
Denmark	6.93	4.51	2.41	65
Cyprus	4.46	2.46	2.00	55
Malta	4.26	1.99	2.28	47
Chile	4.23	2.93	1.30	69
Mauritius	4.02	2.46	1.57	61
Malaysia	3.72	2.13	1.59	57
Morocco	2.82	0.81	2.01	29
Lebanon	2.63	0.46	2.16	18
Mexico	1.81	0.95	0.86	48
Tunisia	1.60	0.14	1.46	9
Turkey	1.31	0.24	1.07	18
United Arab Emirates	1.25	0.23	1.02	18
Egypt	0.58	0.18	0.40	31
Saudi Arabia	0.53	0.01	0.52	2

Source: Sigma, 6/2002

In Jordan, life business has been held back by the lack of strong fiscal incentives. Only premiums for medical and term life insurance are deductible from taxable income; those for whole life and endowment policies, which generate long-term savings, are not. The poor performance of life insurance is also explained by the underdevelopment of private pension funds and housing finance. Other factors include the negative public image of insurance companies, the absence of a strong regulatory framework on market conduct and consumer protection, the weak marketing effort of most insurance companies, and the shortage of well trained selling agents.

Total per capita premiums amounted in Jordan to 26 US dollars in 2001. This compared with 144 in Lebanon, 33 in Morocco and Tunisia, and less than 10 US dollars in Algeria and Egypt. In Chile, a country that experienced a rapid growth of life insurance following the pension and insurance reforms of the early 1980s, total per capita premiums reached 176 US dollars in 2001. Per capita life premiums amounted to 122 US dollars in Chile against less than 4 US dollars in Jordan.

After rising in line with nominal income between 1997 and 2000, insurance premiums grew at an accelerated rate in the past couple of years, when annual real growth reached over 15 percent (Table 2). In 2002, premium growth reflected a significant and long overdue upward adjustment of the administered tariff on compulsory motor insurance. Gross premiums reached 146.9 million JD or 2.2 percent of GDP. The fall in nominal life premiums in 1998 was due to the reclassification of medical premiums from life to general insurance.

Table 2: Jordan: Evolution of Insurance Premiums, 1997-2002

	1997	1998	1999	2000	2001	2002
		Million JD				
Life Premiums	20.27	14.57	15.31	16.28	17.40	18.47
General Premiums	69.94	85.11	85.05	87.90	103.04	128.40
Total Premiums	90.21	99.68	100.36	104.18	120.44	146.87
		% GDP				
Life Premiums	0.39	0.26	0.27	0.27	0.27	0.28
General Premiums	1.36	1.52	1.47	1.46	1.62	1.95
Total Premiums	1.76	1.78	1.74	1.74	1.89	2.23
		% Total				
Life Premiums	22.5	14.6	15.3	15.6	14.4	12.6
General Premiums	77.5	85.4	84.7	84.4	85.6	87.4
Total Premiums	100.0	100.0	100.0	100.0	100.0	100.0
		% Growth				
Life Premiums		-28.1	5.1	6.3	6.9	6.1
General Premiums		21.7	-0.1	3.4	17.2	24.6
Total Premiums		10.5	0.7	3.8	15.6	21.9
Real Growth		7.2	0.1	3.1	13.6	19.8

Data for 2002 are preliminary
Source: Insurance Commission

B. Institutional Structure

There are 26 licensed insurers in Jordan, divided between 18 composites (engaging in both life and general business), 7 specializing in general insurance, and 1 life insurer. Foreign companies may operate with branches. The life subsidiary of a leading American group has branch operations in Jordan and is by far the local leader in life business.

Market concentration is very high in the life sector, where the largest company controls almost 60 percent of total premiums and the largest 3 companies have 71 percent of the market. The Herfindahl Index amounts to 3489, a very high level. In the non-life sector, concentration is much smaller with the largest 3 companies representing 25 percent of the market and a Herfindahl Index of 489. In fact, the non-life sector suffers from high fragmentation with nearly half the companies each having less than 3 percent of total premiums.

The expansion of the number of companies has taken place in spurts. 3 companies date from the 1950s and 1960s, 6 were established in the mid-1970s, 5 in the early 1980s, 3 in the late 1980s, and 10 in the mid-1990s. One company, established in 1980, was put under liquidation in 2001. The most recent waves of expansion took place despite the prevailing view that the market was already overcrowded.

C. Asset and Liability Structure

In several countries insurance assets exceed 50 percent of GDP, while contractual savings, combining the assets of both insurance companies and pension funds, exceed 150 percent of GDP in such countries as the Netherlands, South Africa, Switzerland, the UK and the US. In Jordan, contractual savings amount to 30 percent cent of GDP, but the lion's share of this is accounted for by the assets of the Social Security Corporation, a rare example of public sector dominance in the Jordanian financial landscape.

The total assets of insurance companies amounted to 260.5 million JD in 2002, equivalent to 3.9 percent of GDP. Assets grew slightly faster than GDP, at a real growth rate of 6.3 percent per year between 1997 and 2002. The low level of assets reflects the preponderance of general insurance, which involves a limited creation of assets compared to life (and pension) business that gives rise to a large accumulation of long-term financial resources. Life companies accumulate assets that are 5 to 7 times their annual premiums, whereas in general insurance companies total assets rarely exceed twice the level of annual premiums.

The 3 largest insurance companies had 36 percent of total assets. Liquid assets represented 30 percent of total assets, securities (mostly company shares) 27 percent, real estate 11 percent, and other assets 32 percent (Table 3). Other assets include accounts receivable, claims on reinsurers, and fixed assets. Among securities, company shares accounted for 16 percent of total assets, corporate bonds for 8 percent, and government bonds for 3 percent.

Table 3: Composition of Assets and Liabilities, 1997-2002

	1997	1998	1999	2000	2001	2002
Total (mn JD)	177.6	199.1	211.0	221.1	236.6	260.5
Total (% GDP)	3.5	3.6	3.7	3.7	3.7	3.9
Liquid Assets	30.9	32.3	33.9	33.2	35.1	29.9
Securities	25.9	26.3	26.9	23.6	23.0	27.0
(Gov Bonds)	(3.2)	(3.5)	(3.2)	(3.5)	(3.4)	(2.5)
(Other Bonds)	(1.5)	(3.0)	(3.5)	(3.6)	(4.0)	(7.9)
(Company Shares)	(21.2)	(19.8)	(20.2)	(16.5)	(15.6)	(16.6)
Real Estate	11.4	12.0	14.1	13.5	11.5	11.5
Other Assets	31.8	29.4	25.1	29.8	35.3	31.6
Total	100.0	100.0	100.0	100.0	100.0	100.0
Equity	39.8	40.8	40.4	38.5	37.5	34.9
Technical Reserves	42.7	42.5	42.6	44.3	46.0	46.9
Other Liabilities	17.5	16.7	17.0	17.2	16.5	18.2

Data for 2002 are preliminary
Source: Insurance Commission

The equity position of the insurance sector is quite strong with an equity ratio of 35 percent of total assets, although this declined from 41 percent a few years back. The equity position also appears very solid with regard to gross premiums (62 percent) and

even more so with regard to net retained premiums (97 percent). However, insurance equity may be overstated by a failure to maintain adequate technical reserves. As discussed further below, several companies specializing in motor and medical insurance report relatively low levels of reserves. This could well imply inadequate reserving policies and thus by extension an overstatement of equity.

The large exposure to bank deposits and company shares is a characteristic of insurance sectors dominated by non-life business. It is explained, on the one hand, by the need for liquidity to settle immediate claims and, on the other, the need for durable assets to cover long-tail claims. Equities and fixed assets provide a better hedge against inflation than either government or corporate bonds. General insurance companies do not have long-term liabilities that are fixed in nominal terms and do not therefore need to hold long-term fixed-interest bonds.

The one company that specializes in life insurance invests in bonds and bank deposits with very little exposure to equities. This company accounts for 86 percent of government bonds and 62 percent of other bonds held by all insurance companies. The main types of life policies sold in Jordan are traditional protection policies with long-term values that are fixed in nominal terms. Demand for participating and unit-linked policies that would favor investments in equities is generally weak. The large holdings of bank deposits is explained by the limited supply of bonds. Because of this, life insurance companies effectively engage in reverse maturity transformation, investing long-term liabilities in short-term assets. The same problem is also faced by the Social Security Corporation.

The growth of holdings of non-government bonds is worth noting, since it reflects the success of mortgage bonds issued in the local market. Even though the total volume of business is still small, it underscores the strong demand by life insurance companies (and the Social Security Corporation) for long-duration assets. In fact, institutional investors complain that commercial banks discriminate against them, offering them lower rates of interest than are available on retail deposits and effectively treating them like captive investors.

Table 4: Institutional Structure and Asset Composition, 2002

	% of Total Assets	% in Liquid Assets	% in Securities	% in Real Estate	% in Other Assets	% Own Funds
7 Large	54.5	27.4	29.5	15.0	28.1	34.5
10 Medium	29.5	40.4	23.5	10.2	25.9	43.1
9 Small	16.0	41.3	14.8	10.2	33.7	40.7

Large: Over 10 M JD; Medium: Between 6 and 10 M JD; Small: Below 6 M JD
Source: Insurance Commission

Large companies (i.e. those with more than 10 million JD in total assets) invest less in liquid assets and more in securities and real estate (Table 4). Small companies tend to invest more in liquid assets and in other assets, which mainly consist of accounts

receivable, including claims on other insurance companies. In fact, 5 companies (3 small, 1 medium and 1 large) have other assets well in excess of 40 percent of total assets (in 3 cases by a large margin). Small and medium size companies report higher equity ratios than large companies although, as already noted above, some of these equity positions may be overstated.

D. General Insurance

As in most other developing countries, motor insurance is the largest component of general insurance, accounting for 50 percent of gross premiums (Table 5). Medical insurance represents 20 percent of general premiums, while fire, marine and general accident insurance, that tends to cover large industrial and commercial risks, accounts for about 30 percent of the market. The fall in the relative market share of these three branches between 1997 and 1998 is due to the reclassification of medical insurance from life to general business. The use of product and professional liability insurance is non-existent.

Table 5: Composition of General Insurance, 1997-2002

	1997	1998	1999	2000	2001	2002
Motor	55.1	52.5	53.1	50.6	47.8	50.3
Fire	16.0	12.4	12.1	12.2	10.2	10.6
Marine	14.4	9.6	8.4	9.0	8.8	8.2
General Accident	14.5	8.5	8.9	9.2	10.0	10.7
Credit				0.3	0.2	0.1
Medical		17.0	17.6	18.7	22.9	20.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Data for 2002 are preliminary
Source: Insurance Commission

Most large industrial and commercial risks rely heavily on reinsurance. Fire, marine and general accident have reinsurance ratios in excess of 80 percent (Table 6). In contrast, motor and, to a lesser extent, medical insurance operate with high retention ratios. Several lines are reinsured with proportional treaties, although non-proportional reinsurance is used in fire, marine and motor business.

Table 6: Reinsurance Ratios, 1997-2002

	1997	1998	1999	2000	2001	2002
Motor	8.8	11.0	11.5	13.0	10.8	8.0
Fire	94.5	94.3	94.1	94.1	94.1	95.7
Marine	81.5	79.6	79.8	78.2	80.5	81.4
General Accident	67.5	80.0	79.2	80.8	81.0	87.2
Credit				74.7	71.3	46.7
Medical		50.8	48.2	46.9	37.0	37.6
Total	41.5	40.5	39.7	41.5	38.6	37.8

Data for 2002 are preliminary
Source: Insurance Commission

The business composition of general insurance reflects the size of different companies. Large companies tend to engage more in fire, marine and general accident business where profit margins are higher and reinsurance plays a much bigger part. Small and medium companies rely more on motor and/or medical insurance (Table 7), where technical results have historically been poor, although a major turnaround was observed in 2002. 6 companies (5 small and 1 medium) engage preponderantly in motor insurance (over 80 percent of their business), while another 9 (4 large, 3 medium and 2 small) are mainly active in motor and medical insurance. Small companies rely less on reinsurance and report higher levels of reserves (relative to their net earned premiums). However, as discussed further below, the latter statistic masks large differences among companies, irrespective of size.

Table 7: Institutional Structure and Business Composition of General Insurance, 2002

	% of Total Premiums	% from Motor Premiums	% from Medical Premiums	% from Other Premiums	% Re-Insured	% Reserves /NEP
8 Large	50.8	43.0	23.9	33.1	42.7	76.4
9 Medium	31.6	53.6	21.7	24.7	33.4	71.3
8 Small	16.0	76.5	5.2	18.3	25.4	91.9

Large: Over 6 M JD; Medium: Between 3 and 6 M JD; Small: Below 3 M JD
Source: Insurance Commission

Despite the presence of a large number of companies, the overall results of the insurance industry have not been very bad. The underwriting result was negative, except for 2002 when a major turnaround took place (Table 8). Between 1997 and 2001 the underwriting result fluctuated between –1.8 and –8.0 percent. But in 2002, the overall loss ratio was 76 percent, down from 82 percent in 2001. With net acquisition costs of 11 percent, this produced a traditional combined ratio of 87 percent and a positive underwriting result of 4.2 percent of NEP.

The technical loss of earlier years was more than made up by investment income earned on the assets representing the reserves and equity capital of insurance companies. Reported data do not show the total investment income of insurance companies. This is because in implementing IAS 39, local rules require companies to show any unrealized capital gains from using fair values for investments available for sale as changes in equity rather than posting them through the income statement. However, with reserves representing about 80 percent of NEP and equity capital amounting to a similar amount, total investment income would have covered even the large technical deficits of 2000 and 2001.

Insurance reserves appear to be consistent with a policy of expeditious settlement of claims. However, the adequacy and appropriateness of reserve levels cannot be ascertained without direct knowledge of the business of each insurer. A low level of reserves for outstanding claims may reflect short delays in settling claims or it may be caused by inadequate reserving in the face of protracted disputes. Similarly, a high level

of reserves may reflect conservative reserving in the face of long delays in settlement or it may be caused by excessive reserving in order to understate profits and lower tax liability. As concerns the unearned premium reserves, their appropriate level depends on the periodicity of premium payment. Policies with premiums paid annually require higher unearned premium reserves than those where premiums are paid on a monthly or quarterly basis. Companies specializing in the latter type of policies, such as medical insurance, would tend to report lower levels of reserves.

Reserving policies take account of the reserves established by reinsurers. The unearned premium reserves may have to be increased in the future under new required reserving practices. The level of the outstanding claims reserves implies that on average claims are settled in less than 6 months. The vast majority are probably settled within a few weeks of reporting but larger and more complicated and disputed claims may take much longer.

Table 8: Performance of General Insurance, 1997-2002

	1997	1998	1999	2000	2001	2002
Gross Premium Income (GPI) (mn JD)	69.94	85.11	85.05	87.90	103.04	128.40
GPI Growth (%)		21.7	-0.1	3.3	17.2	24.6
Reinsurance Ratio %	41.5	40.5	39.7	41.5	38.6	37.8
Loss Ratio (NIC/NEP) (%)	78.6	77.2	78.9	80.9	81.6	75.9
Net Commission (% GPI)	-3.1	-2.6	-3.1	-2.5	-2.3	-2.6
Total Expenses (% of GPI)	17.5	16.8	17.6	18.5	16.2	13.8
Traditional Combined Ratio (%)	93.0	91.4	93.5	96.8	95.5	87.1
Net Combined Ratio (% of NEP)	103.3	101.8	103.3	108.0	106.2	95.8
Underwriting Result (% of NEP)	-3.3	-1.8	-3.3	-8.0	-6.2	4.2
Unearned Premium Reserves (% of NEP)	46.7	42.6	42.2	43.0	40.5	42.1
Outstanding Claims Reserves (% of NEP)	33.7	30.4	31.5	34.9	35.4	35.0
Total Reserves (% of NEP)	80.4	73.0	73.7	77.8	75.9	77.1
Outstanding Claims Reserves (% of NIC)	42.9	39.4	40.0	43.1	43.4	46.1

Source: Insurance Commission

Expense ratios amounted on average for all branches to 14 percent of gross premiums. They were much higher for credit insurance, probably in part because of its very low volume and in part due to the nature of the business: for credit insurers the objective is to utilize underwriting techniques so as to avoid claims altogether, just as a bank seeks to eliminate loan losses. The result is high underwriting expenses and low claim ratios. Several lines benefited from net commission income, i.e. commissions received from reinsurers exceeded the commissions paid to local brokers and agents. This is a usual occurrence in developing countries and reflects the large reliance on reinsurance, especially in fire, marine and general accident policies.

Insurance performance varies considerably across individual lines (Table 9). Fire, marine and general accident policies tend to produce positive results, whereas motor,

medical and especially credit insurance suffer large technical losses. Motor insurance experienced a large turnaround in profitability in 2002 as a result of the significant increase in the tariff for compulsory third-party liability. It is not clear what lies behind the improvement in medical insurance, given the tendency of companies to compete aggressively for this line of business.

Table 9: Evolution of Underwriting Results, 1997-2002

(% of NEP)	1997	1998	1999	2000	2001	2002
Motor	-9.6	-6.6	-6.0	-11.6	-7.9	0.7
Fire	73.5	48.2	76.4	20.6	28.7	151.0
Marine	59.7	64.1	57.3	48.6	74.2	103.3
Gen Accident	12.7	27.1	15.0	23.7	-24.9	4.5
Credit				-21.0	-298.1	-233.3
Medical		-5.6	-9.2	-10.8	-9.5	0.6
Total	-3.3	-1.8	-3.3	-8.0	-6.2	4.2

Data for 2002 are preliminary
Source: Insurance Commission

E. Motor Insurance

Motor insurance is the largest branch of general insurance with more than 50 percent of total premiums, but because it relies less on reinsurance, it represents an even higher share of net premiums. Motor insurance accounted for 73 percent of net earned premiums (NEP) and 74 percent of net incurred claims (NIC) in 2002.

The structure of the motor insurance market is affected by the existence of the Unified Motor Insurance Bureau. This is a market control mechanism, operated by the Federation of Insurance Companies, that allocates third-party policies to insurance companies on a rotational basis. This method of allocating compulsory motor business favors small companies (Table 10). Even after including comprehensive policies, which are contracted freely, no insurance company has a market share that exceeds 7 percent of the total. The Unified Bureau tends to perpetuate the fragmentation of the sector.

Table 10: Institutional Structure of Motor Insurance, 2002

	% of Motor Premiums
8 Large	46.5
9 Medium	32.3
8 Small	21.2
HHI	450

Source: Insurance Commission

Motor insurance reports relatively low loss ratios, especially by the standards of developing countries (Table 11). These were less than 80 percent in 2002. Acquisition costs amounted to 18 percent, resulting in a combined ratio of 95 percent. The combined ratio was significantly higher than 100 percent in earlier years, but the 2002 adjustment in

the compulsory tariff caused a major improvement. Acquisition costs declined as a percentage of gross premiums in 2002.

Most claims are reportedly settled without long delays. However, some claims suffer from long delays and effectively represent long-tail business. Because of the operation of the Unified Bureau, expense ratios are similar for large and small companies. Some of the smaller and/or weaker companies reportedly suffer from a greater number of disputes with claimants and from longer delays in settling claims.

There appears to be general dissatisfaction with the impersonal allocation mechanism of the Unified Bureau among both companies and policyholders. Drivers complain about the lack of individual choice and control in selecting an insurance company. Insurers, both large and small, also profess a preference for greater freedom, arguing for the right of insurers to reject bad risks and for encouraging the use of a market-based mechanism with greater competition. However, the survival of the Unified Bureau for nearly two decades and the fact that it favors smaller companies suggest that the majority of insurance companies support the current system.

Table 11: Performance of Motor Insurance, 1997-2002

	1997	1998	1999	2000	2001	2002
Gross Premium Income (GPI) (mn JD)	38.55	44.68	45.15	44.48	49.24	64.56
GPI Growth (%)		15.9	1.0	-1.5	10.7	31.1
Reinsurance Ratio %	8.8	11.0	11.5	13.0	10.8	8.0
NIC/NEP	83.3	80.2	80.6	83.7	81.7	77.4
Net Commission (% of GPI)	6.0	4.9	4.6	5.0	4.4	3.7
Total Expenses (% of GPI)	17.9	17.6	17.9	19.5	17.6	14.3
Traditional Combined Ratio	107.1	102.6	103.1	108.2	103.6	95.3
Net Combined Ratio (% of NEP)	109.6	106.6	106.0	111.6	107.9	99.3
Underwriting Result (% of NEP)	-9.6	-6.6	-6.0	-11.6	-7.9	0.7
Unearned Premium Reserves (% of NEP)	41.9	40.8	40.3	41.6	40.5	40.4
Outstanding Claims Reserves (% of NEP)	34.9	34.6	34.9	39.5	40.1	38.0
Total Reserves (% of NEP)	76.8	75.5	75.1	81.0	80.6	78.4
Outstanding Claims Reserves (% of NIC)	41.9	43.2	43.3	47.2	49.1	49.2

Source: Insurance Commission

Development of an insurance information bureau to collect data on loss experience, driving records and fraudulent claims among all licensed companies would facilitate the sharing of data and the use of a malus-bonus system, rewarding good drivers with premium discounts and penalizing bad ones with heftier premiums. The development of an insurance information bureau could make easier the lifting of administered tariffs on TPML and the elimination of the unified bureau. As companies would retain the right to reject bad risks, the creation of a national pool for bad risks would also need to be considered.

F. Medical Insurance

Medical insurance has experienced rapid growth and keen competition. It mostly covers group business and seems to be preponderantly oriented toward large employers. In fact, government departments and public sector entities appear to be major clients of medical insurance companies. 5 companies (4 small and 1 medium) do not participate in this branch of business. 47 percent of medical premiums are generated by 5 companies (3 large and 2 medium). Concentration in medical insurance is much higher than in motor insurance (Table 12), as is indicated by a Herfindahl index of 726 (against 450 for motor insurance).

Because it is a group business, medical insurance operates with lower acquisition costs than motor insurance (Table 13). Its reinsurance ratio is higher but has been declining sharply in recent years, probably because reinsurers were not supporting the low premiums charged by primary insurers. The loss ratios and underwriting results are comparable to those of motor insurance. There was a sharp improvement in the technical result in 2002.

Table 12: Institutional Structure of Medical Insurance, 2002

	% of Medical Premiums
3 Large	32.7
8 Medium	49.0
10 Small	18.3
HHI	726

Source: Insurance Commission

The low level of reserves of medical insurance would merit special attention. Most companies have reserves for outstanding medical claims that are below 10 percent of net incurred claims. In the case of the single foreign company operating in Jordan, the corresponding reserve level is 61 percent. In fact, some companies have outstanding claims reserves that are less than 2 percent of net incurred claims.

The relatively low level of unearned premium reserves could reflect the payment of premiums by quarterly or monthly installments, which would lower the required provisions. In a similar vein, the low level of reserves for outstanding claims could reflect a speedy settlement of most claims. But the generally low level of reserves could also reflect inadequate reserving in the face of overly aggressive competition.

Table 13: Performance of Medical Insurance, 1997-2002

	1998	1999	2000	2001	2002
Gross Premium Income (GPI) (mn JD)	14.50	14.95	16.46	23.62	25.82
GPI Growth (%)		3.1	10.1	43.5	9.3
Reinsurance ratio %	50.8	48.2	46.9	37.0	37.6
NIC/NEP	85.4	89.7	85.6	85.5	78.3
Net Commissions (% of GPI)	-2.0	-3.8	-1.9	1.1	0.9
Total Expenses (% of GPI)	11.8	13.7	14.7	12.4	12.4
Traditional Combined Ratio (%)	95.2	99.6	98.5	99.0	91.6
Net Combined Ratio (% of NEP)	105.6	109.2	110.8	109.5	99.4
Underwriting Result (% of NEP)	-5.6	-9.2	-10.8	-9.5	0.6
Unearned Premium Reserves (% of NEP)	31.1	30.1	30.2	24.8	24.9
Outstanding Claims Reserves (% of NEP)	5.9	8.1	9.6	10.6	11.2
Total Reserves (% of NEP)	37.0	38.2	39.8	35.4	36.1
Outstanding Claims Reserves (% of NIC)	6.9	9.1	11.2	12.4	14.3

Source: Insurance Commission

G. Other General Insurance Lines

Only 2 large companies and one medium company generate 45 percent of their premiums from fire, marine and general accident business. Most of the other companies rely on motor and/or medical insurance for two-thirds or more of their premium income. Many companies have a very small presence in the market, generating less than half a million dinars in gross premiums. The Herfindahl index of market concentration is 648 (Table 14). This is higher than in the motor branch, but lower than in medical insurance.

Table 14: Institutional Structure of Other General Insurance, 2002

	% of Other Premiums
2 Large	24.8
11 Medium	57.0
13 Small	18.2
HHI	648

Source: Insurance Commission

Large industrial and commercial risks operate with low loss ratios and benefit from negative commissions, implying high profits (Table 15). The commissions they receive from reinsurers exceed those they pay to their agents. This is normal practice in business with developing countries since reinsurers need to compensate local primary insurers for the general expenses they incur in generating their business. However, 2002 was an unusual year in the sense that the level of negative commissions exceeded the level of general expenses. In previous years, negative commissions covered 80 percent of general expenses.

This pattern implies that several local companies effectively act as "brokers", "fronting" business for foreign reinsurers. This practice may represent a reasonable division of labor between local companies that understand better local market conditions and foreign reinsurers that have greater capacity to underwrite risks. Assuming that local companies are operated by experienced professionals, and that foreign reinsurers are highly rated companies, this cooperative arrangement may be an efficient way of expanding insurance business on a sound basis.

On the other hand, because the local insurer has little or no retention of the business, there is no incentive to adhere to proper standards of underwriting, and because the ceding company receives a fee based on volume of premium there is every incentive to maximize volume at the expense of underwriting soundness. In light of these characteristics, fronting arrangements can result in abrupt cancellation of terms by the foreign reinsurer and sometimes even a denial of payment of claims because the domestic ceding insurer has not kept to the understandings with regard to business quality that were arrived at when the arrangement was being negotiated. Thus fronting agreements can sometimes be a source of considerable risk, with local policyholders being exposed if the fronting company is viewed by the reinsurer as having abused the arrangement.

Loss ratios and overall technical results exhibit large fluctuations reflecting the low frequency of large losses. 2002 was a very good year with a reported preliminary underwriting result of 73 percent of net earned premiums. The technical profit was much smaller in some earlier years and especially in 1997, 2000 and 2001.

Table 15: Performance of Other General Insurance, 1997-2002

	1997	1998	1999	2000	2001	2002
Gross Premium Income (GPI) (mn JD)	31.39	25.93	24.95	26.96	30.17	38.02
GPI Growth		-17.4	-3.8	8.1	11.9	26.0
Reinsurance ratio %	81.6	85.7	85.5	85.2	85.3	88.5
NIC/NEP	50.7	36.2	33.7	43.7	67.0	41.8
Net Commissions (% of GPI)	-14.3	-15.7	-16.5	-15.4	-15.9	-15.5
Total Expense (% of GPI)	17.0	18.3	19.5	19.0	16.9	14.1
Traditional Combined Ratio	53.4	38.8	36.7	47.3	68.0	40.4
Net Combined Ratio/NEP	65.2	52.6	56.2	67.7	75.4	26.8
Underwriting Result (% of NEP)	34.8	47.4	43.8	32.3	24.6	73.2
Unearned Premium Reserves (% of NEP)	75.5	77.9	93.2	83.7	97.0	149.1
Outstanding Claims Reserves (% of NEP)	26.8	33.1	45.2	42.8	72.9	99.0
Total Reserves (% of NEP)	102.3	111.0	138.3	126.6	169.9	248.1
Outstanding Claims Reserves (% of NIC)	52.8	91.4	133.8	98.0	108.9	236.9

Source: Insurance Commission

The overall level of reserves for these lines of business also appears to be reasonably high. In addition to their extensive reliance on reinsurance, companies make

adequate provisions to cope with the low frequency of large losses and the customary longer delays in settling complex claims.

H. Life Insurance

The life insurance sector is dominated by the life subsidiary of one of the largest American insurance groups. This company has branch operations in Jordan and focuses almost exclusively on personal business, emphasizing the financial protection benefits of life policies. Its success is attributed to the training of a relatively large number of sales agents.

Table 16: Institutional Structure of Life Insurance, 2002

	% of Other Premiums
1 Large	57.5
6 Medium	30.6
11 Small	11.9
HHI	3489

Source: Insurance Commission

Most other companies have expended little effort in creating a well trained sales force. Even a local company that was created with the specific objective of competing with this foreign company has ended up generating more business in motor and medical insurance than in life business. Many companies offer life business on an ad hoc basis, generating very low levels of annual premiums. The result of all this is a very high index of market concentration (Table 16).

As already noted, growth of life insurance has been modest (Table 17). The 1998 decline in reported statistics is due to the reclassification of medical insurance. Reinsurance is on the high side for life business, exceeding 20 percent of gross premiums. Acquisition costs (including net commissions and administrative expenses) range between 25 and 30 percent of net retained premiums, while net claims fluctuate between 35 and 50 percent of net premiums. Investment and other income is low but is probably understated since changes in reported fair asset values are taken straight into equity and are not included in the annual income statement. This is also reflected in a low implied rate of return on accumulated reserves. In contrast, the annual surplus is large, ranging between 31 and 47 percent of net premiums (average 38 percent). The amount allocated to the life fund ranges from 61 and 74 percent of the annual surplus, averaging 68 percent between 1997 and 2002. This appears low and may be explained by the high level of market concentration.

Several of the larger companies launched various life products that have been successful in other countries but met with limited response in Jordan. The strong liquidity preference of savers and the high level of interest rates traditionally offered on bank deposits may also have depressed the demand for long-term saving instruments. The recent decline of bank deposit rates creates an opportunity for the offer of long-term

savings. Authorizing life policies denominated in US dollars could stimulate the development of the market as would the offer of better targeted fiscal incentives, the growth of private pension plans and the hiring and training of sales staff.

Table 17: Performance of Life Insurance, 1997-2002

	1997	1998	1999	2000	2001	2002
Gross Premium Income (mn JD)	20.27	14.57	15.31	16.28	17.40	18.47
Growth Rate (%)		-28.1	5.0	6.4	6.9	6.2
Reinsurance Ratio (%)	24.4	22.6	21.8	21.0	24.0	23.6
Net Claims/Net Retained Premiums (%)	49.8	35.2	39.6	43.7	50.3	42.2
Net Commissions/NRP (%)	4.7	10.3	10.5	11.3	10.9	11.8
Expenses/NRP (%)	15.7	16.0	15.5	18.2	17.3	18.1
Investment and Other Income/NRP (%)	7.5	8.1	6.0	8.2	9.2	7.1
Annual Surplus/NRP (%)	37.3	46.6	40.3	35.0	30.8	35.0
Addition to Life Fund/NRP (%)	26.1	28.4	29.3	23.2	22.8	21.9
Profit Before Tax/NRP (%)	11.2	18.2	11.1	11.8	8.0	13.1
Profit Before Tax/Annual Surplus (%)	30.1	39.1	27.4	33.6	25.8	37.4

Source: Insurance Commission

I. Insurance Solvency

The financial standing and results of individual insurance companies reflect the lines in which they specialize. Those that have a high proportion of fire, marine and general accident business perform well, while those that rely preponderantly on motor or medical insurance suffer from unsatisfactory results. Several companies have strong capital, adequate reserves, appropriate reinsurance arrangements, and low retention ratios of the large industrial risks. They appear to operate efficiently with low costs and short delays in settling claims.

However, several other companies appear to operate with weak financial ratios and exhibit a relatively high occurrence of disputes with policyholders and beneficiaries. They tend to suffer from long delays in settling claims, often forcing their customers to seek recourse to the courts. This clearly affects small and poorer consumers (and third party victims).

The one company that was put under liquidation in 2001 was found to suffer from a large deficiency in reserves. Of the companies that are currently licensed, 3 have unusually low reserve levels (less than 50 percent of NEP for both unearned premiums and outstanding claims) and another 6 probably have inadequate reserves (less than 70 percent of NEP). These companies, which tend to specialize in motor and/or medical insurance, need to undergo special audits, even if they satisfy the required solvency margin, since their reported capital is probably overstated.

Another factor that may overstate equity capital is the presence of large amounts of accounts receivable (both from brokers and the insured and from reinsurers). Also, large investments in real estate, company shares and other assets that are illiquid and difficult to value fairly may also result in an overstatement of equity. On the basis of 2002 data, 5 companies have high levels of accounts receivable and investments in other illiquid assets (i.e. other than shares or real estate).

A newly solvency margin of 150 percent of required capital was introduced in 2003. This is based on a risk-based capital requirement on both assets and liabilities. Companies are required to comply with the new margin by the end of 2003. Preliminary calculations show that most companies satisfy the new margin.

III. Regulation and Supervision

Insurance operations suffer from asymmetric information and symmetric mistrust. These are linked to high information costs that may give rise to deceptive practices by both insurers and their customers.

Of particular importance are the problems of moral hazard and adverse selection. Moral hazard occurs when the very act of insurance increases the risk of loss by affecting the behavior of the insured, while adverse selection occurs because people with higher risks (e.g. people with poor health or in hazardous occupations) are more likely to seek insurance cover than people with lower risks. To reduce the incidence of moral hazard and adverse selection, insurance companies include co-insurance in the form of deductibles, incentives for the taking of risk prevention measures and elaborate clauses for various types of exclusions. The latter are often hidden in the small print of insurance policies and increase the complexity of contracts. They heighten the need for consumer protection against abuse of exclusion clauses by insurance companies.

To protect consumers from deceptive packages and unfair practices, an effective system of regulation and supervision is required to set acceptable standards on market conduct and information disclosure. Regulation is also required to ensure that insurance companies maintain adequate reserves to meet future claims and invest them in a prudent way.

A. Regulatory Authority

The insurance industry used to be regulated by an under-staffed and largely ineffective office that was part of the Ministry of Trade and Industry. The 1999 insurance act created the Insurance Commission (IC) as an autonomous and operationally independent regulatory agency.

The new Commission has made considerable progress in its short life in expanding its staff, undertaking a wide-ranging training program to upgrade skills, and implementing a multi-year action plan aiming at modernizing the regulatory framework, strengthening supervision, and enhancing the efficiency of the sector. However, its work is constrained by the shortage of experienced staff.

The IC is financed from annual levies imposed on insurance companies (0.75 percent of gross written premiums), various fees (application, licensing and registration fees), fines and other revenues. It is required to maintain a reserve fund equivalent to twice the gross value of its annual expenses, while any surplus is transferred to the Public Treasury.

The remuneration of staff is not subject to the civil service salary scale, but the transfer of surplus revenues to the Public Treasury diminishes its operational autonomy in terms of hiring and remuneration policy. The IC has a well-defined plan of staff

expansion and upgrading of skills through training. The IC is also authorized to appoint experts and consultants, including actuaries and auditors, to carry out inspections and other functions and to outsource services to third parties.

The IC is empowered to issue secondary regulations (instructions) on a wide range of areas related to the insurance business[2], covering prudential and solvency norms as well as corporate governance and internal controls. It has adequate powers of information gathering, including from actuaries and auditors, inspection and investigation as well as intervention in cases that require corrective action, including delicensing, rehabilitation or liquidation of companies.

The IC has introduced several new measures and instructions. Among the latter worth particular mention are the adoption of international accounting standards in the reporting and valuation of assets (especially IAS 39), the use of internationally approved actuarial methods in determining insurance liabilities, the introduction of risk-based capital requirements based on the Canadian model, and the regulation of reinsurance. Recent amendments to legislation have introduced "whistle blowing" responsibilities on actuaries and auditors.

Most of the new measures have moved the regulatory framework in the right direction. The two major exceptions to this positive trend have been the increase in the minimum capital requirement to a very high level and the "grandfathering" of existing companies from meeting the new capital levels and from creating separate companies for their life and general business. The negative implications of these provisions are discussed below.

The regulatory framework covering the constitution and powers of the Insurance Commission also suffers from some important shortcomings. While the IC has been established as an autonomous entity with its own financial resources, its operational and budgetary autonomy is somewhat diminished by four elements: the appointment of the Minister of Trade and Industry as *ex officio* chairman of the Board of Directors of the IC; the failure to appoint the Director General for a fixed term and to require cause for the termination of this appointment; the transfer of any surplus financial resources to the Public Treasury; and the submission of the IC's budget to the Ministry of Finance for review before it is presented to the Council of Ministers for approval. These shortcomings should be removed to strengthen the budgetary and operational autonomy of the IC.

B. Licensing Criteria

Licensing criteria are in general well specified. They include "fit and proper" tests on directors and senior managers and review of business plans and reinsurance

[2] The IC is empowered to approve policy terms and conditions, but not to fix the level of premiums. However, reflecting established practice, the IC issues instructions fixing the tariff for the compulsory third-party motor liability.

arrangements. A major weakness is, however, the failure to empower the IC to vet the probity and financial standing of founders and large shareholders or to approve changes in insurance company control. Licenses are subject to annual renewal.

The IC is also responsible for licensing agents, brokers and loss adjusters. Agents are only allowed to act for one company and must submit to the IC a written agreement of their appointment. For all licensed intermediaries, a clean criminal record and no prior violations of the provisions of the insurance law are required.

Insurance companies are required to appoint actuaries and auditors. Actuaries, but not auditors, are licensed by the IC. However, the IC will issue instructions regarding the qualifications of external auditors.

An important shortcoming of the licensing process concerns the uneven treatment of existing and new companies. Under new regulations, separate companies must be created for life and general business. Very high levels of minimum capital have been imposed on new companies. These amount to 10 million JD for general insurance and 15 million JD for life business, whereas the previous requirement was 2 million JD for both sectors. However, existing companies have been exempted from these requirements. They have been "grandfathered" without time limit and have been allowed to operate as composite insurers without the need to meet the new minimum capital requirements. The "grandfathering" of existing companies effectively discriminates against new companies, may act as a barrier to new entry and may also weaken incentives for mergers and consolidation. Thus, both robustness and innovation may suffer as a result.

The licensing criteria need to be changed to remove these important shortcomings. The IC should be empowered to vet the probity and financial standing of founders and large shareholders and approve changes in control. The minimum capital requirement should ideally be lowered and set at a more realistic level. It should be neither too high to discourage new entry nor too low to result in an excessive number of companies and market fragmentation. It should apply equally to both new and existing companies, although the latter may be given some leeway to comply with the new requirement with a clear timetable. Existing companies should also be required to create separate subsidiaries for life and general business with a clearly defined timetable.

C. Corporate Governance and Internal Controls

The concept of corporate governance was introduced in the 2002 amendments of the Insurance Regulatory Act, which authorize the IC to issue instructions for corporate governance and review the internal controls set by the board of directors of insurance companies. At present, there are no specific provisions regarding the structure of the board of directors, the independence of non-executive directors, or the fiduciary duty of directors to serve the best interests of policyholders.

However, insurance companies are set up as public shareholding (joint stock) companies and are covered by the provisions of the Companies Act 1997 regarding the

fiduciary duty of directors toward the company and its stakeholders and regulations of transactions with related parties (which must be effected on market terms and conditions). While no reporting of such transactions to the IC is imposed, accounting standards require them to be noted in audited accounts. In addition, the internal controls of insurance companies are subject to review by their external auditors, who are in turn required to report any serious deficiencies to the Audit Committee of the Board of the companies and to the IC.

Many issues relevant to corporate governance are covered in other rules issued by the IC, such as the licensing and reinsurance instructions. The instructions on reinsurance, issued in late 2002, provide a very good example of the emerging emphasis on the responsibilities of the Board of Directors and the effectiveness of internal controls. Special importance is also generally attached to the role of the Audit Committee of the Board of an insurance company, which must consist of non-executive directors and must receive the reports of the external auditor and the appointed actuary.

Instructions dealing with corporate governance are expected to be issued in 2004. They will be based on international best practice as reflected in the IAIS Core Principles. The rationale for extensive provisions on corporate governance is fully endorsed. Insurance companies conduct extensive transactions with large numbers of policyholders and their corporate governance should reflect a higher standard than that which applies to general purpose corporations.

The observance of principles that depend on good corporate governance, such as those related to internal controls, investment and reserving policies, and the monitoring of transactions with related parties, would benefit from a strengthening of the legal requirements for good corporate governance among insurance companies.

However, corporate governance is one of the areas where the new rules come into potential conflict with prevailing patterns of business. It is argued by most insurance companies that observance of modern corporate governance principles would face difficulties given the preponderance of family control and the absence of non-executive directors with professional knowledge of insurance matters. Although this would seem to be a valid concern, the importance of sound corporate governance could not be ignored. A pragmatic plan of implementation of these rules would appear to be called for, emphasizing some aspects (such as transparency and disclosure and the role of the Audit Committee) more than others.

D. Underwriting Policies and Technical Provisions

For large commercial and industrial risks underwriting policies and technical provisions are based on the practices of international reinsurers, which cover more than 80 percent of the risks involved. In compulsory motor insurance, the tariff is set by the regulatory authority in consultation with the Insurance Federation. Companies use their own data on loss experience, acquisition costs, and settlement delays for a relatively small part of their business.

Development of an insurance information bureau is essential for motor insurance and other retail lines if the regulation of the motor sector and reliance on reinsurance are to be reduced and the companies are to engage in their own underwriting policies. Also, for life insurance, better data on mortality, lapse and surrender rates are required. On the other hand, large industrial and commercial risks should continue to rely extensively on international reinsurance. Their underwriting and reserving policies should thus reflect international practice.

The IC specifies the types of technical provisions that insurance companies are required to maintain. For general insurance business, these include provisions for unearned premiums, unexpired risks, outstanding claims, incurred but not reported claims, and catastrophic risks, while for life insurance business, they cover mathematical provisions and provisions for unearned premiums and outstanding claims.

Companies are required to use internationally approved actuarial methods in setting their reserves. The new instructions require use of the remaining period to maturity of a policy for setting the unearned premium provisions, except for those cases (such as shipping insurance) where a policy does not have a fixed timeframe. For these cases and for the outstanding claims reserves, companies are required to rely on their past experience. Companies are not allowed to use the discounted present value of claims in setting the required provisions.

The level of provisions held by reinsurance companies is allowed to be deducted. However, the outstanding claims provisions should not be lower than 10 percent of the gross outstanding claims provisions even if more than 90 percent of the gross written premiums has been ceded to reinsurers, except for fire and other property damages where the minimum level is set at 5 percent. The amount of credit taken for amounts recoverable from reinsurers is controlled by the instructions on reinsurance and solvency margin.

Composite companies must maintain segregated provisions for general and life insurance business. All companies are required to attach actuarial certificates confirming the adequacy of technical provisions to their closing annual financial statements for both life and general business. Because of the dearth of trained actuaries in Jordan, companies use actuarial services from other countries.

Companies are required to disclose to the IC the methods and assumptions used in the calculation of reserves and any changes in them. Although current rules do not authorize the IC to vet the assumptions used by actuaries regarding loss experience, interest rates, and mortality, the DG has the right to request any clarification from the actuaries and the IC has in practice considerable power to influence actuarial calculations. In addition, actuaries are obliged to testify on the adequacy of reserving policies. The company that is currently under liquidation was found by a special audit to suffer from a large deficiency in its reserves.

The IC is strengthening the effectiveness of both its off-site surveillance and on-site inspection in determining the adequacy of reserve levels by expanding the number of qualified staff and increasing the frequency of inspections. In addition, the instructions that will be issued on corporate governance will address the responsibility of Board of Directors in setting and monitoring reserving policies.

The lack of a solid statistical information on loss experience and other aspects of insurance business for both the life and general sectors is a major impediment to the adoption of sound underwriting and reserving policies. The creation of an Insurance Information Bureau is therefore an urgent need. The requirement of actuarial certification of the adequacy of general insurance reserves is causing some concern among insurance companies, mostly on grounds of the high cost of foreign actuaries. As discussed below, group contracts on behalf of all or some companies could alleviate this cost.

E. Rules on Asset Segregation, Diversification and Valuation

No limits are currently imposed on the types of admitted assets and their investment. The adoption of risk-based capital requirements in 2002, which apply a 100 percent capital requirement on low quality assets, dispenses with the need to define the categories of admitted assets.

Insurance companies are currently allowed to invest in overseas assets and could thus attain a more optimal diversification of risks. However, few, if any, companies have taken advantage of this opportunity, probably because their liabilities are in domestic currency.

There are no explicit provisions on asset segregation. As in most other jurisdictions, insurance companies are not required to hire external custodians to ensure the safety of their assets. However, they should be expected to have robust internal control systems in place that would prevent individual asset managers from putting the safety of assets at risk and from engaging in unauthorized investment transactions. At present, it is unlikely that the internal control systems of most companies meet these challenging requirements, but the IC intends to emphasize the need for strengthening internal controls.

The adoption of international accounting and auditing standards and risk-based solvency margin rules favor prudent asset diversification and fair value accounting. However, several insurance companies report very high levels of accounts receivable, including claims on policy holders, agents and reinsurers, as well as investments in illiquid assets (such as real estate and shares in unlisted companies) for which it is difficult to obtain fair market values.

Fair value accounting of illiquid assets is a challenging proposition for insurers, auditors and supervisors. There are reports that insurance companies engage in artificial transactions (sometimes with each other) near the end of the financial year for the purpose of establishing a favorable market price for an illiquid asset and then reverse

these transactions in the ensuing financial year. Since even most listed equities are illiquid (the turnover of the Amman Stock Exchange is very low at around 10 percent of market capitalization), this represents a major obstacle to the meaningful application of modern accounting rules. There is no easy answer to this problem, other than stimulating greater liquidity in asset markets and developing a consistent and uniform valuation model for illiquid assets.

The new rule on solvency margin imposes higher capital weights on some of these assets, but does not fully address the need to maintain a well-diversified portfolio of liquid and fairly valued assets. The IC will issue instructions on investment policies that will emphasize the importance of adequate diversification, security, liquidity, and fair valuation and will address the responsibilities of the Board of Directors in setting and monitoring investment policies. Nevertheless, implementation of policies that emphasize market valuation of assets faces difficulties because asset markets, even for listed equities, are generally illiquid.

F. Solvency Margin Requirement

Traditionally, the solvency margin for general insurance companies in most developing countries was set at between 10 and 20 percent of gross premiums. This discriminated against insurers that made extensive use of reinsurance and failed to take account of the level of claims incurred by a company.

The European Union approach to insurance solvency has addressed these shortcomings by basing the required margin on net premiums as well as net claims (subject to a minimum retention ratio). The EU approach has been adopted in many developing countries around the world. However, this approach does not allow for differences in the risk of asset classes.

The IC has adopted a risk-based solvency margin that follows the Canadian model. It applies specific capital weights to different risk assets, policy liabilities, reinsurance exposures and life assurance risks. The capital requirement varies with the perceived riskiness of each category of asset. High requirements are placed on overdue accounts receivable and on claims on reinsurers with low or no rating. For general insurance business, there is a basic 8 percent capital requirement for net reserves, while for life insurance business, the basic capital requirement is set at 3 percent of net reserves plus 0.15% of net insured sums. The capital requirements on reinsurance are 30 percent on the net claims from group 2 reinsurers, 50 percent for group 3 and 100 percent for group 4 (see the next section for the definition of groups).

The risk-based capital (RBC) approach to insurance solvency represents an improvement over the EU approach. However, it is far more complex and involves the setting by the regulators of a large array of weights that apply to different asset classes. One major problem is the difficulty of taking account of large differences in exposure to risk of assets that belong to the same class. For example, all company shares are assigned

a risk capital requirement of 15 percent without any distinction between highly liquid listed equities and holdings of private equities in unlisted companies.

No capital provision is imposed for market risks. While these may be reflected in the adopted risk capital weight for company shares and other risk assets, the adoption of a nil capital requirement for holdings of government bonds exposes insurance companies to fluctuations in the market value of these bonds. However, this potential problem is mitigated by the extent to which government bonds are held to maturity and are therefore posted at their amortized value.

The solvency margin is defined as the ratio of capital available to the capital required and is set at a minimum of 150 percent at all times. A distinction is also drawn between core and supplementary capital with an upper limit on the latter of 50 percent of the former. Core capital includes paid up capital, equity reserves, retained earnings, and issuing premiums. Issuing discounts, own stocks held by the company, accumulated losses and deficits in technical provisions are deducted. Supplementary capital includes changes in the valuation of real estate, in the fair value of financial assets available for sale and from foreign currency translation as well as subordinated loans (on a sliding scale depending on residual maturity).

The risk capital weights were simulated on insurance companies before their promulgation but the effectiveness of the risk-based capital requirement remains to be tested since its introduction is too recent and companies have yet to go through a full cycle of reporting on their compliance.

G. Reinsurance Controls

The regulation of reinsurance is based on modern principles. There are no minimum retention ratios and no compulsory cession to any local company, although some local reinsurance takes place. Responsibility for determining and monitoring reinsurance policies is placed on company directors, while companies are required to provide the IC annually with the basic documentation supporting their reinsurance programs.

The evolution of the regulation of reinsurance provides a good example of the flexibility of the new Insurance Commission and the impact of its wide consultation with insurance companies and other parties. The original instructions imposed limits on the proportions of cessions to different reinsurance companies on the basis of their rating status. The limits were a minimum of 70 percent for reinsurers in groups 1 and 2, a maximum of 20 percent for those in group 3, and a maximum of 10 percent for those in group 4. Group 1 includes companies in the first two categories of international ratings; group 2 those in the following two categories of international ratings; group 3 those in the next two categories of international ratings; and group 4 all companies with lesser or no ratings.

Because they do not have international ratings, local insurers complained that these rules placed a very low limit on their ability to engage in local reinsurance. They argued that they were authorized to assume 100 percent of risks as primary insurers, but were restricted to a maximum of 10 percent as local reinsurers. Regional reinsurers with a good payment record but without an international rating also complained that these rules were likely to have an adverse effect on their ability to serve the Jordanian market. Consideration was given to amending the reinsurance rules to accommodate the concerns of local insurers and regional reinsurers, while preserving the basic objective of promoting sound reinsurance arrangements.

The reinsurance instruction was amended in November 2003. The new rules imposed a combined minimum requirement of 75 percent for groups 1 and 2 and a maximum limit of 25 percent for groups 3 and 4. These limits would apply for a period of 3 years until 2005. From 2006 onwards, reinsurance business would be ceded only to reinsurers of groups 1 and 2. However, cessions to companies of group 3 and 4 could be selectively approved on the basis of specific requirements. However, any companies of group 3 and 4 would be expected to meet the solvency margin as it is applied to local companies. Reinsurance business with funds or pools of insurance rates within groups 3 and 4 may also be approved on a selective basis. The amendments to the rules aim to safeguard the integrity and quality of reinsurance contracts, while allowing some flexibility to the regulator to respond to market developments.

H. Code of Market Conduct

A code of market conduct is required to ensure that insurers and intermediaries act with due skill, care, and diligence in conducting their business activities, seek to obtain adequate information on the insurance needs of their customers, and support effective systems of handling complaints and resolving disputes.

In Jordan, a code of conduct on insurers and intermediaries is under preparation and will be issued in 2004. Most general insurance, outside the motor branch, concerns large industrial and commercial risks where consumer protection is less of an issue. The compulsory third party motor liability insurance is distributed among licensed companies on a rotational basis by the Unified Compulsory Motor Insurance Bureau, operated by the Federation of Insurance Companies. Most disputes between policy holders or third party beneficiaries and insurance companies relate to these policies and concern small and weak companies. The IC has established a disputes and enquiries office that mediates between aggrieved policyholders and beneficiaries and the companies concerned. It offers advice on amicable settlement, but its decisions do not have a binding effect on insurance companies.

The concepts of the Ombudsman and Alternative Dispute Resolution in insurance were introduced in the recent amendments to the act. The decisions of the Ombudsman office will have a binding effect on insurance companies, while insurance customers will retain the right to seek redress in the courts. The creation of an Alternative Dispute Resolution Center is under way with the assistance of the American Bar Association.

The regulatory framework covering life insurance requires considerable strengthening. There is a need to provide for cooling off periods and for clear disclosure of meaningful information to policyholders, including surrender values, benefit participation rates, expected and realized rates of return, product risks, commission levels, and other aspects of life insurance contracts. Some of the leading companies already follow best practice in their selling of life policies, but a strong regulatory framework offering adequate consumer protection will contribute to building public trust in insurance companies and their intermediaries.

As regards motor insurance, development of an insurance information exchange with data on loss experience, driving records, and fraudulent claims is required in order to replace the Unified Bureau mechanism. This will also allow the elimination of administered tariffs. The information bureau could also cover all other types of general insurance.

I. Off-Site Surveillance and On-Site Inspections

Current rules stipulate the financial reporting requirements of insurance companies. Audited consolidated annual statements must be provided 2 months after the end of the fiscal year (which the insurance act defines as the calendar year for all companies). Various statistical returns on specified forms, reviewed by external auditors, must be submitted one month after the end of each calendar quarter. Insurance companies are required to appoint licensed external auditors and to comply with international accounting standards. The responsibilities of auditors, including their obligation to report to the IC any material shortcomings and deviations from acceptable norms, are set out in the act.

The IC undertakes off-site financial analysis of insurance companies. Considerable progress has been made in developing an Insurance Regulatory Information System that is able to identify companies with weak operating and financial structures. This early warning system should be completed and formally introduced. It could play an important part in improving the effectiveness of off-site surveillance and guiding the program and timing of on-site inspections.

The IC has broadly adequate powers of inspection and investigation. It can assign staff to verify or audit, at suitable times, any of the transactions, records or documents of insurance companies. The IC is empowered to take copies or extracts of relevant documents and to conduct regular as well as unannounced inspections. Based on the findings of the inspections, the DG may appoint experts, consultants, auditors or actuaries to undertake special audits of insurance companies.

In practice, the IC has been able to conduct inspections of all operating companies, jointly with international experts. It is in the process of expanding its capacity in this area by hiring more qualified staff and upgrading their skills through training. Increasing the frequency of inspections and focusing on internal control and risk

management systems of weak companies should be a high priority. A task that requires immediate attention is the undertaking of special audits of companies with weak reserve levels and inadequate solvency margins.

J. Sanctions and Ladder of Compliance

The insurance act empowers the IC to take a broad range of corrective measures when insurance companies face financial difficulties. These measures include: the undertaking of special audits, imposing a maximum limit on new premiums, requiring localization of assets, imposing investment restrictions, requesting the replacement of management, removing the chairman and board of directors, appointing administrators, arranging for mergers, suspending or canceling licenses, and rehabilitating or liquidating companies. The insurance act also defines a wide range of offences for which specific penalties are applied. Penalties are doubled for repeat violations. The act contains several provisions on the rehabilitation or liquidation of ailing companies. The power to appoint liquidators and supervise their work has been given to the IC.

Action has been taken in the case of one company with insufficient reserves and a large capital shortfall . This company was placed under liquidation in 2001. The action was taken under the Companies Act because of a precipitous fall in its equity capital. The liquidation of this company appears to be proceeding smoothly. All claimants and other creditors are likely to be satisfied from the disposal of available assets and some distribution may even be made to shareholders.

A clear ladder of compliance needs to be developed that would link particular deficiencies, violations of rules and other offences to specific action by the regulator. The aim of such a ladder would be to establish objective and clearly understood criteria of regulatory action, avoid criticisms of unjustified intervention, and ensure that intervention action is taken early to ensure the financial soundness and good conduct of the insurance industry. The IC has started working on the development a Supervisory Ladder.

K. Compensation Funds

As noted above, the liquidation of the one company that faced serious financial difficulties is proceeding smoothly and will not require any support from a compensation fund. However, creation of compensation funds may be required to settle outstanding claims of companies that are placed under liquidation in the future. Ideally, separate funds should be established for life and general business, while the latter could, at least initially, only cover third party motor liability.

While policyholders and beneficiaries, especially third party victims, need to be protected from insurance company insolvencies, care must be taken to control the risk of moral hazard. Effective supervision and successful implementation of risk-based capital requirements would be important preconditions before the creation of a compensation fund.

L. From Reactive to Proactive Risk-Based Supervision

The high information costs of insurance operations create a strong need for robust regulation and effective supervision. The objective of regulation is to ensure the financial soundness of companies, promote good market conduct, and protect the interests of policyholders. Traditionally, regulators relied on reactive supervision to achieve these objectives. This was because of the large number of companies and the small size of supervisory staff in most countries as well as the absence of well-developed information systems. But increasingly, greater reliance is placed on proactive risk-based supervision.[3] This uses an increased number of staff with higher skills as well as modern computerized systems of financial reporting and analysis.

The traditional reactive supervision relied on basic licensing and reporting rules with limited off-site analysis and even more limited and infrequent on-site inspections. The main pattern of operation was reaction to crises as they occurred with little attempt to prevent crises by identifying and acting on weak insurance companies. Insurance companies lacked transparency because of their large number, the complexity of their operations, and the limited resources of supervisors.

The growing emphasis on proactive risk-based supervision involves very clear rules on licensing, on changes in control, on corporate governance and internal control systems, and on extensive disclosure and high transparency. Particular emphasis is placed on ensuring the financial soundness and good conduct of individual insurance companies. Regular reporting is required, preferably in electronic form, to facilitate off-site financial analysis. The supervisory agency is expected to have strong capability for financial analysis and to conduct frequent inspections. It is also given clear powers of intervention to be able to take early action to contain losses and protect policy holders.

A most important aspect of proactive supervision is the emphasis placed on strengthening corporate governance structures. Regulations address the role of directors and require the presence of independent non-executive directors with adequate expertise and with primary responsibility in audit, remuneration and compliance committees. Directors are required to ensure that there are adequate and effective internal control systems. The key to this new approach is to emphasize the fiduciary duty of directors toward policy holders and the avoidance of conflict of interest situations.

Certified actuaries and auditors are called upon to play a key role in the supervision of insurance companies. Their work should be subject to peer review and independent oversight with disciplinary action. The system is also predicated on extensive cooperation and exchange of information between actuaries, auditors and supervisors. Actuaries and auditors have a responsibility to report to the Chairman of the Board of Directors and to the regulator any major infractions of rules they discover in the course of discharging their duties.

[3] The proactive risk-based approach to supervision is emphasized in Savage (1998) and FSA (2001).

Regulators play a major part in promoting sound prudential risk management. In cooperation with actuaries, they issue guidance notes on the creation of technical reserves and the methodology used for key actuarial assumptions. They also issue clear rules on asset segregation and safe custody as well as asset diversification and valuation. Prudent risk management also requires the setting of an adequate and well specified solvency margin. Increasingly, this is formulated as a risk-based capital requirement that takes into account the level of risk of both assets and liabilities. Finally, formulation and publication of a regulatory ladder is an important tool to ensure consistency and predictability in the exercise of supervisory functions.

As the preceding discussion amply demonstrates the new Insurance Commission of Jordan has embraced the new regulatory and supervisory approach and is well on its way in creating a modern and effective system of insurance regulation and supervision. It needs to become an effective and proactive supervisory agency, focusing on risk-based supervision. It also needs to emphasize the importance of internal control systems, complement the corporate governance role of non-executive directors, play an active part in developing comprehensive databases, develop objective and uniform valuation models for illiquid assets, and commission special audits of companies with weak financial structures (low reserves and solvency margins and/or large exposure to illiquid assets and accounts receivable).

IV. Policy Issues and Future Prospects

This section discusses the continuing policy issues facing the insurance industry and insurance regulation in Jordan and evaluates the future prospects for accelerated growth and development.

A. Policy Issues

The creation of the Insurance Commission and adoption of a modern approach to insurance regulation and supervision represent major steps forward in promoting the development of the insurance industry. The new Commission has expanded its staff and undertaken a wide-ranging training program to upgrade skills. It has adopted a multi-year plan aiming at modernizing the regulatory framework, strengthening supervision and enhancing the efficiency of the sector.

Most of the measures introduced by the Commission, such as the new rules on accounting and asset valuation, risk-based capital and solvency margin, technical provisions, reinsurance, and requiring the creation of separate subsidiaries for general and life business aim in the right direction. The two significant exceptions are the very large increase in the minimum capital of new companies and the “grandfathering” of existing companies from meeting the new high capital requirements and from creating separate subsidiaries for life and general insurance.

The minimum capital requirements should ideally be lowered and set at more realistic levels, while existing companies should be given a clear timetable to comply with the capital and business separation rules. Many companies engage in life business on a very rudimentary basis and their licenses could be withdrawn without causing a negative effect on competition.

The need to complete the modernization of insurance regulation and supervision and the restructuring and consolidation of the insurance industry cannot be overstressed. The budgetary and operational autonomy of the IC should be strengthened, while the Commission should be empowered to vet the probity and financial standing of founders and large shareholders of insurance companies and approve changes in their control.

The IC should complete the issuance of new instructions strengthening corporate governance and internal controls, setting out sound diversification principles for investment policies, and introducing a code of market conduct for both insurance companies and intermediaries. Full implementation of the Insurance Regulatory Information System and publication of a clear regulatory ladder would facilitate the taking of early and consistent intervention action on weak companies.

The regulatory framework covering life insurance requires considerable strengthening. There is a need to provide for cooling off periods and for clear disclosure of meaningful information to policyholders, including surrender values, benefit

participation rates, expected and realized rates of return, product risks, commission levels, and other aspects of life insurance contracts.

The IC needs to build a solid reputation for effectiveness and consistency in its intervention action. It should have the operational independence and strong political backing to take action to ensure that only companies that are financially strong and are able to adopt sound marketing, reinsurance, reserving and investment policies are allowed to continue to operate in the market.

The IC is taking steps to reduce delays in settlement and to address consumer complaints against insurers. It has created a settlements and enquiries office that listens to complaints and seeks to settle disputes on an amicable basis. Plans are also under way for establishing a complaints committee (similar to an ombudsman service) for mediating in insurance disputes with a binding effect on insurance companies. Moreover, the IC is establishing an alternative disputes resolution center for insurance disputes to be settled through arbitration and mediation.

There is a need to develop an insurance information bureau for motor insurance business to facilitate sharing of data on loss experience, driving records and fraudulent claims among all licensed companies. Its development could make easier the lifting of administered tariffs on third party motor liability (TPML) and the elimination of the unified bureau. It could allow companies to offer discounts to good drivers and penalize bad ones as well as reject bad risks. The creation of a national pool for bad risks could be considered. The insurance information bureau could also collect data on other retail policies as well as assist in the development of mortality tables and lapse and surrender data for life business.

The need for establishing one or more compensation funds to cover the unpaid claims of failing companies should be reviewed in consultation with the Federation. However, effective supervision and full implementation of the risk-based capital requirements would provide a better safeguard against such losses.

Some concern is expressed by insurers about the cost of regulation, the risk of over-regulation, and the fast pace of implementation of the new instructions. However, many of these concerns need to be taken in context. The insurance industry has long been used to operating with inadequate regulation and weak supervision. Adjusting to the new approach creates difficulties, although there is widespread strong support for the basic objectives of the IC.

Nevertheless, compliance with some instructions is likely to prove difficult. For example, observance of modern corporate governance principles will face difficulties given the preponderance of family control and the absence of non-executive directors with professional knowledge of insurance matters. The requirement of actuarial certification of general insurance business may turn out to be expensive because of the dearth of qualified actuaries in the local market. In this respect, an approach that could mitigate the cost of foreign actuaries would be to facilitate group contracts, covering

several companies and thus economizing on travel costs. Implementation of fair value accounting rules is also problematic when most local markets are illiquid. Engaging in artificial reversible transactions does not create a fair market value for illiquid assets. While there is no easy answer to this problem, developing a consistent and uniform valuation model for illiquid assets might help.

A phased implementation of the new instructions on technical provisions, especially with regard to the unearned premium reserve, is suggested by insurance companies to mitigate the impact on reported profitability. A phased implementation of the new solvency margin could also be envisaged. On the other hand, the IC needs to increase the frequency of on-site inspections and take strong action against companies that fail to maintain adequate levels of technical reserves, report very high levels of accounts receivable, and invest heavily in illiquid assets (for which it is difficult to obtain fair market values). Action to force companies to maintain adequate levels of technical reserves and meet the new solvency margin would encourage the consolidation of the insurance sector into a smaller number of stronger and more efficient companies.

B. Future Prospects

The level of development of general insurance is already fairly high and appears to have accelerated in recent years. The new regulatory approach promises to stimulate further its growth. However, life insurance is lagging considerably behind other countries in the region and elsewhere.

The insurance sector will be called upon to play a major role in meeting two important challenges of the Jordanian economy in the future: the mobilization of long-term financial resources for a more stable financing of economic growth; and the financing of the growing retirement needs of an aging population. Both economic intuition and empirical evidence support the argument that contractual long-term savings, mobilized by pension funds and life insurance companies, can act as a countervailing force to the dominant role played by commercial banks, promote the development of securities markets, encourage long-term borrowing by non-financial enterprises and by households for housing purposes, and contribute to banking sector stability (Vittas 1998, 2000, Impavido et al 2001, 2002, 2003).

Even if no major systemic reform of the pension system is undertaken in the immediate future, stimulating the development of life insurance would provide a major impetus to the mobilization of long-term financial savings. This would require the introduction of tax incentives favoring life policies that generate long-term savings and a strengthening of the regulatory framework covering life insurance. A strong regulatory framework offering adequate consumer protection would contribute to building greater public trust in life insurance companies and their intermediaries.

In addition to tax incentives and a strong regulatory framework, the growth of life insurance would also require a positive public image for the whole sector. The public would be reluctant to entrust its long-term savings to insurance companies if its dealings

in motor insurance continued to be bedeviled by disputes and long delays in settlement of claims. A negative experience in one part of the insurance market would affect the development prospects of other parts. Every effort would need to be made to complete the modernization process by eliminating the remaining shortcomings and contradictions of the regulatory framework.

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