MARMORE
MENA INTELLIGENCE
A المركز MARKAZ Subsidiary

January 2021

GCC Institutional Investors

Pension Funds

Research Highlights

Analyzes the current status and role of GCC pension funds and provides suggestions to overcome challenges.

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www.marmoremena.com

enquiry@e-marmore.com

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Executive Summary

Globally the pension funds are one of the most popular instruments that sovereign governments and large institutional investors have used in order to fund the retirement benefits of their workforce. In the past two decades, they have been the ones to undergo a sea change as burgeoning fiscal deficits and increasing inflation prompted the governments to put their schemes and benefits under review. These reviews helped the shift to a defined contribution model from the previously popular defined benefit model. GCC region on the other hand has been an outlier when it comes to development of pension funds.

Tight-knit family structures, religious obligations and generous government benefits mean that many of the nationals in the region have little to worry about pensions. Higher oil prices before 2014 gave enough confidence for the GCC governments in their ability to fund any shortfalls that might arise in the future. With significant asset base and growth prospects, pension funds are key institutional investors in the region.

However, given the way, oil prices have broadly remained in the lower range since their drop in 2014-16 and muted outlook towards fossil fuels warrants a re-assessment of the pension system structure in the region. Recognizing this, GCC governments and pension funds have initiated reforms in the structure of pension systems, their obligations, retirement age etc. Additional reforms to address major challenges in the segment would aid in ensuring wealthy and sustainable pension funds.

Table 1.1: Prominent Pension Funds in GCC

Pension Fund	Country	AuM (USD bn)
The Public Institution for Social Security	Kuwait	124.0
General Organization for Social Insurance (GOSI)	KSA	115.4
Public Pension Agency	KSA	51.5
General Retirement and Social Insurance Authority	Qatar	23.6
Social Insurance Organization	Bahrain	10.1
Ministry of Defence Pension Fund	Oman	4.8
Civil Services Employee Pension Fund	Oman	4.5
Abu Dhabi Retirement Pensions and Benefits Fund	UAE	3.0

Source: SWFI, Annual Reports

Development and Role of Pension funds in the GCC region

Pension funds are relatively new development in the GCC region. Local traditions and culture such as the elderly providing for their next generation and donations from charitable organizations effectively delayed the arrival of pension and insurance in the region. Despite the struggles, pension funds currently manage assets of USD 341.3billion. Earliest of the pension fund started in Saudi Arabia in 1969 while the Qatar's insurance scheme was established only in 2002. Concepts such as retirement benefits and payouts to its citizens were not seriously considered, due to generous government salaries and associated benefits coupled with the higher proportion of expatriate workers, until recently. Lower oil prices and the impact that it had on the region's SWF assets and other rainy day funds has prompted the respective authorities to review their plans for the respective retirement funds.

Pension Systems

GCC countries have generous pension systems for their national workforce and owing to their relative infancy, they still follow the defined benefit model[1] while globally the trend has shifted to defined contribution model[2]. The replacement rate, defined as the pension divided by the last salary, indicates the share of total gross income that the retiree would get post retirement. Income replacement rate after retirement is quite high at 80% compared to global average of 35[3]%. This higher than average rate is mainly due to years of high oil prices. Schemes for civil servants target, in general, higher levels of income replacement than schemes for private sector workers. The targets for the basic pension also tend to be among the most generous in the world.

To add to the complexity, pension eligibility starts at a relatively early age in the GCC countries. For instance, in Qatar, it is possible to retire after just 15 years of work and still be eligible for maximum pension with an early retirement option at 45.

GCC pension systems are at a nascent stage and are only partially funded with most retirement benefits paid out with the help of excess contributions from the employees rather than income derived from pension assets. The position may not be sustainable in the long-run unless structural reforms in the pension system are introduced.

[1] *Defined Benefit – These schemes promise to pay a fixed amount (Sometimes indexed for Inflation) for retirees till the end of their lifetime*

[2] *Defined Contribution – These schemes do not promise a fixed benefit but instead only a fixed amount of funds is invested in a portfolio. Beneficiaries are usually given the choice of portfolios that cater to all risk requirements*

[3] *IMF – Finance and Development – June 2017*

Table 2.1: GCC Pension Indicators

Organization	Replacement Ratio[1]	Contributors per retiree[2]
KSA, Public Pension Agency (PPA)	110%	3.9
KSA, General Organization for Social Insurance	108%	7.3
Kuwait, Public Institution for Social Security	103%	3.2
Qatar, General Retirement & Social Ins. Authority	55%	6.8
UAE, General Pension & Social Security Authority	68%	5.1
Oman, Civil Service Employees Pension Fund	53%	3.9
Oman, Public Authority for Social Insurance	61%	19.2
Bahrain, Social Insurance Organization	78%	3.6
GCC, Average	80%	6.6

Source: International Social Security Association (issa); Data as of latest available
[1] Monthly average pension income received as a percentage of monthly insured salary
[2] Computed as the ratio of number of pension contributors to the number of pensioners

Population Characteristics

Population Characteristics play an important role in the structure of pension systems and in turn in the management of pension funds.

A Young and Growing Population

To comprehend the sheer scale of demographic change in the GCC region requires some insights in the population and its growth. The aggregate population has increased more than tenfold in little over half a century. The increase from four million in 1950 to 40 million by 2005 is widely considered the most rapid population growth rate anywhere in the world during that period. It is projected that the aggregate population will grow to 62.7 million people by 2025.[4] A growing population while increasing the base for pension funds to cater too, also increase the number of contributors. Currently, Kuwait and Qatar has the largest amount of funds relative to its population. Kuwait's recapitalization initiatives in the past have paid off. From 2008-15, the Kuwait government has worked on to fill in the actuarial deficit that has been estimated at nearly USD 40bn[5]. The previous recapitalization took place in 2014/15 when Kuwait government transferred USD 8.25bn to its pension fund.[6] The fund was restructured in 2017 and recent profits have also helped build its asset base.

Table 2.2: Pension Fund Assets Relative to GDP and Native Population

	Pension Fund Assets (USD billion)	Nominal GDP USD billion (2020e)	Pension Assets as % of GDP	Native Population (mn)	Pension Assets per capita (USD)
Bahrain	10	35	29%	0.7	14,716
Kuwait	124	109	114%	1.4	90,842
Oman	13	62	21%	2.7	4,720
Qatar	24	148	16%	0.3	67,768
KSA	167	681	25%	20.8	8,036
UAE	3	354	1%	1.1	2,766

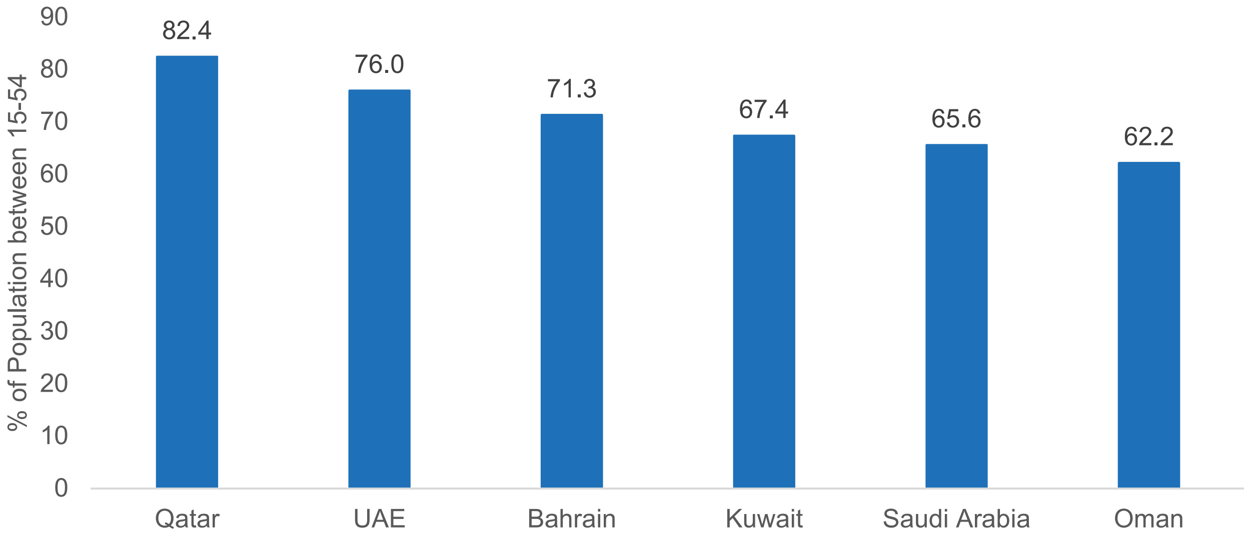
Source: SWFI, IMF, Marmore Research; Latest available data;

[4] *UN World Population Prospects*
[5] *IMF*
[6] *IMF. Exchange Rate 1USD=3.52 KD*

Although there are important differences in demographic structure, all countries in the GCC region share a relatively young population. The working age population (15-64 years) is close to 75% while those aged 65 and above comprise just over 3% of the total.[7] A rapid increase in old-age dependency ratios will take place only after 15 to 20 years.

Current demographics of GCC countries, dominated by youth population, remain favourable. This coupled with expected increase in female participation rates would increase the overall labour force, allowing the pension subscription base to expand and mop up further assets. It also positions GCC pension funds in a favourable sweet spot wherein their risk appetite could be higher and investments could be made in riskier asset classes at much higher proportions, as the liabilities and cash outflow requirements are years ahead. Pension assets are expected to grow further and expected to taper off by next decade, when the schemes mature triggering payments.

Figure 2.1: Demographic Dividend – 2020 Estimates



Source: CIA World Fact Book

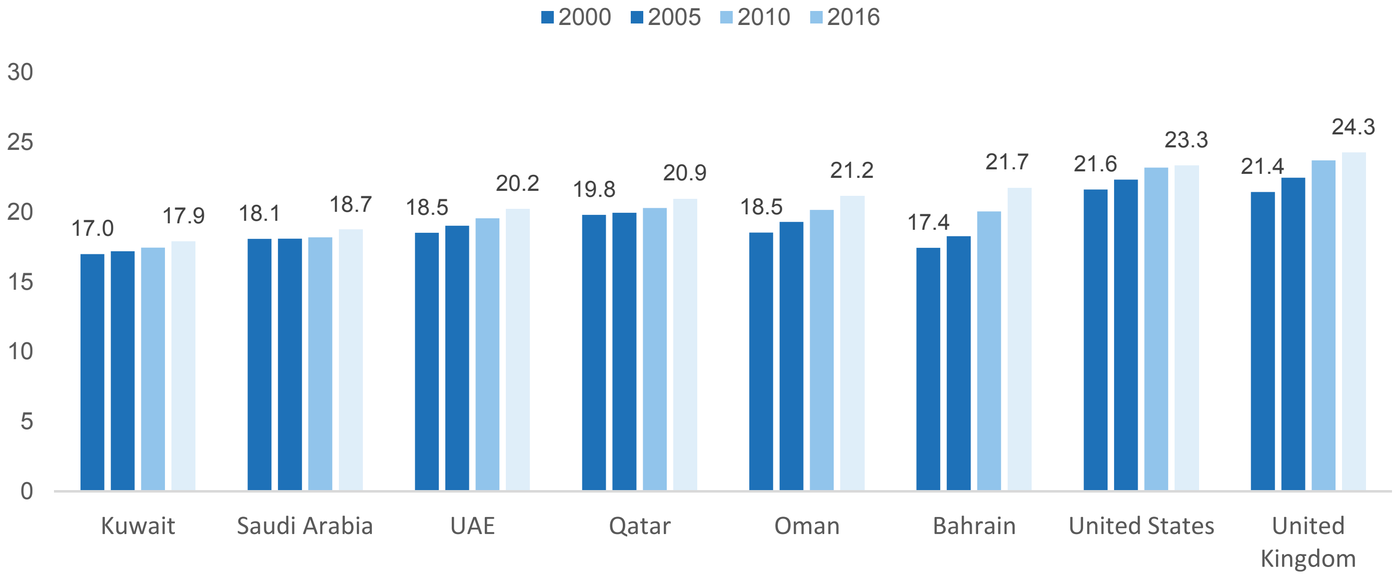
Longevity of the population

Pension schemes contribution and reserves vary according to the number of years that a pensioner is expected to live post his retirement. Simply, higher life expectancy means more cost to be borne by the government if the retiree component is not sufficient. Advancing healthcare facilities available in the GCC countries is extending the expected life expectancy of retirees adding to further complications in terms of fund requirement for fulfilling pension obligations.

Longevity is one factor that is beyond the control of the governments and it can make a huge difference. Some of the models that have forecasted the pension outgo found that the cost of serving pension for five more years increased by 22% per person. Longevity of the population is population is a problem that has no easy solutions at hand – revamping the investment strategy, reducing the benefits and converting the defined benefit schemes to defined contribution might help but requires some strong initiatives from the government side.

[7] *UN World Population Prospects*

Figure 2.2: GCC life expectancy at 60 years has been slowly improving and reaching developed country levels



Source: World Health Organization

GCC Pension Fund Landscape

GCC Pension Fund

GCC pension funds differ in terms of asset sizes, performance of funds and the pension systems. While Kuwait PIFSS underwent a revamp in 2017 and reported a 60%, y-o-y increase in profits for April-June 2020, Bahrain is facing a possible exhaustion of their public pension funds by 2024. Meanwhile, Saudi Arabia ranks 23rd out of 39 pension systems ranked by the Global Pension Index. The system has been awarded an index value of 57.5, indicating that while the system has good features, it also has major risks that need to be addressed.

Table 3.1: GCC Pension Funds' Assets (AuM)

Pension Fund	Country	AuM (USD Bn.)
General Organization for Social Insurance (GOSI)	KSA	115.4
Public Pension Agency	KSA	51.5
The Public Institution for Social Security	Kuwait	124.0
General Retirement and Social Insurance Authority	Qatar	23.6
Social Insurance Organization	Bahrain	10.1
Ministry of Defence Pension Fund	Oman	4.8
Civil Services Employee Pension Fund	Oman	4.5
Abu Dhabi Retirement Pensions and Benefits Fund	UAE	3.0

Source: SWFI, Annual Reports

The funds differ in terms of their asset mix too. Saudi Arabia's Public Pension Agency and Qatar's pension fund hold significant portions in the local equity markets at 20% and 46% respectively. Qatar has invested 99.2% of its assets locally. UAE's pension fund invested USD 300mn in ADNOC; a state owned Oil Company in 2019 and again made a joint investment of USD 2.1billion with ADQ[1], a holding company of Abu Dhabi Government, in 2020.

Kuwait's PIFSS has holdings in over 40% of stocks in domestic exchange. However, majority of the fund's assets are offshore, focused mainly on developed markets such as North America and Western Europe. The fund being optimistic in the infrastructure space especially in the U.S., is planning to more than triple investments in infrastructure as part of its asset-allocation strategy over the next couple of years.

[1] *Erstwhile Abu Dhabi Developmental Holding Company (ADDH)*

Table 3.2: Asset Mix of GCC Pension Funds

Asset Class	KSA (PPA)	Qatar	Oman
Local Equity	20.0%	42.9%	16.1%
Int'nl Equity	29.1%	0.3%	N.A
Local Real Estate	6.2%	6.0%	4.0%
Int'nl Real Estate	0.4%	0.1%	
Infrastructure	N.A	N.A	N.A
Fixed Income	36.0%	46.2%*	20.5%
Investment Funds	N.A	4.2%	18.2%
Alternatives	2.5%	0.4%	1.3%
Cash	N.A	N.A	N.A

*Source: Annual Reports, Marmore Research; Latest available data. Note: PPA- Public Pension Agency; Real Estate for KSA includes real estate and infrastructure; Alternatives include Private Equity and Hedge Funds; *Includes Bank Deposits and Fixed Income*

Table 3.3: Kuwait's Pension Fund Target Asset Allocation Mix

Asset Class	Kuwait
Stocks and Fixed Income	40%-60%
Real Estate	12%-17%
Private Equity	8%-13%
Infrastructure	10%
Cash	4%

Source: Bloomberg Quint, Data as of August 2020

The funds also have specialized investment arms. Hassana Investment Company, owned by GOSI, was created as an investment vehicle that has greater independence from Saudi Arabian Monetary Authority (SAMA) in asset management. In addition to its investments in local market, it is also active in international markets. Apart from exposure to listed equities, it also invests in real estate and commercial projects. Osool Asset Management is the investment arm of Bahrain's Social Insurance Organization and Military Pension Fund.

Growth Drivers & Challenges

Pension Fund Reforms

The countries have been undertaking measures to improve issues pertaining to their pension funds. Saudi Arabia's PPA announced Strategy 2022 in 2018 that encompasses a variety of measures such as improves investment and risk management capability, improvement of pension scheme etc. Saudi Arabia has also increased retirement age for women to 60 years in line with that for men. Kuwait PIFSS' management was revamped in 2017. The fund is actively focusing on efficient asset allocation and maximizing of returns and has not sought government's recapitalization since 2014-15. In the context of possible exhaustion of its funds, the parliament is reported to be considering reforms to its pension system including increase in retirement age. Some of the reforms that have been implemented include merging the public and private sector funds, halting annual pension increase, unless there is a surplus, and decoupling salaries and pensions.

Institutional investors such as pension funds play an increasingly important role in financial markets worldwide. They are often specialized investors, possessing sophisticated investing skills and manage substantial amount of capital. Due to their wide scope and scale of operations, institutional investors often play a key role in increasing market liquidity, improving corporate disclosures and influencing corporate governance. They also have a number of challenges that needs to be addressed.

Increasing Population and Early Retirement Age

While GCC's current demographic is favorable, it is not clear that the future expansion of the labor force would be absorbed by the employment sector in the region and, therefore, an expansion of the covered population. Saudi Arabia, the most populous of the region, has an overall unemployment rate of 9.0% as of Q2, 2020 while the youth unemployment rate is in the double digits. Second, even if this were to occur in the majority of cases, the implicit rates of return paid on contributions by the pension systems are too high to be sustainable given the depressed outlook on oil prices and without retirement related reforms. Hence, independent of the aging process, pension systems will eventually run into trouble. The future aging of the population will simply make things worse.

The aggregate funding gap in public pension systems in GCC has reportedly exceeded 25% of the region's total GDP.[2] Actuarial Shortfall of the GCC pension funds has mainly been due to the generous benefits and early retirement options. While Kuwait's official retirement age is 55 for men and 50 for women, the country introduced an option of retiring five years earlier in December 2018. Though this early retirement option was accompanied by a clause of 2% reduction in pension, the move is expected to widen the state pension fund's actuarial gap to 45 percent of GDP.[3]

[2] *Zawya*
[3] *IMF*

All of the GCC countries have made important reforms and mandated fiscal cuts aimed at achieving macroeconomic stabilization, which improves the operational conditions of pension funds. The main challenge remains to stimulate economic growth and job creation in the private formal sector. Not doing so implies that an important part of the labor force will remain outside the pension system and might not be accumulating sufficient savings to finance an adequate standard of living during old age. Moreover, better living standards for the elderly can result only from sustained economic growth.

With GCC government's ability to absorb more workers into its government sector limited there are two main challenges that the nations have to face – 1) setting expectation with the younger population about shifting to a market-model (i.e) moving from a defined benefit program to a defined contribution program; 2) increasing the retirement age - a thorny subject albeit one that needs to be done in a phased manner.

Large Mandate in terms of Income Replacement and Target Base

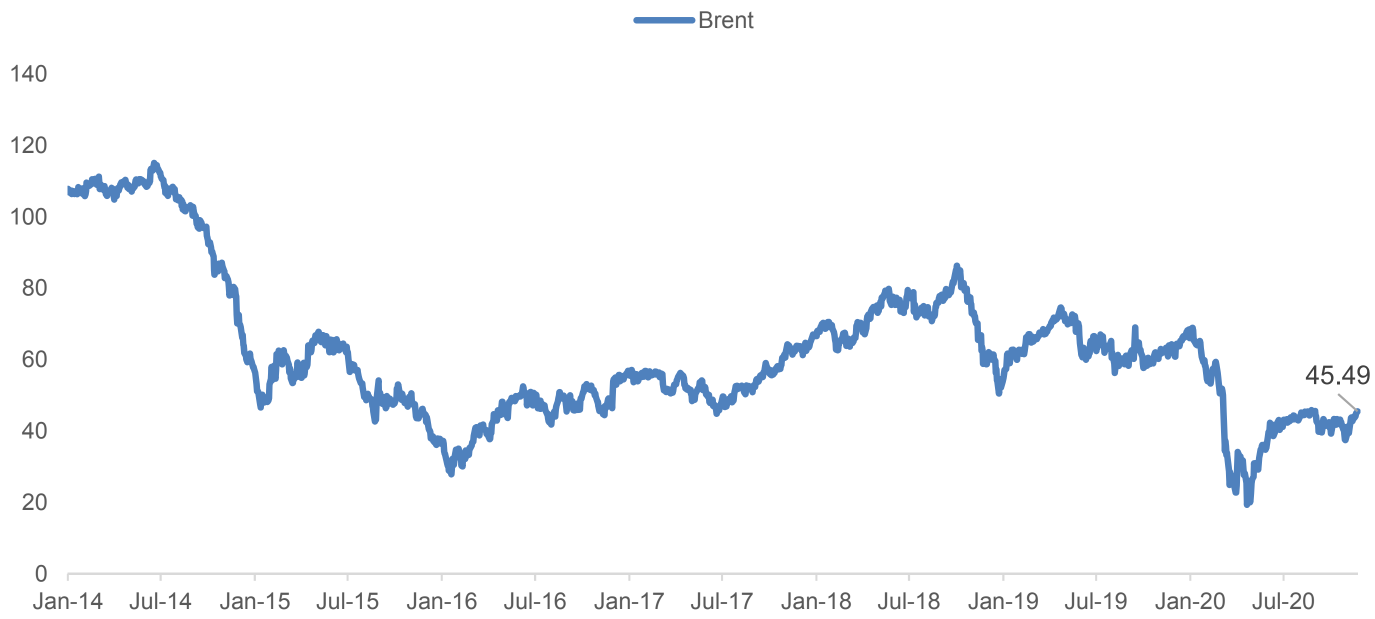
The issue with having large mandates is that few people will want to save for retirement outside the mandatory pension system and should the government pension funds fail to deliver, the beneficiaries would be left in a soup. Faced with oil price realities on the one hand, and the burgeoning population that is expected to enter the workforce in the next few years, GCC governments have to majorly revamp, recapitalize and regulate state pensions and personal contributions. While a full-fledged change is unlikely given the sensitiveness of the region, we could expect a step in that direction given the less than ideal fiscal situation of these countries.

Sustainability of the Funds

Non-Transparent actuarial information and limited public disclosure of data by the respective authorities make it difficult to assess the solvency and sustainability of current pension schemes. However, given the way that the oil prices have moved in the past few years, some of the pension fund schemes in the region appear to be underfunded relative to the benefits that are being promised. In as early as 2014, Bahrain was advised to ensure sustainability of its pension funds by IMF. Recently, an actuarial report on the country's pension funds have concluded that the civil public sector pension fund is expected to be exhausted in 2024, the private sector pension fund will run out in 2033.

The issue of sustainability assumes more significance in the current low oil price environment. Oil and the GCC economies have symbiotic relationship with each other; the precipitous fall in price clearly reflected in their fiscal balances and GDP growth rates. During the oil price fall of 2014-16, real GDP growth rates for most GCC economies fell about 40% in 2016 compared to 2013. In 2020, while real GDP for Emerging and Developing Asia is expected to fall by 1.7% and that for U.S is expected to fall by 4.3%, GCC's real GDP is expected to fall by as much as 6.0%. This greater contraction is due to the fall in the oil prices compounding the contraction due to COVID-19 related lockdowns.

Figure 4.1: Oil Price Movements – 2014-2020 (USD/bbl)



Source: Refinitiv

Factors like emergence of shale oil, lower global growth, trade tensions and more recently COVID-19 have kept oil prices under pressure in the recent past. This coupled with the general tendency to reduce the use of fossil fuels across the globe has led to depressed outlook on oil prices. This poses an interesting challenge for the Gulf pension funds.

Lack of Privatization

Privatization increases stock ownership, market capitalization and broadens the scope of capital markets. Privatization of state owned enterprises would re-orient them towards free market approach and enhance their efficiency and improve the business environment. Improved investor confidence would unlock further investment opportunities and would augur well for the expansion of investor base for institutional investors.

Ownership rights are safegaurded in capitalist model and the resultant wealth effect would spur the growth of entrepreneurs who would actively seek opportunities and deploy their capital in the most efficient way.

Lack of Market Depth and Liquidity

Institutional investors have specific guideline and norms to evaluate suitable investment opportunities and liquidity is one among them for investments in equity and debt markets. GCC markets, which are represented by handful of blue chips in few sectors, limit the ability of institutional investors to deploy funds. Tepid market volumes and lack of liquidity further exacerbate the problem as the price impact could be significant and it could take days to establish their position.

Inadequate Trading and Hedging Tools

Market making wherein dedicated market makers risk their own capital to warehouse instruments, earning bid-ask spreads in the process could be helpful in improving liquidity of the instrument. However, market making in GCC markets is in a nascent stage and widespread adoption across securities would help to increase the market liquidity. Lack of hedging instruments due to restrictions on stock futures or stock options limit the ability to hedge market exposures.

Policy Recommendation to tap GCC Pension Funds

Improving Pension Systems

The primary objective of a pension system is to ensure that older people have a decent standard of living in retirement. However, the different interpretations of this primary objective muddle the pool.

The first interpretation is that the pension system should need to ensure only a basic standard of living. The main rationale for the existence of the pension system in this case is the need to reduce poverty (measured in relative terms), and the focus is on the “adequacy” of the pension benefit, which can be defined relative to economy wide average earnings. Given the relatively wealthy status of the individual in the GCC region incorporating such an objective cannot be achieved without reasonably compromising on the living standards, which would again prove to be a huge burden and a politically charged decision.

The second interpretation is that the pension system should ensure a reasonable standard of living in retirement relative to the position before retirement. This means the pension system plays the role of insurance. Replacement rate would be in focus in this scenario rate: the value of the pension relative to individual earnings. While GCC region is currently following this second interpretation, they are too high compared to global standards bringing into question the sustainability of these funds.

Across countries, there are various degrees of emphasis on these two objectives. Countries such as Australia, Canada, Denmark, and the United Kingdom focus on the former. Pension systems in Finland, Italy, and Luxembourg prefer to operate on the latter. In between, countries such as France, Germany, and the United States balance the dual objectives of adequacy and insurance. These countries guarantee both a basic pension and a replacement rate ranging between 25 and 50 percent of the last salary.

Another major change that GCC pension funds have to make is to reduce the replacement rate as the income level changes. In GCC, it is customary for retirees to earn the same level of pension from the lower level income bracket to the higher-level income bracket making it increasingly difficult for pension funds to satisfy the return requirement. GCC pension funds can look at a two-pronged strategy – for low-wage earners it should focus on the adequacy and insurance functions while for higher wage earners it should look at incorporating other alternative investment options gradually shifting them into a market-model.

Currently there is no One-Size-Fits-All rule to define the proper level of basic pension or replacement rate. GCC region needs to take into account a multitude of factors to find the right mix. Cultural factors, such as family structures or the willingness of individuals to save for old age play a big role. Economic factors, such as the general standard of living of the population, estimates about minimum consumption needs (for example, the poverty line), the existence of other formal and informal social assistance programs, and, of course, the costs. For starters, the GCC pension funds can mix the defined benefits and defined contribution schemes.

Responsibility for managing the assets should gradually shift away from the government towards the individuals, and thereby to private pension fund managers. It would also lead to a gradual shift in pension systems from defined benefit plans to defined contribution plans, wherein the liability of institutions ends with pension contribution and the management of the same would fall under the scope of respective employees.

Promote Corporate Governance Standards

Corporate governance measures focusing on rights of minority shareholders, information disclosure, responsibilities of board, ensuring board independence should be accelerated. Companies that have tapped the capital markets for financing should be made clear of their responsibility towards various stakeholders in ensuring clear, transparent, timely and complete disclosures of material information.

Table 5.1: Establishment of Corporate Governance Code

Country	Issuance of Corporate Governance code
Oman	2002
Saudi Arabia	2006
UAE	2007
Qatar	2009
Bahrain	2010
Kuwait	2013

Source: Marmore Research

Enhance Market Liquidity

Financial instruments that are not covered by research analysts usually have meager volumes and are rarely traded. Transacting in those instruments entails significant price impact and the transaction may take days to complete. Introducing market-making mechanism would help narrow down the bid-ask spread and make large volume transactions possible. Off-market bulk deals should also be actively encouraged when significant stake needs to acquired or off-loaded between consent mutual parties under the ambit of regulatory/exchange approval.

Broaden Investment Offerings

Arsenal of investment products should be broadened to cater to multiple investors needs and requirements. Real Estate Investment Trusts (REITs), Exchange Traded Funds (ETFs) and structured products have enormous scope for expansion in GCC region.

Development and deployment of qualified finance professionals should be actively encouraged by the regulators, as they could foster product innovation by providing appropriate feedback on investor needs and concerns.

Build Market Infrastructure/Surveillance System

Fradulent activitives such as insider trading, front running trades could undermine market integrity and sap investor confidence. Every effort should be made to detect and deter market manipulation. Market infrasturcture should be upgraded to auto detect or raise alarm over fradulent transactions. Conflict of interest should be eliminated or disclosed.

APPENDIX (GCC Pension Fund Structure & Contributions)

Table 6.1: Pension funds in the GCC region – Structures, Contributions and Computations

Country	Organization	Subscription Salary	Employer's Share	Employee's Share	Total
Bahrain	Social Insurance Organization (Pension) -Government Sector	Basic salary + social allowance	15%	6%	21%
	Social Insurance Organization (Insurance) - Private Sector	Basic salary + Fixed allowance	9%	6%	15%
Oman	Civil Service Employees Pension Fund - Government Sector	Basic salary + 75% of housing, electricity & water allowance	15%	7%	22%
	Public Authority For Social Insurance - Private Sector	Basic Salary	9.50%	6.50%	16%
KSA	Public Pension Agency - Government Sector	Basic Salary	9%	9%	18%
	General Organization For Social Insurance - Private Sector	Basic Salary + housing allowance			
Kuwait	The Public Institution for Social Security - Government and Private	Basic salary +all allowances & bonuses & grants pursuant to the provisions of law (38) of 1964 provided that the subscription salary until December 2011 does not exceed KD(2500) and is not less than KD(230) and from January 2012 up to date is KD(2750).	11%	7.50%	18.50%
Qatar	General Retirement And Social Insurance Authority - Government and Private	Basic salary +Social allowance	10%	5%	15%

UAE	Abu Dhabi Retirement Pensions and Benefit Funds				
	Government	Basic salary +Children Allowance + Housing Allowance + Social Allowance + COLA (Cost of Living Allowances)	15%	5%	20%
	Private	Regular monthly Allowances Minimum 3000 Maximum 60000			
	Dubai - General Pension and Social Security Authority				
	Government	Basic monthly salary + social allowance of a national + allowance of children + allowance of cost of living + allowance of accommodation.	15%	5%	20%
	Private	Salary +gratuities +allowances (to be paid regularly and monthly)	15% (2.5% paid by the government)	5%	20%

Source: General Pension and Social Security Authority

Authors

M.R. Raghu CFA, FRM
CEO
+965 2224 8280
RMandagolathur@markaz.com

Rajesh Dheenathayalan, CFA
AVP – Research
+965 224 8000 Ext: 4608
RDheenathayalan@e-marmore.com

Aparna K S
Analyst
+965 224 8000 Ext : 4634
ASrinivasan@e-Marmore.com

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