

Social Insurance in Oman

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Prepared by:

Sheikhan Al-Abri
Public Authority for Social Insurance
Sultanate of Oman

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Social Insurance in Oman **Challenges and Reforms**

Introduction:

The Public Authority for Social Insurance (PASI) in the Sultanate of Oman operates a defined benefit social insurance scheme. PASI covers Omani citizens working in the private sector (with an employer-employee contract) against old age, disability, death, work injuries and occupational diseases. The authority is administered by a board of directors chaired by the Minister of Manpower and has representatives from the three parties; employees, employers and the government.

PASI started in 1992 and has noticeably expanded in terms of coverage and improvements of benefits. And by end of 2008, there were above 127,000 active contributors and more than 5,000 pensioners.

Contributions paid by both employees and employers comprise the main source of income of the scheme. PASI invests its assets based on the regulations made by the Ministry of Finance that governs the investments of assets of PASI and other pension funds in Oman.

As stated in the law, the social insurance scheme is reviewed at least once every three years by an actuarial consultant. So far, PASI carried out four actuarial reviews and it currently prepares for the fifth review.

Since the establishment of PASI, the social insurance law witnessed some changes in the contribution and benefit structures examined/proposed by the actuary. In the year 2005, and after an actuarial consultancy, PASI applied a set of reforms aiming to improve benefits as well as protecting the social insurance scheme for the long run. And due to the increase of inflation in the last 3 years, all pensions were increased in 2008 by different percentages; high percentage for low pensions and low percentage for high pensions.

This paper addresses the current situation of PASI, the reforms recently adopted, investment performance and the effect of the current financial crisis.

Funding of the scheme:

As previously mentioned, PASI operates a defined benefit scheme. The scheme is partially funded. Current contributions, paid by employees and employers are not actuarially sufficient to finance the promised benefits, which is the case for most social security and pension funds in the region.

Currently, employees pay 6.5% of their basic salaries and employers pay 9.5% of their employees' salaries. Another 1% contribution is paid by employers to finance the coverage of work injuries and occupational diseases.

At normal retirement age (60 for men and 55 for women) and upon completion of the required number of years of contributions (15 for men and 10 for women), the pension is calculated as 2.5% of the last-5-years average salary for each year of contribution. Early retirement pension is reduced by different percentages according to age at retirement.

Demographic and Economic Challenges:

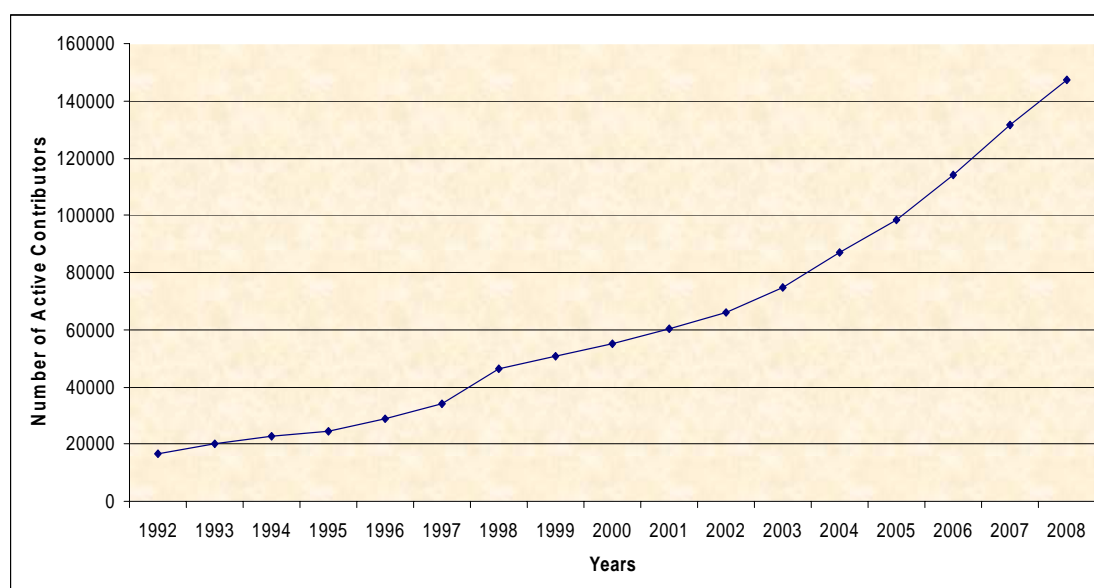
Due to the improvement of health services and lifestyle in the society, Oman witnessed some changes in its demography. The following table shows some characteristics of the Omani population for selected years :

	1995	2000	2005	2006
Under 5 Years (% of Omani Population)	16.3	14.0	11.9	11.68
Under 15 Years (% of Omani Population)	49.9	43.2	38.9	37.4
60 Years and Over (% of Omani Population)	4.7	4.8	3.5	3.6
Crude Birth Rate (per 1000 population)	34	32.58	24.75	24.17
Total Fertility Rate (births per woman 15-49 years)	6	4.7	3.14	3.19
Crude Death Rate (per 1000 population)	6.1	3.65	2.53	2.48
Life Expectancy at birth (in years)	67.4	73.38	74.28	74.29

Source : Ministry of Health, Sultanate of Oman, www.moh.gov.om

It is obvious from the above table that aging is a phenomenon that should be treated with high importance. Aging affects the social insurance scheme, as it is the case with other social security schemes, in the sense of having more and more pensioners and on the other side less contributors to the scheme in the long run.

The graph below shows the number of active employees who were contributing to PASI in December of the years (1992-2008):



PASI scheme is still young and the average age of active contributors is around the age of 30 as can be seen from the following table which shows the distribution of active contributors by age in December 1992 (six months since the beginning of PASI) and in December 2008 :

Age Groups (years)	December 1992			December 2008		
	Number	%	Accum. %	Number	%	Accum. %
20 or less	1945	11.6%	11.6%	11999	8.2%	8.2%
21-25	3428	20.4%	32.0%	45287	30.8%	39.0%
26-30	2771	16.5%	48.5%	39176	26.6%	65.6%
31-35	2255	13.4%	61.9%	20256	13.8%	79.4%
36-40	1893	11.3%	73.2%	9385	6.0%	85.4%
41-45	1570	9.4%	82.0%	6930	5.0%	90.4%
46-50	1321	7.9%	89.9%	6431	4.4%	94.8%
51-55	1055	6.3%	96.2%	4140	2.8%	97.6%
56-60	459	2.7%	98.9%	2566	1.7%	99.3%
61+	94	0.6%	100%	1024	0.7%	100%
Total	16791	100%		147194	100%	
Average Age	33			31		

The increase of pensionable salaries above the expected limits imposes additional burden to the social insurance scheme. This is due to the fact that the scheme is partially funded which means that contributions collected are less than the contributions required to finance the promised benefits. Salaries have increased by around (6%) for the period 2004/2005 whereas the increase in salaries between 2006/2007 exceeded (13%).

Reforms:

Following the change of the accrual factor for pension calculation purposes in 1997 (from 1/60 to 1/40) and the inclusion of past service (prior to the establishment of PASI) in return of end-of-service benefits that were transferred by employers to PASI, there were other reforms in the following years. In 2005, there were major parametric reforms, including increase of contribution rate (additional 3%), setting a maximum pensionable salary (3,000 Omani Rials), a maximum pension (80 Omani Rials) and a maximum pension (80% of the 5-year-average pensionable salary). Also, earliest retirement age was set to be 45 and new reduction factors were implemented. (1 US\$ = 0.385 Omani Rial).

As inflation became a concern after 2005, PASI had to deal with it seriously. It definitely affects the net investment return assumed for the actuarial studies as well as other purposes. Inflation has a negative impact on the value of pensions. Those pensions need to be re-valued from time to time with the aim of protecting their values. Therefore, PASI increased all pensions in April 2008 by different percentages ranging from 5 to 25 per cent according to the level of

pension. PASI has also raised the minimum pension for current and future pensions from 80 Rials to 100 Rials per month.

Investment performance:

Contributions are invested with other assets keeping in mind that investment return is another source of income that supplements the income from contributions.

PASI follows the investment guidelines that were set by the Ministry of Finance. The guidelines give certain allocation of assets in terms of the type of investment both locally and abroad.

As part of its effort to obtain a better allocation of assets that meets its goals as a long-term investor, PASI appointed a specialized consultant to prepare an Asset/Liability Model that takes into consideration the nature of PASI as a young and immature scheme that looks ahead to the future to maintain a sustainable scheme able to meet long-term liabilities.

This study was carried out following the fourth actuarial review (as at end 2005) that showed projections for income and outgo and other demographic and economic factors.

The following two tables show the distribution of assets by asset type as of 31/12/2008 and also composition of assets (proposed and actual):

Type of Investment Asset	Actual Exposure	Investment Guidelines
Local Equities	32.6%	30% - 80%
Mutual Funds (Local + Foreign)	6.1%	0% - 30%
Hedge Funds-Foreign	0.3%	0% - 5%
Private Equities (US & Europe)	2.4%	0% - 5%
Local Bonds & CD's	10.2%	20% - 60%
Real Estate (Land + Buildings)	3%	0% - 20%
Cash & Cash Equivalents	45.4%	0% - 20%
Total	100%	

It is clear from the above table the large allocation of investment in cash and cash equivalents due to the absence of a better opportunity in other asset classes.

PASI Assets Composition

		2006 - Actual	2007 - Proposed	2007 - Actual	2008 - Actual
Local	Fixed Income	52%	10%	44%	56%
	Equities	40%	33%	47%	35%
	Real Estate	2%	7%	3%	3%
	Local	94%	50%	94%	94%
International	Fixed Income	0%	10%	2%	2%
	Equities	5%	33%	4%	3%
	Hedge funds	1%	5%	0%	0%
	Global real estate	0%	2%	0%	1%
	International	6%	50%	6%	6%

Optimal Asset Allocation proposed by the international consultants on Beginning 2007

The increase was due to the drop in Equities & receiving additional contributions during the year

The drop in the weight was due to the drop in the local equities market.

Impacts of the Financial Crisis:

Being part of this inter-related world, GCC markets have been affected by the decline of oil prices as well as other consequences of the recent financial crisis. The World Bank gives estimates of the growth of GDP (%) for some countries as listed in the following table:

	2007 Actual	2008 Estimate	2009 Forecast	2010 Forecast
World Economy	4.8	3.4	1.2	3.1
US	2.2	1.1	(1.5)	1.1
EURO Zone	2.6	1.0	(0.6)	1.1
Saudi Arabia	3.4	4.9	2.9	2.3
UAE	7.4	6.8	3.5	2.0
Kuwait	4.5	5.6	2.8	1.7
Bahrain	8.1	5.4	3.4	1.8
Qatar	12.5	14.5	9.5	
Oman*	8.3	6.4	3.3	
GCC Average			3.5	

(Oman state budget for 2009 assumed 1% economic growth)

Oman, along with other GCC states, still relies on oil products as the main source of revenue. The decline in oil prices has definitely affected the overall

performance of the economy and it is expected to continue to impose its effects in 2009 and maybe in the coming year(s). The World Bank estimates the decline of revenues from oil in the GCC region by (44%) in 2009. The oil price dropped sharply from around US\$ 150 a barrel in July 2008 to less than US\$ 40 a barrel early 2009; around 75% decrease (www.aljazeera.net).

The GCC states have also a remarkable investment share in the global markets. Bad returns in the global markets are highly reflected in the overall return of the economies of these states. Some sovereign wealth funds (SWF) in the Gulf region are facing certain challenges in light of the current financial crisis. In a working paper published in January 2009, CFR's Brad W. Setser and RGE Monitor's Rachel Ziemba estimate that the SWFs and foreign-currency funds of the Gulf Cooperation Council (GCC) lost about 27 percent of their assets, or \$350 billion, in 2008. (CFR: Council on Foreign Relations).

The table below shows the performance of stock markets in the GCC region:

	2008 closing	End January 2009 closing
Oman	(39.78%)	(13.47%)
Kuwait	(38.03%)	(11.13%)
Saudi Arabia	(56.49%)	(0.18%)
Abu Dhabi, UAE	(47.49%)	(9.02%)
Dubai, UAE	(72.42%)	(12.42%)
Bahrain	(34.52%)	(11.11%)
Qatar	(28.12%)	(25.08%)

(Source: Global International Investment House), () means negative

The Crisis and Pension Funds:

According to OECD's publication "Pension Markets in Focus", December 2008, the assets of pension funds have been hit by the financial crisis. "By October 2008, the total assets of all pension funds in the OECD had declined by about USD 3.3 trillion, or 20% relative to December 2007. Funding levels in defined benefit plans are down by more than 10% on average, creating a funding gap at the end of October as high as USD 2 trillion."

Experts revealed that the effects of the financial crisis in the GCC region were not highly visible in 2008 but the region will face them heavily this year 2009 and beyond.

The financial results for year 2008 of PASI are not yet available. Although there is no official disclosure of any possible effect of this financial crisis, it seems clear from the allocation of assets that the investment performance was affected, especially in the global investment. Despite the allowance by the new strategy to invest half of its assets abroad, the crisis in the global markets prevented PASI from following the planned schedule to achieve this goal.

Conclusion:

I read an article from the internet that shows that the financial crisis may threaten the increase of birth rates in Germany which suffers from a high average age of its population. The government offers additional supports to families and encourages mothers to join the work force which in turn will boost the national economy. And who knows, the future may bring other negative implications of this crisis on the sustainability of pension schemes.

Therefore, unless necessary measures are taken on time and prudently, the financial positions of all pension and other social security schemes might become subject to other negative implications.

I think one of the measures is to have a continuous specialized asset/liabilities modeling, preferably after every actuarial review.

Another point is that any decision related to the change of contribution or benefit levels must be preceded by an actuarial review that shows the financial consequences of such a decision.

Finally, if there is a chance to implement any kind of necessary parametric or structural reform today, do not delay it. Otherwise, the cost will be more severe.