



Arab Pension Systems

Trends, challenges and options for reforms

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ABBREVIATIONS AND ACRONYMS

AMF	Arab Monetary Fund
CMD	Capital Market Development
DB	Defined Benefit
DC	Defined Contribution
EAP	East Asia Pacific
ECA	Eastern Europe and Central Asia
EMDCs	Emerging Markets and Developing Countries
EMEs	Emerging Markets Economies
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
ISSA	International Social Security Association
LAC	Latin America and the Caribbean
MENA	Middle East and North Africa
MSAs	Mobility Savings Accounts
NDC	Notional Defined Contribution
IMF	International Monetary Fund
IOPS	International Organisation of Pension Supervisors
OBA	Outcome-Based Assessments
OECD	Organisation for Economic Co-operation and Development
ORBS	Outcomes and Risk Based Supervision
SSA	Sub Saharan African
UK	United Kingdom
US SSA	The United States Social Security Administration
WBG	World Bank Group
WDI	World Development Indicators

TABLE OF CONTENTS

ACKNOWLEDGEMENTS	2
ABBREVIATIONS AND ACRONYMS	3
TABLE OF CONTENTS.....	4
LIST OF FIGURES.....	5
LIST OF TABLES AND BOXES	5
 I. Executive Summary	 6
 II. Arab Pension Industry Landscape: Overview and Main Trends	 10
II.1 Demographic Structure.....	10
II.2 Labor Markets	13
II.3 Pensions: Spending and Benefits.....	17
II.4 Pension Coverage	23
II.5 Administration and fragmentation	24
 III. Challenges for Pension Schemes in the Arab Region	 26
III.1 Data Gaps	30
III.2 Sustainability, Affordability, and the Growing Financial Burden.....	31
III.3 Coverage.....	33
III.4 Inefficiency of Labor Market and High Costs caused by fragmentation	36
III.5 Efficiency and Governance Constraints in Pension Institutions	40
III.6 Security, Regulation, and Supervision	41
 IV. Options for Reforms.....	 43
IV.1 Systemic: Adapting the Multi-Pillar Pension Design to the Arab Region	43
IV.2 Parametric: What Combinations of the Key Parameters (Accrual Rate, Pensionable Age, and Contribution Rate) Deliver Financial Sustainability?	45
IV.3 Extending and Financing Coverage: The Role of Employers.....	45
IV.4 Extending and Financing Coverage: Addressing Informality.....	46
IV.5 Improving Efficiency through Consolidated Administration	52
 V. Leveraging Investment Opportunities for Pension Funds for Sustainable Growth and Development in the Arab Region	 55
V.1 Investing in Arab Region: International Institutional Investor's Perspective	55
V.2 Improving Governance and Scale of Pension Funds in the Region.....	57
V.3 Strengthening Arab Capital Markets and Opportunities for Pension Funds.....	60
 VI. How the AMF and the WBG Can Support Policy and Institutional Reforms by Governments, Employers, and Regulators.....	 65

LIST OF FIGURES

Figure 1. Total Population in Arab Countries, 2014	10
Figure 2. Life Expectancy and Fertility Rates, 1980-2014.....	11
Figure 3. Percentage of Population Over Age 65, 2014.....	12
Figure 4. Projected Old Age Population Dependency Ratios, 2015–50	13
Figure 5. Labor Force Participation Rate (Aged 15 and Older), 2014	14
Figure 6. Labor Force Participation Rate	14
Figure 7. Non-contributor to Pension Scheme	15
Figure 8. Self-Employment	15
Figure 9. Share of Employment in Agriculture, Services, and Industry	16
Figure 10. Share of Employment in Agriculture, Services, and Industry	16
Figure 11. Relationship between Pension Spending and Population Older Than 65	18
Figure 12. Accrual Rates: International Comparisons	19
Figure 13. Benefit Ratios: Average Pension Relative to Average Wage	19
Figure 14. Monthly Disability Pension for Total Permanent Disability	22
Figure 15. Relationship between Coverage and Income Per Capita	23
Figure 16. Sustainable Pension Possibilities	31
Figure 17. Survivors and Early Retirees.....	32
Figure 18. Size of Informal Sector in Selected Arab Countries, 2010	34
Figure 19. Coverage of Pension Contributors and Beneficiaries in the Arab World	36
Figure 20. Retirement Income Pillars as defined by the World Bank.....	43
Figure 21. Good Old-Age Income Requires Diversification and Good Labor and Capital Markets	45
Figure 22. The Pension Value Chain.....	46
Figure 23. Matching Role of Employer to Scale and Potential Engagement	46
Figure 24. Average Earnings, Expenses, Remittances, and Savings of Return Migrants While Abroad	50
Figure 25. Typology of Mergers.....	52
Figure 26. Growing Demand for Infrastructure Financing in Arab World	55
Figure 27. Real Investment Trends in the Arab Region.....	56
Figure 28. Process to Establish a Long-Run Outcome Benchmark	59
Figure 29. Ensuring Portfolios Adapt and Diversify over Time: Mexico's Example....	59
Figure 30. Cost Discipline Is Essential to Improving Long-Term Net-of-Fee Returns ..	60
Figure 31. Market Capitalization of Listed Domestic Companies	60
Figure 32. Total Listed Domestic Companies Figure 33. Stocks Traded, Total Value..	61

LIST OF TABLES AND BOXES

Table 1. Required Degree of Disability in Arab Countries for claim	21
Table 2. Fragmentation of Pension and Social Insurance Schemes in Arab Countries..	25
Table 3. Social Insurance Programs in Arab Countries.....	25
Table 4. Pension Schemes in Selected Arab Countries	39
Box 1. Overview of Some International Expatriate Retirement Schemes	49

I. Executive Summary

This report provides an overview of current pension challenges and opportunities for members of the Arab Monetary Fund (AMF)¹. There is an urgent need to address pension issues in the region to address fiscal, macroeconomic, sustainability, equity and welfare challenges. The report sets out potential solutions and proposals that countries could adopt to improve their pension outcomes. The analysis and the reforms grew out of the high-level conference: “Arab Pension Reforms,” that took place on January 25th, and 26th, 2017, in Abu Dhabi. The conference was co-hosted by the AMF and the World Bank Group (WBG).

The January AMF-WBG conference was the start of a journey linking global insights with regional know-how to develop policies tailored to each country. A diverse group of countries were at the conference, in terms of institutions, histories, labor markets and challenges. But amid the diversity there were many common themes. Countries have young populations, but also rapid ageing, low female labor force participation rates, fragmented systems, often with generous benefit formulas (particularly for public sector employees), flexible and easy provisions for early retirement, generous survivorship programs and under-developed private pensions and capital markets.

Throughout this report, groups of countries are identified where this aids the analysis—for example, highlighting common challenges and potential solutions for Gulf Cooperation Council countries (GCC). Such groupings can be important for the politics of pension reform. Global experience shows that countries can be strongly influenced by bold steps taken by a close neighbor. So, efforts by countries in the GCC to develop a joint discussion on how to reform their systems could prove to be very useful. However, there are no neat classifications along all the dimensions reviewed in this report – from life expectancy to average age and dependency ratios, labor market structure, current pension system, capital market or politics. Ultimately all pension reforms will be undertaken as initiatives of individual countries – so the key political issue is how to build the case and momentum for change and a viable reform pathway in each country individually.

Participants discussed many times at the AMF-WBG Conference, that compelling examples for reform often come from outside the Arab countries. The experience of Greece or Italy, for example, show the consequences for a pension system of a failure to get ahead of the demographic wave. This can lead to very tough decisions on pensions. Examples from Canada, to Turkey to Malaysia, show the benefits from improving the governance and investment of pension fund assets - both for members and the capital market. So, whilst the report shows how some Arab countries form sub-groups with broadly similar characteristics in parts of their pension systems or economy, many of the messages and reform suggestions from global experience have broad relevance. The approach suggested in this report is one where each country should use the diagnostic and analytical tools the WBG and AMF can provide to develop country specific reform packages and paths.

¹ Member countries are Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, and Yemen.

A key message for all Arab countries is that diversification is a good policy with pension systems. No one pillar – public or private, contributory or non-contributory, pay as you go or funded – can take the full strain. The mix between each pillar needs to be matched to each country's unique arrangements and labor market. It is important to push on a number of fronts in order to develop the right policy mix. Political courage will be as important as analytical prowess in developing reforms that will work. Having a mix of reforms that offer both positive improvements as well as tackle tougher issues can help to deliver a viable package – as can public discussion of the historic challenges of aging.

After reviewing the main features of pension systems in the Arab countries and highlighting key challenges, the report moves on to suggestions for reform. The ultimate aim is to expand the coverage of good quality pensions – where good quality is defined as pensions that create a balance between sustainability and affordability on the one hand and adequacy on the other, without creating inequities, or other distortions, and are delivered in an efficient way in terms of costs, investment returns and labor market impact. Finally, the pensions should be secure – with robust regulation and supervision. It is also important to emphasize that the recommendations here would pursue what is best for the individual countries given their specific overall development objectives, as well as each country specific institutional and policy environment. It is equally important to emphasize that the needed pension reforms should be considered in the context of the current overall trends and reforms regarding Labor Markets policies, and Social Protection systems (e.g.: efforts to promote private sector employment, labor mobility, and more efficient welfare state/wealth redistribution mechanisms).

The first recommendation is for *development of adequate data to understand the pension system*. Almost all Arab countries have significant data gaps in key areas. These gaps can be filled by national efforts. They could also be supplemented by comparable surveys across the whole Arab countries or in sub-sets of countries like the GCC who are able to take particular initiative – for example on cost benchmarking. Without good data, it would not be possible to use and gain added value from powerful tools such as **microsimulation** of pension entitlements or **income distribution analysis** to support equity in delivery or use the **World Bank Pension Database** to benchmark countries against sub-regional, regional and global peers. Equally, it is not possible to use the **Pension Reform Options Simulation Toolkit** (PROST) to project pension liabilities.

Secondly, the *national identification and information Technology systems to support delivery of public and private pensions need to be reviewed*. A common global theme in pension work is the lack of attention often placed on whether a country can robustly identify citizens and workers so that contributions can be collected, or entitlements recorded. Not enough attention is also placed on IT systems used by pension institutions. Without good ID and IT even a well- designed pension scheme can fail to deliver. The WBG has tools to review both elements, which could be used by any country with gaps in these areas.

Third is the need to focus on *improving the sustainability, equity and affordability*² of pensions. For most Arab countries, sustainability issues are similar to those of the rest of the world – can current benefits in a range of Defined Benefit pensions (for all citizens, or particular groups such as civil servants) be funded through available contributions or tax revenue? For GCC countries, the pensions are also facing sustainability challenges in the sense that contributions will not cover benefits. With lower oil prices, the costs of funding pensions will become increasingly unaffordable or crowd out other priority areas of spending. But even beyond financial needs to finance the current schemes, transfers occurring among participants result in different benefits for similar career paths or transfers from lower income to higher income workers. In all cases, there is a need to examine parameters such as accrual rates, contribution rates, and retirement ages. There is also a need to look into the programs other than old-age pensions, particularly survivorship pensions, which are more generous in the Arab region than in the rest of the world. On the other hand, in some cases, there is a need to consider extending some benefits—for example on disability—that may be neglected. The WBG PROST model is a dynamic tool used to analyze the sustainability or affordability of pension schemes, projecting their financial costs and implicit pension debt as baseline scenarios and, in particular, simulating the impacts of different policy reform options.

Fourth is a focus on *expanding coverage of pensions in a way that improves the diversification of public and private pension provision*. Most countries need to focus on urgent challenges of the existing public pension provisions³, but there is also a need to develop private pension coverage. In all countries, the role of the employer is critical in improving access to pensions. For countries with high levels of informality in the labor market (nearly all non-GCC countries), the focus on the employer needs to be supplemented by building systems that can be accessed by people without a formal employer. For countries with very high participation of resident foreign workers who are likely to retire in their home country, the debate should focus on Mobility Saving Accounts and linking workers automatically to their home country pension systems if they are high quality. The World Bank has extensive experience in developing policies to expand coverage in all these areas, and recent examples—for example in Turkey - where reforms started in January 2017 have already added over 2.5 million more accounts and cut costs by more than 50 percent. This, and other projects, have used Outcome-Based Assessments for Private Pensions (OBA) to develop implementable recommendations, including bespoke coverage expansion strategies.

A fifth group of issues relate to *improving the efficiency of pension systems – reducing costs and fragmentation, improving investment strategies and governance and*

² Although the concept of affordability examines only the costs of pension benefits, the concept of sustainability compares retirement benefits with contributions paid to earn pension rights. Most contribution rates of current pension schemes in Arab countries cannot sustain promised pensions—even before factoring in future adverse demographic changes.

³ In addition to parametric reforms, in recent years, a large number of countries worldwide have introduced specific cash-transfer programs for the elderly population. These programs—sometimes referred to as social pensions—come in a wide variety of shapes and sizes. The appropriate role of these programs within the overall pension and social protection system is an increasingly important policy question that Arab countries should consider in their policy discussions for pension system reform. Although many contributory pension schemes are increasingly receiving transfers from the government, such transfers are benefitting only those who are covered. On the other hand, social pensions could benefit everybody (above a certain age) or, if well designed, those who need it the most.

improving the capital market. Across the Arab countries some systems are highly fragmented. This reduces scale and adds costs. There is no particular sub-regional pattern, so this is an area to be tackled country-by-country. Along with greater cost efficiency, in countries with assets to invest, it is important to improve governance, investment expertise and execution to improve returns to members, or to improve asset-liability matching. Again, there is no particular regional or sub-regional pattern in countries for whom this area is critical. Moreover, governance and investment are important issues where pension assets are invested by public, not-for-profit or private sector institutions – and can be investigated using a range of tools and approaches to suit the country and institution. Developing the capital markets in Arab countries is an important priority. Local and global capital markets can support and benefit from developing pensions in all Arab countries. Reforms are needed to corporate governance to improve liquidity in secondary markets. The new WBG “Cascade” approach is designed to enhance the ability of capital markets to support infrastructure finance.

The sixth and final area of focus on *enhancing the security of pension systems through developing or creating regulators and supervisors that can successfully supervise pensions.* There is a wide range of current practice in the region (and globally) as to regulatory and supervisory capacity and whether such regulators cover private pensions as well as social security institutions that invest assets. Moreover, there are different solutions in terms of individual regulators focusing only on pensions, or having a single regulator that covers the whole capital market. Among other tools that can be used is the introduction of Outcomes and Risk Based Supervision (ORBS) that ensures a regulator looks at the long-run outcomes a system is aiming to provide and prioritizes action against the biggest risks to these outcomes – by choosing the most effective tools – from new regulations, to training or communication through to off-site or on-site supervision and enforcement.

The AMF and the World Bank came together to host the January 2017 pension conference and develop this report to set out the challenges and potential solutions that can be deployed to improve pensions. They stand ready to support countries, sub regional groups, or the whole AMF membership, where viable projects can be created and financed. As well as the six areas highlighted above, perhaps the most-important message to reiterate is the need to develop the political and social case for change. The AMF and the World Bank want to support willing partners in their journey to improve their pension systems now and in the future. Initial priorities and road maps will differ between countries. It is hoped that the commitment to improve pension outcomes in the long-run is shared broadly.

II. Arab Pension Industry Landscape: Overview and Main Trends

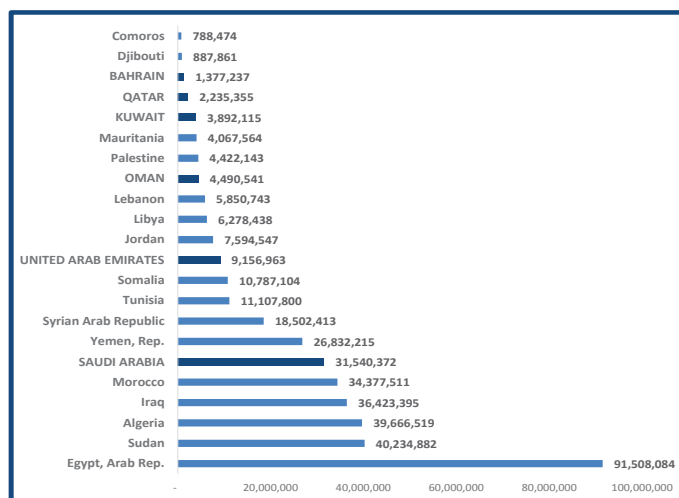
This section provides an overview of:

- the demographic structure
- labor markets
- pension spending and benefits
- pension coverage
- administration and fragmentation

II.1 Demographic Structure

From a demographic perspective, there is often a tendency to treat the Arab world as a homogeneous region, with a large youth population and high population growth rate. But beyond the obvious differences in size (figure 1), countries in the region are heterogeneous in population structure and dynamics. These demographic factors have important effects on labor markets and pension systems. This is also why it is important to develop good data and country-specific diagnoses on how to improve. Despite the heterogeneity, common trends in all Arab countries include that fertility rates have been decreasing and life expectancy increasing. The elderly population will start to grow faster than the young population, putting pressure particularly on the finances of public pensions (and health insurance systems). Over the next 25 years, it is expected that the elderly population in the Arab region will grow at close to 4 percent per year while the total population grows at 1.4 percent.

Figure 1. Total Population in Arab Countries, 2014



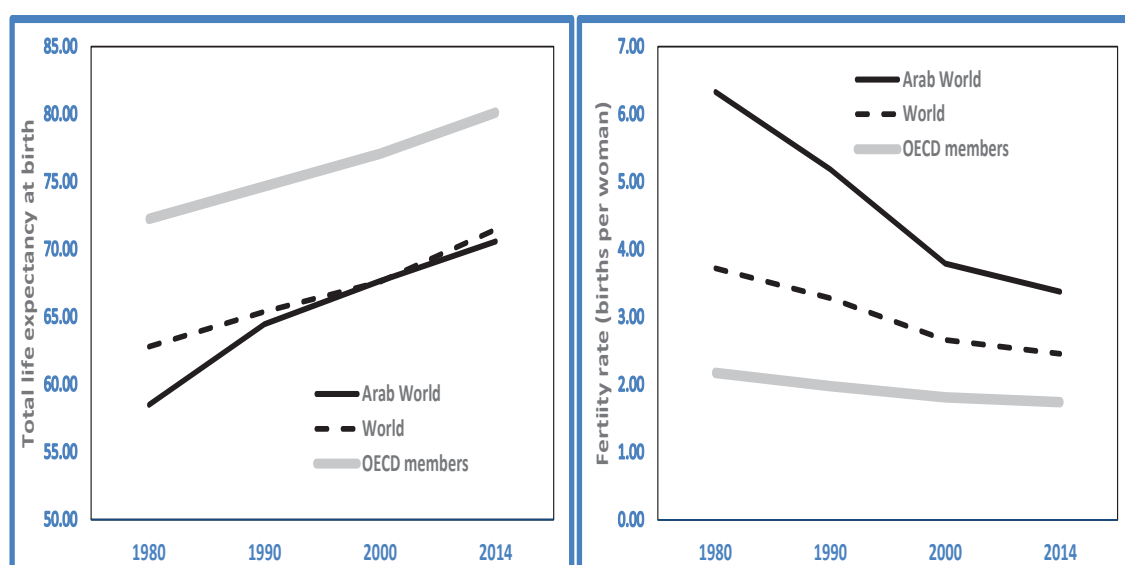
Source: World Development Indicators, World Bank

The Arab countries together have a population of approximately 400 million people, or approximately 5 percent of the world population. There are large countries such as Egypt, Sudan, Algeria, Iraq, Morocco, and Saudi Arabia with populations of more than 30 million, and small countries such as Djibouti and Comoros with populations of fewer than 1 million.

Although there are important differences in demographic structure, all countries in the region have relatively young populations, when comparing worldwide, although there will be a rapid increase in old-age dependency ratios in only 10 to 20 years. Also, it is expected that an increase in female participation rates will accompany the expansion of the working-age population, which will have dramatic effects on the size of the labor force. These themes were repeatedly highlighted during the January conference.

For virtually all countries in the region, the first stage of the demographic transition took place in the 1950s, when mortality rates declined sharply and life expectancy increased gradually, triggered by progress in health care. The second stage of the demographic transition has been happening during the last 10 years and has been characterized by a relatively small reduction in fertility rates. The delayed reduction in fertility rates was the main driver of the sustained population growth between the 1960s and 1990s. Life expectancy has increased in many Arab countries and attained higher than world average levels in most (figure 2), although the fertility rate, despite an overall decreasing trend, has remained somewhat higher than the world average. Only a few Arab countries rank at or below world-average levels. Survival and fertility rate forecasts imply a continuation of the demographic transition and gradual convergence of rates in some of the countries.

Figure 2. Life Expectancy and Fertility Rates, 1980-2014
(Arab World, World vs OECD members)



Source: World Development Indicators, World Bank

Survival rates are expected to improve further throughout the region, while total fertility rates are expected to continue to decline. As a consequence, fertility rates and life expectancies will gradually become more homogeneous. Only Djibouti, Mauritania, Sudan, Comoros, Iraq, Saudi Arabia, Palestine, and Yemen are expected to continue having high levels of fertility. Oman experienced the greatest decrease in fertility rates, from 8.2 births per woman in 1980 to 2.7 in 2014, followed by all other GCC countries, as well as Algeria, Libya, Tunisia, and Morocco. In all these countries, the fertility rate was higher than 5 in 1980 but less than 3 in 2014. The increase in the working-age population and the gradual aging of the overall population led to increases in total and old-age dependency ratios, although the dynamics are heterogeneous.

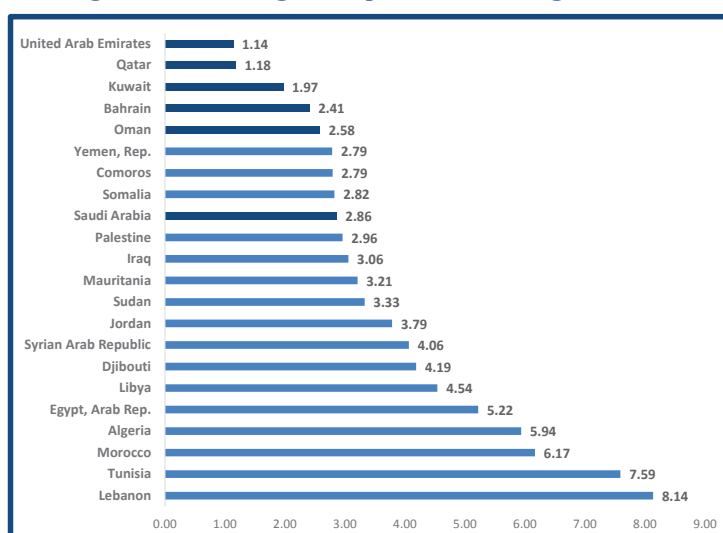
When looking at life expectancy at birth in all Arab countries, the heterogeneity is clear. The countries could be divided into three groups in this respect. The five sub-Saharan African countries have the lowest life expectancies, with an average of 61.5 years. Somalia has the lowest, at 55. A second group (Iraq, Syria, Libya, Palestine, and Egypt) has an average life

expectancy of 69.8. Of this second group, Yemen has the lowest life expectancy, at 63.8; Egypt has the highest, at 70.1. The third group of countries includes those with the highest life expectancies. With an average life expectancy of 76, those countries include the six GCC countries, Morocco (with the lowest life expectancy in this group of 74), Jordan, Algeria, Tunisia, and Lebanon. Qatar and Lebanon have the highest life expectancies of all countries, at 79. Life expectancies in Morocco, Algeria, and particularly Oman, have increased faster since 1980 than in any other Arab country. Life expectancy in Oman increased from 59 in 1980 to 77 in 2014.

Figure 3 illustrates the percentage of old-age population in each Arab country⁴. The populations in Arab countries are growing older. Some of

them, such as Lebanon⁵, Tunisia, and Morocco, are starting to notice this important challenge. Unless reforms are implemented soon, the aging of the population will aggravate financial problems, inequities, and labor market distortions. Figure 4 illustrates the projected old-age dependency ratio for all countries in the Arab world. Lebanon and Tunisia have the highest percentage of older people; the

Figure 3. Percentage of Population Over Age 65, 2014



Source: World Development Indicators, World Bank

Gulf countries have the lowest but are growing older faster than others⁶. Most older adults in Arab countries rely on family or other types of informal care or on state transfers⁷. With falling birth rates; rising life expectancies; and changes in urbanization, migration, and family structures,⁸ the reach and scope of these informal arrangements have been weakening in recent years and require implementation of new policies to protect older adults.

⁴ Pension systems are already facing financial challenges even without the aging of the population. Even if current demographic structures remain constant, pension systems face difficulties given misalignments between sustainable and observed implicit rates of return on contributions; population aging will only aggravate the problem. Moreover, given low coverage rates in the region, currently favorable old-age dependency ratios do not necessarily translate into favorable pension system dependency ratios.

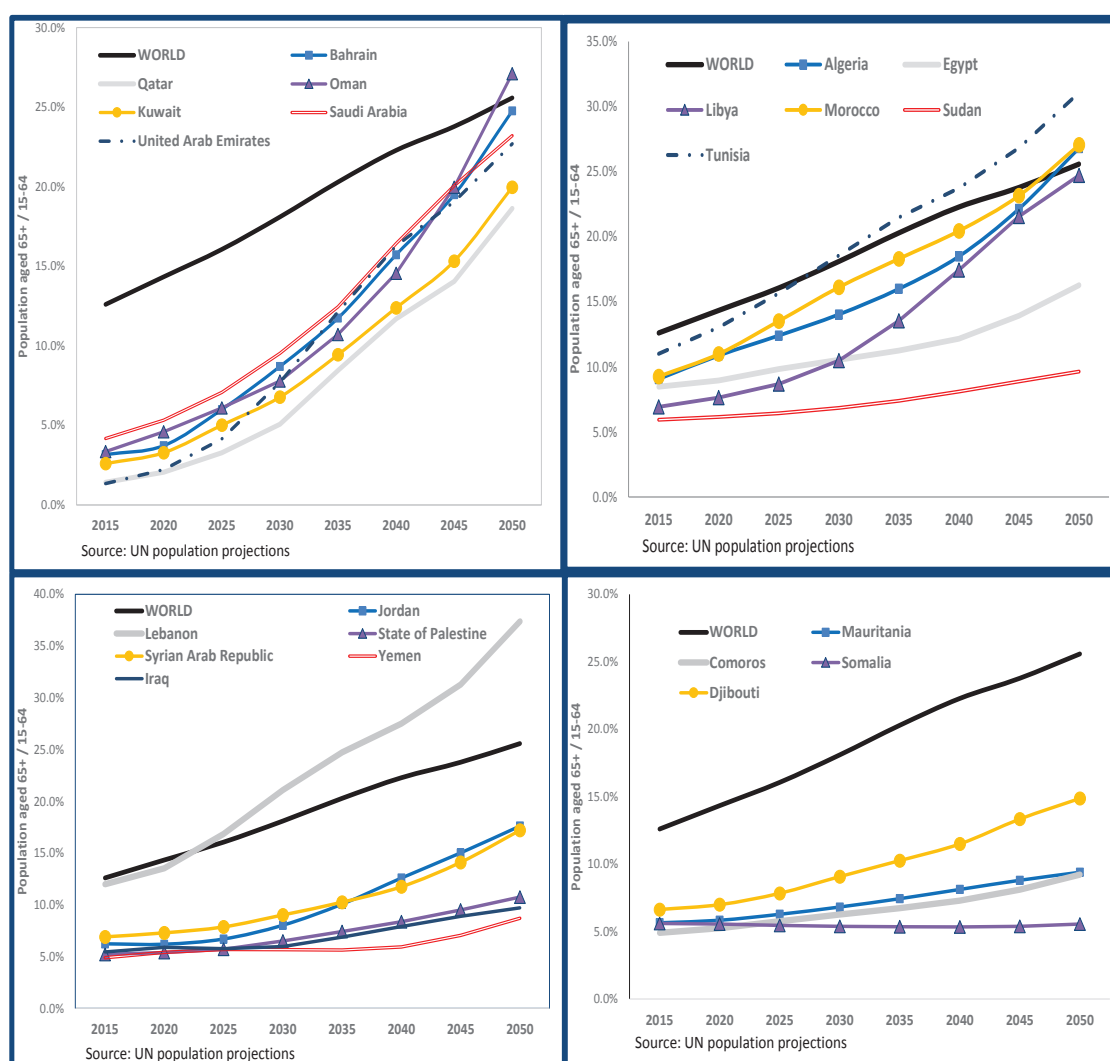
⁵ Because of external migration, the population in Lebanon has increased from 4.7 million people in 2012 to 5.8 million in 2014 to 6.4 million in 2017. Lebanon has the highest percentage of population older than 65 (9 percent of total population).

⁶ Careful consideration should be given to the indicators of the GCC countries, because foreign labor recruitment is high and accounts for more than half of the total population. In Qatar, for instance, the total foreign population accounts for more than 80 percent of the total. When considering only the national population in Qatar, people older than 65 accounts for 3.37 percent of the population, instead of 1.18 percent as indicated in figure 3, when foreign nationals are included.

⁷ Some non-contributory social safety net programs targeted to poor and vulnerable groups might also include some old people.

⁸ Countries such as Tunisia clearly show a decrease in the elderly population living with nonelderly individuals (co-residence). In the early 2000s, more than 80 percent of elderly adults in Tunisia lived with nonelderly relatives; today fewer than 75 percent of elderly adults live with nonelderly relatives.

Figure 4. Projected Old Age Population Dependency Ratios, 2015–50

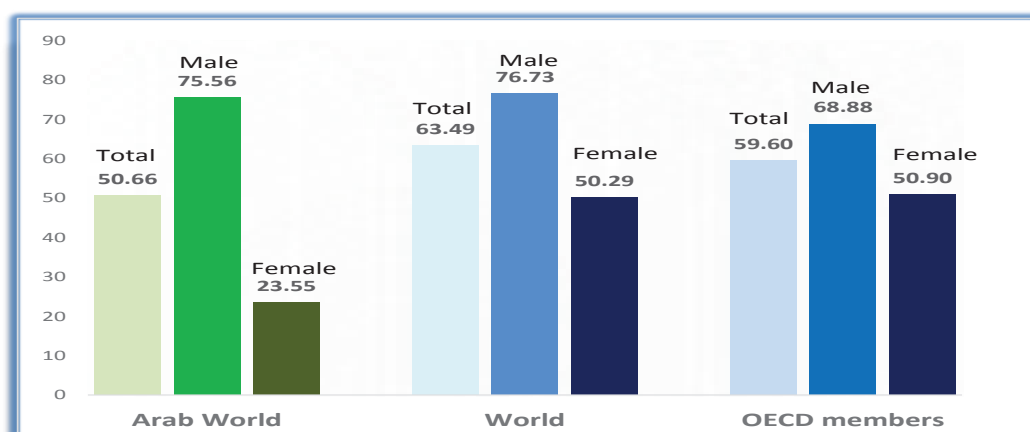


Source: World Development Indicators, World Bank

II.2 Labor Markets

The rapid growth of the labor force in the Arab world may create conditions that will allow the growth rate of the contributory base of pension systems to increase. This could allow pay-as-you-go systems to pay potentially higher implicit rates of return on contributions and, hence, higher replacement rates for any given retirement age and contribution rate for the transitional generation. It is not clear that expansion of employment in the formal sector and, therefore, expansion of the population covered by social insurance and pensions will accompany future expansion of the labor force in the Arab world. The informality phenomenon in the Arab world involves the vast majority of workers in the private sector, and some evidence suggests the need to rethink policy-making, especially regarding labor markets and social security reform, because many of the intended beneficiaries operate beyond the reach of legislative reform. Another important aspect of the labor market in the Arab world is that the expansion of the working-age population is expected to be accompanied by a continuous increase in female participation rates from a lower base compared to global averages.

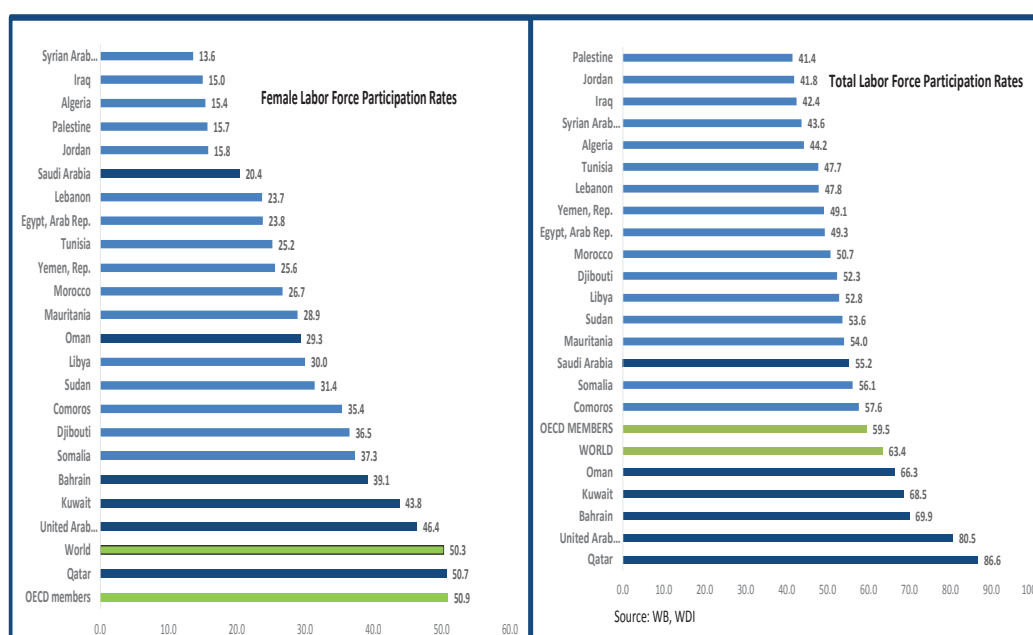
Figure 5. Labor Force Participation Rate (Aged 15 and Older), 2014



Source: World Development Indicators, World Bank; International Labor Organization

The Arab region has some of the lowest female labor force participation rates in the world (figures 5 and 6), even though female participation rates have increased in every country in the region for the past 25 years. Figure 6 also shows that labor force participation rates in the region are low (except in the GCC countries⁹).

**Figure 6. Labor Force Participation Rate
(Percentage of Total Population Aged 15 and Older; Female Population Aged 15 and Older), 2014**

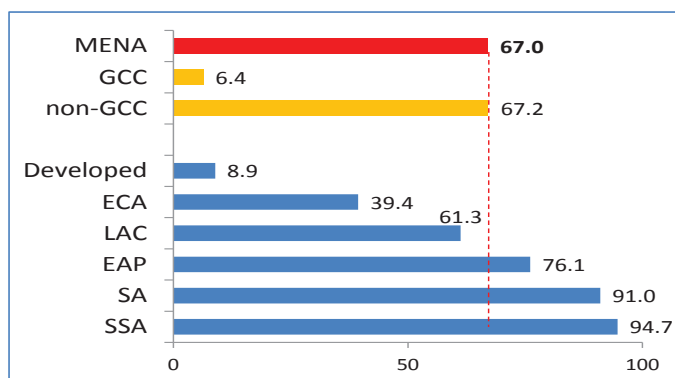


Source: World Development Indicators, World Bank; International Labor Organization

⁹ Qatar, for instance, has achieved impressive labor market participation rates in recent years for men and women as a direct result of explicit employment guarantees offered to Qataris mostly in the public sector. Also, in all GCC countries, most non-national women are part of the labor force—another factor making female labor force participation rates in GCC countries (except for Saudi Arabia and Oman) higher than in all other countries in the Arab region.

Another important aspect of the labor markets in the Arab world is informality. This can be defined as lack of social security coverage, usually understood as pensions or, if there is no pension system, as health insurance. Figure 7 illustrates the magnitude of informality in the Arab world plus some additional countries in the Middle East and Northern Africa (MENA) region by comparing their level of informality with those of other regions¹⁰. It is likely that much of the observed informality is due to segmentation and exclusion factors, which in some countries are linked to the prominent role of the public sector as employer. The need to generate private sector jobs was another key theme at the conference.

**Figure 7. Non-contributor to Pension Scheme
(Percentage of Labor Force)**

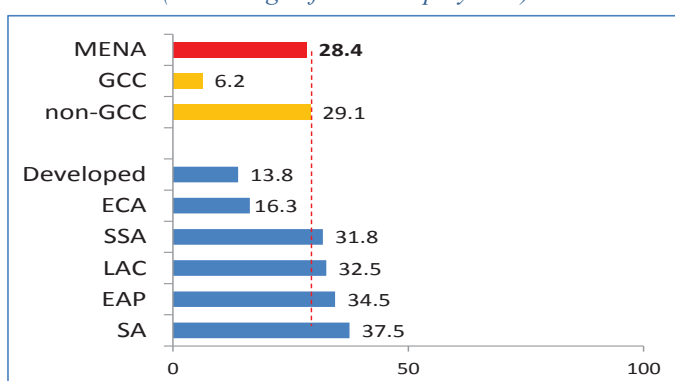


Source : Gatti, R. et al. 2014. "Striving for Better Jobs. Informality in MENA." World Bank.

A typical Arab country produces approximately one-third of its gross domestic product (GDP) and employs 65 percent of its labor force informally. This means that approximately two-thirds of all workers in the region may not have access to health insurance or are not contributing to a pension system that would provide them with income security after retirement. From a fiscal perspective, approximately one-third of total economic output in the region remains undeclared, with considerable implications for government revenue.

Arab¹¹ countries are typically more informal than developed countries and countries in Europe and Central Asia when considering the percentage of labor not contributing to social security and self-employment (figure 8), although they are less informal than most Latin American, Caribbean, East Asian, Pacific, South Asian, and Sub-Saharan African countries. There are important differences in the

**Figure 8. Self-Employment
(Percentage of Total Employment)**



Source : Gatti, R. et al. 2014. "Striving for Better Jobs. Informality in MENA." World Bank.

prevalence of informality between non-GCC countries, depending, among other factors, on availability of natural resources and labor and on the size of the public sector. Non-GCC countries are heterogeneous in terms of size, availability of resources and labor, economic

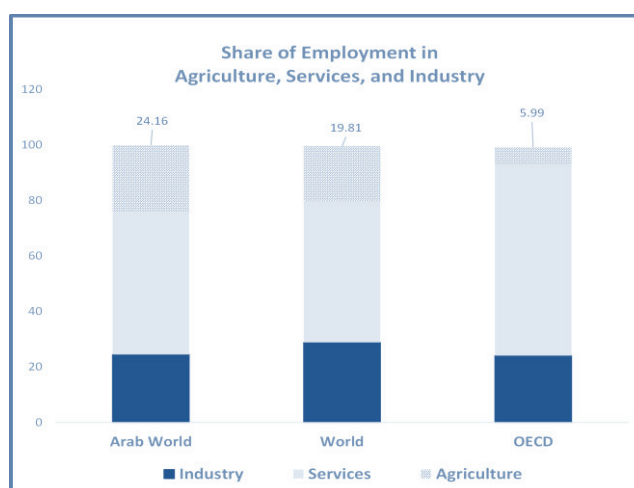
¹⁰ In this case, only national labor forces are being referred to in GCC countries. (Non-nationals are not included)

¹¹ Some figures show the Middle East and Northern Africa region, which includes 18 of the 22 Arab countries, because of data availability and presentation in the original sources. Reliable data are needed for all Arab countries to produce further analysis using the indicators presented here.

development, and demographic structure—all factors that influence the size of the informal economy, which, as a result, varies significantly. In general, resource-rich, labor-abundant economies tend to have high rates of informality, as the share of the labor force not contributing to social security (66–73 percent) and the share of self-employment to total employment (32–54 percent) indicate, although their share of undeclared output to total GDP (~20 percent) is comparable with that of GCC countries because these countries generally have few, but large, formal, capital-intensive firms (many in the energy sector), resulting in less informality in production than in labor.

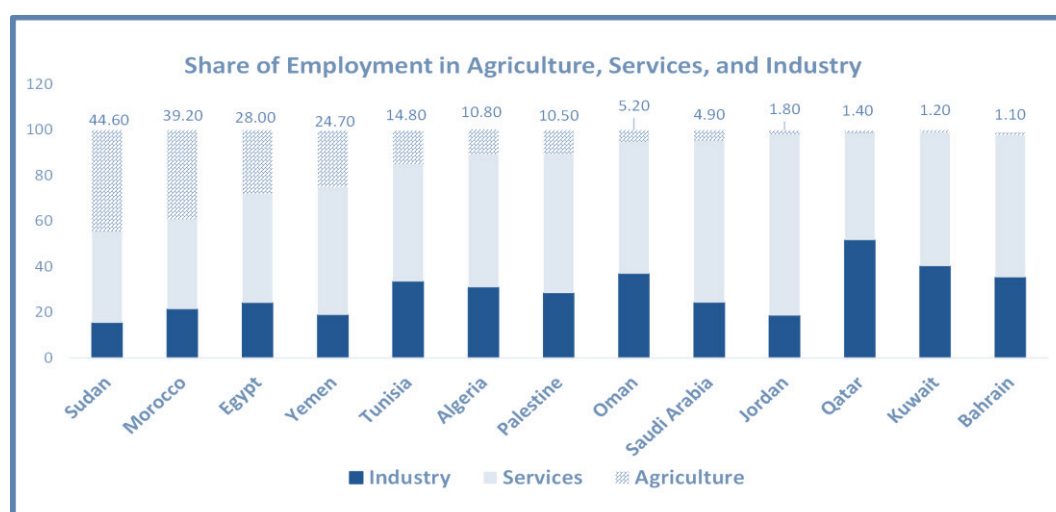
In addition to the low female labor force participation rate and high percentage of employment in the informal sector, the Arab region also has a higher share of employment in the agriculture sector than globally or in Organization for Economic Cooperation and Development (OECD) countries (figures 9 and 10). These characteristics require special consideration given that there are important coverage gaps in the pension systems particularly for self-employed individuals and in rural areas. International experience shows that there are usually special schemes (some innovative) that cover these categories of employees because the many conventional pension systems have been unable to increase coverage of these sectors. In countries such as Tunisia and Egypt, coverage rates are relatively high because there are special schemes covering the agricultural sector.

Figure 9. Share of Employment in Agriculture, Services, and Industry (by Region)



Source: World Development Indicators, World Bank

Figure 10. Share of Employment in Agriculture, Services, and Industry



Source: World Development Indicators, World Bank

II.3 Pensions: Spending and Benefits

All 22 countries in the Arab region have some type of mandatory contributory earnings-related social insurance system. They are mostly financed as pay as you go, with pensions calculated using a formula (Defined Benefit). The most common programs are for old-age, disability, and survivors' pensions. Some countries have benefits for work injuries and occupational diseases, sickness and maternity, family allowances, and unemployment. Design characteristics and coverage (by law and in practice) vary widely in different countries in the region. Pension spending is high, benefits are generous, coverage is low, and there is much room for improvement in governance of social security institutions and pension departments. Contributory systems were mostly designed with the intention of being self-financed, but they mostly and increasingly rely on general budget financing rather than contributions (or returns on assets). The country presentations at the conference highlighted the unique features of each country but also demonstrated these common concerns.

All countries in the Arab region except for Lebanon¹² have some type of pension program for public and private sector employees¹³. There are work injury programs for private sector workers in all except four countries in the region (Kuwait, Qatar, United Arab Emirates, and Palestine). In most countries, there is no minimum qualifying period, and benefits are provided for accidents that occur while commuting to and from work. Other social insurance programs vary according to country, and some countries have numerous schemes. More than half of the countries in the Arab region also provide sickness and maternity social insurance programs for private sector workers. Cash and in-kind benefits are provided as part of social insurance programs. On the other hand, more than half of the countries in the region do not have any social insurance programs for unemployment or family allowances.

Pension Spending

Pension spending in the Arab region is very high by international comparison, despite the relatively low coverage. Spending in some of the Arab countries is only slightly lower than average pension spending in high-income OECD countries (where coverage is almost 100 percent). Figure 11 illustrates the high correlation worldwide between pension spending and percentage of population older than 65. Arab countries are usually well above the correlation line, having higher spending than other countries with similar percentages of elderly adults¹⁴. This is due to various factors, including the generosity of some schemes (particularly civil

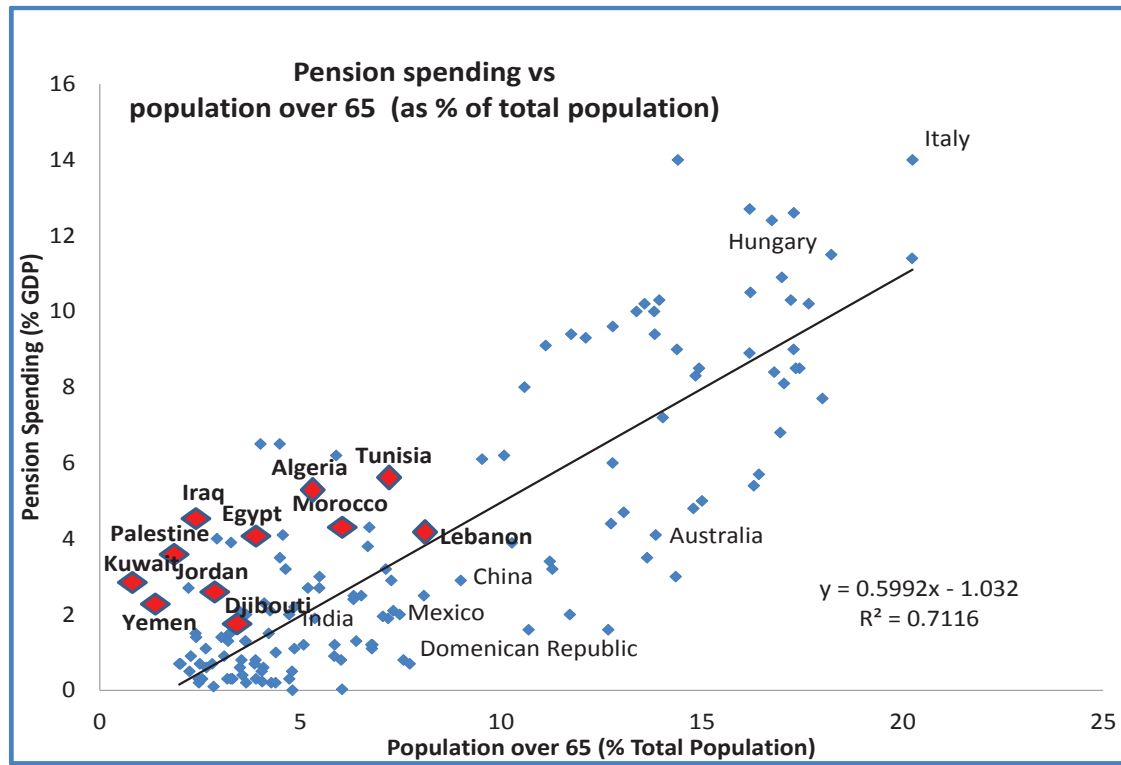
¹² Lebanon is unique in the Arab region in terms of the design of its pension system. Two defined benefit pension schemes financed on a pay-as-you-go basis have been set up to cover the civil service and the military, but private-sector workers only have access to a lump-sum end-of-service indemnity program, supposedly financed through capitalization. This scheme does not provide adequate protection to plan members.

¹³ In most Arab countries, public sector employees drive pension coverage. In practice, coverage of the private sector is low in most countries—hence the focus in this report on the need to develop private pensions to make the pension systems more diversified.

¹⁴ Although Iraq and Palestine have young populations, with only approximately 4 percent older than 65, pension spending is already high. In both cases, survivorship pension beneficiaries account for 30 percent of all beneficiaries. Other factors contribute to high pension spending. In Lebanon (where no regular pensions are paid to private sector employees), pension spending is high, considering that such spending is only on pensions for civil servants and the military. Such schemes have the highest implicit rates of return in the region (in addition to the schemes in the Gulf countries).

servants and other special schemes), high numbers of survivors, and early retirement programs¹⁵.

Figure 11. Relationship between Pension Spending and Population Older Than 65



Source: World Bank Pension Database.

Benefits

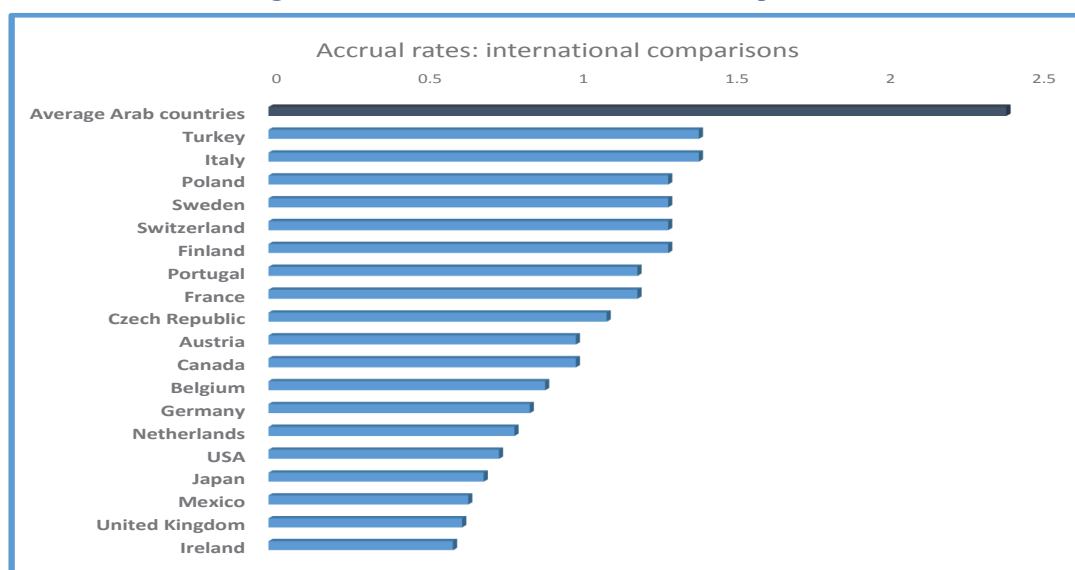
The current mandatory earnings-related pension schemes in the Arab countries are Defined Benefits plans, which means that the pension is calculated according to a formula. There is a fundamental misalignment between the contribution rate and benefits paid at various retirement ages in most of these schemes. Balancing these three indicators is essential to guarantee the financial sustainability of defined benefit pension schemes financed on a pay-as-you-go basis. Most schemes do not have such a balance.

The accrual rate is the proportion of earnings paid in a pension for each year of contributions. Multiplying the number of years of contributions by the accrual rate gives the gross replacement rate, a standard and important indicator in the analysis of these types of retirement-income provision. Figures 12 and 13 illustrate how generous pension schemes in the Arab region are compared with those of European and other OECD member countries. In most contributory pension schemes in the Arab region, many individuals contribute much

¹⁵ One peculiarity of the Arab region that makes such systems costly is the generous survivorship pension programs. Most countries are traditional, with higher marriage and fertility rates and lower divorce rates than most other regions worldwide. Labor force participation rates of prime-age women are only about one-third those of men. More than 20 percent of pension beneficiaries in the Arab region are survivors (e.g., widows, orphans). Another peculiarity of the region is that early retirement is widespread; more than one-third of all pension programs beneficiaries in the Arab region are younger than 50.

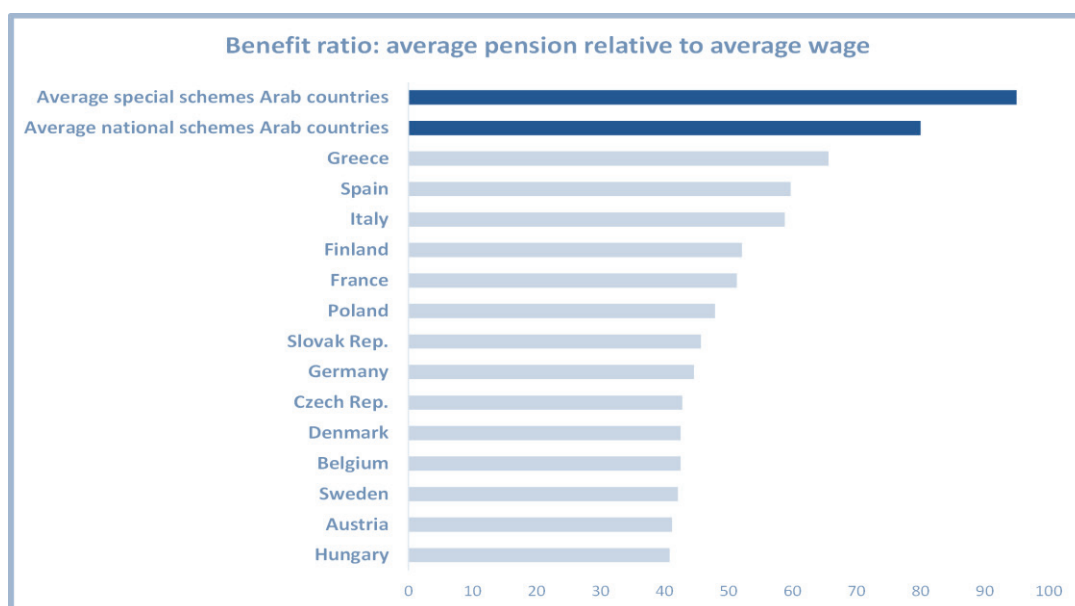
less to the schemes than they receive, leading to the challenge of unsustainability (see next section on challenges).

Figure 12. Accrual Rates: International Comparisons



Source: World Bank Pension Database.

Figure 13. Benefit Ratios: Average Pension Relative to Average Wage



Source: World Bank Pension Database.

In addition to old-age pensions, social insurance covers a variety of risks affecting workers' ability to earn regular income to support their families. Among them, disability and survivorship pensions have a prominent role.

Most Arab countries provide social insurance programs for workers who become disabled, in some cases on a noncontributory basis. These programs generally provide income support

and rehabilitation to workers who become disabled because of illness or accidents that result in a significant reduction in their ability to work. The illness or accident resulting in reduced capacity may be associated with work (work accident or injuries) or another reason (general disability programs).

Although social insurance programs provide the most-important, regular, and sustainable income support to people with disabilities in the Arab region, they apply only to formal sector workers at the time they become disabled. In addition, how eligibility criteria (and thus the disability assessment) are defined is sometimes unclear or not entirely objective and seldom follows international benchmarks generally accepted as best practices.

Disability pensions are integral parts of pension programs, but the definition of monetary benefits is not always consistent with the general principles from which old-age pensions derive. In addition, the design of these programs has been the result of less-careful attention than other social security interventions; old-age pensions have been at the center of pension policy design, and even unemployment and health insurance programs have received greater attention. Social security programs do not cost disability programs separately, and the extent to which they comply with basic principles of design, such as sustainability, adequacy, and affordability, is not known.

Finally, although disability insurance programs usually include in-kind benefits (e.g., access to rehabilitation) in addition to monetary benefits, implementation and enforcement of the first is weak, and beneficiaries receive monthly payments and are excluded from the labor force for the rest of their lives.

Disability insurance programs in Arab countries lack some common features usually seen in such programs, including clear definitions of the population being covered. All countries establish a certain “degree of incapacity” as the minimum required to be eligible for a pension, but there are wide variations in percentages across countries, as is the case with the criteria to assess incapacity.

Out of 14 countries analyzed¹⁶ (table 1), five allow for partial disability pensions (Jordan, Yemen, Algeria, Egypt, Libya). Total disability, in turn, is defined as loss of 100 percent of working capability in eight countries, whereas others define total disability as loss of a portion of working capability (50 percent or more). Disparity of criteria is not exclusive to Arab countries. Comparison with other regions shows a lack of clear benchmarks in the way disability is defined, but percentages of loss of ability to work usually concentrate around 66 percent as a standard eligibility criterion. Subjective assessment of disability is also reflected in the way the percentage of loss of ability is measured, which makes international comparisons even more difficult.

The definition of incapacity to work is also ambiguous; in some cases, it is defined as incapacity to perform any job, whereas in others, it refers to inability to perform a specific

¹⁶ The analysis in this section is based on information from U.S. SSA. “Social Security Programs Around the World.

job. In Lebanon, for example, it is defined as loss of normal working ability, whereas in Egypt, it is defined as inability to perform any gainful employment.

Ambiguity in the definition of disability is not exclusive to social insurance programs, and it has important consequences in terms of program objectives and population covered. In Egypt, for example, different definitions of disability have resulted in a variety of estimates. According to the United Nations, Egypt has more than 12 million people living with disabilities, of which children represent one-third. Disabilities directly or indirectly affect more than 36 million people (Plan International 2014). The Central Authority for Public Mobilization and Statistics has estimated that approximately 3.5 percent of the total population is disabled¹⁷.

Table 1. Required Degree of Disability in Arab Countries for claim

Country	Total (%)	Partial	Remarks
Jordan	100	Yes	Totally or partially unable to work
Lebanon	50		Loss of normal working ability
Oman	100		
Qatar	100	Yes	Younger than 60 (men) /55 (women), totally unable to work
Saudi Arabia			Younger than 60, unable to work
Syria	80		80% unable to work
Yemen	100	Public sector: yes; private sector: no	Public sector: total and partial; private sector: total
Algeria	100	50%	Totally or partially unable to work, younger than normal retirement age (60, men; 55, veterans; 55, women)
Egypt	100	Yes	Totally or partially unable to work, younger than 60
Libya	80	60%	80% unable to work
Morocco	100		Totally unable to work
Tunisia	66.7		66.7% unable to work
Kuwait	50		

Source: U.S. SSA: "Social Security Around the World"

Even in countries with retirement saving pension systems, disability pensions are Defined Benefit, with the amounts expressed as a percentage ("replacement rate") of the average income received during a reference period before becoming disabled.

There are large differences between countries in benefits of social insurance schemes. As a result, replacement rates vary from 3.33 percent to 100 percent of salary.

¹⁷ European Commission (2002) includes a detailed discussion of different definitions of disability.

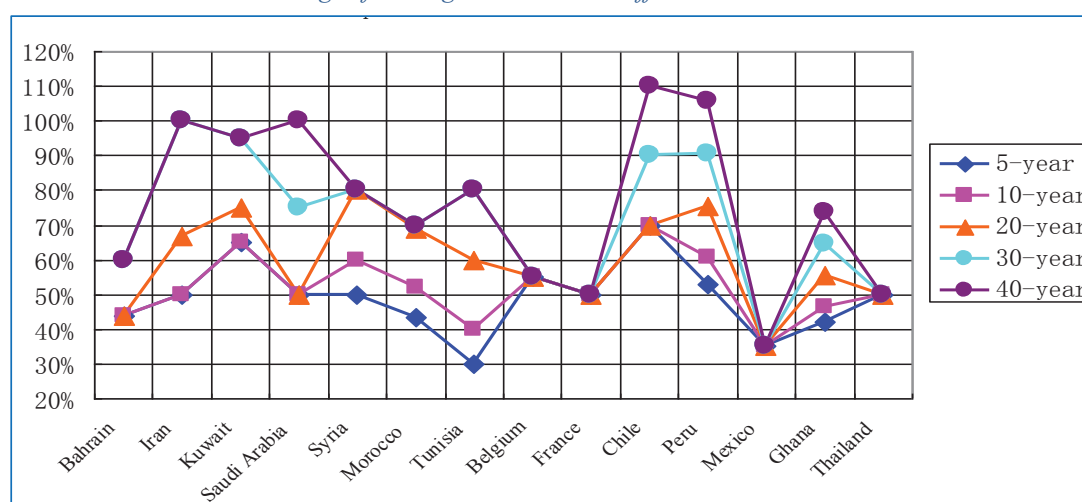
Differences between countries are common for old-age pensions but are even greater for disability pensions. Rules to calculate pensions are usually complex, as reflected in the main parameters of the schemes; there are large differences between countries in commuting factors (replacement rate), minimum contribution requirements, insured wage (salary base and ceiling), and indexation.

For example, in Bahrain, the disability pension is 44 percent of the insured worker's average monthly earnings in the last year of contributions before becoming disabled or 2 percent of the insured's average earnings during the last year of contributions multiplied by the number of years of contributions, whichever is higher. The minimum is 44 percent, or 200 dinars a month.

In Tunisia, the pension is 50 percent of the insured's average earnings in the 10 years before the disability began plus 0.5 percent of average earnings for each three-month period of contributions exceeding 180 months. In Morocco, the pension is 50 percent of the insured's average monthly earnings in the last 96 months plus 1 percent of average monthly earnings for every 216 days of insurance exceeding 3,240 days, up to 70 percent. As a result, workers with identical salaries and a contribution period of five years would receive a monthly disability pension (expressed in U.S. dollars in all cases) of \$355 in Bahrain, \$475 in Tunisia, and \$1,059 in Morocco.¹⁸

The differences are the result not only of different commuting factors, but also of differences in definitions of the insured's wages and the influence of the length of service before the worker became disabled. Figure 14 depicts the wide fluctuation in benefit calculation observed in the region, as shown in the previous examples.

Figure 14. Monthly Disability Pension for Total Permanent Disability
As a Percentage of Average Income with Different Contribution Periods



Source: Source: World Bank, based on U.S. SSA: "Social Security around the World"

¹⁸ Authors' calculation based on the Benefits standards: [Social Security Programs throughout the World \(2011\)](#)

(2) Nominal monthly average wages in local currency units: [International Labor Office. Morocco & Tunisia](#)

(3) Official exchange rate (LCU per US\$, period average) in 2012: World Bank Database.

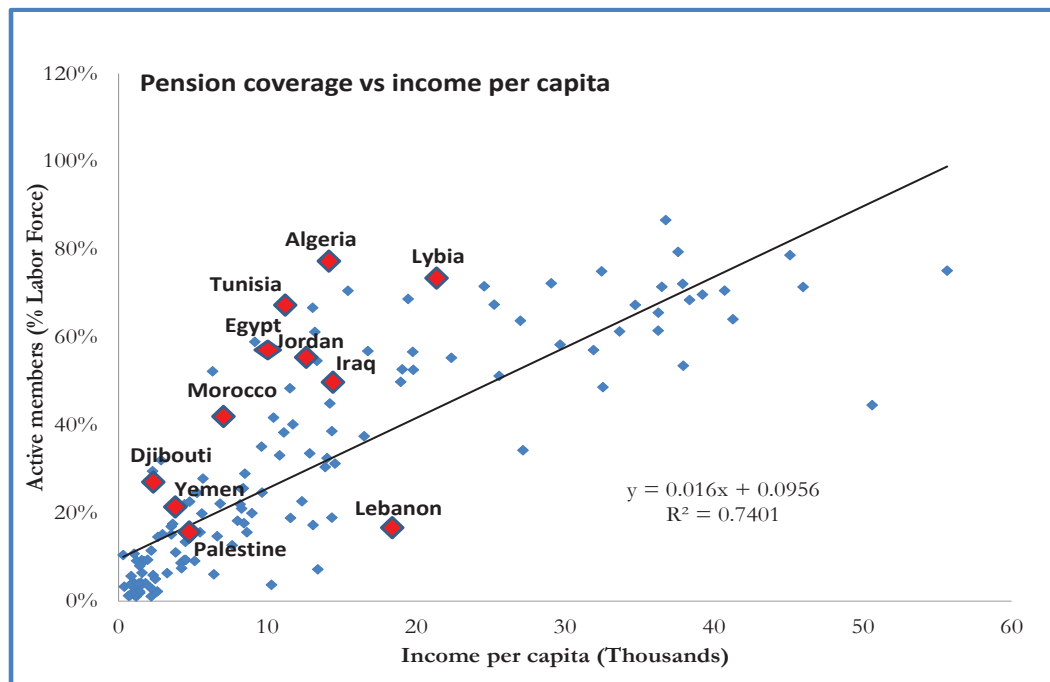
Assessing inclusion and exclusion errors in disability pension programs is complex given the heterogeneity of definitions involved in program design. This, in turn, has implications for program costs, and there is limited scope to assess the efficiency of programs using international benchmarks. Although more efforts are needed to homogenize concepts, reforms of disability pension programs will continue to rely largely on case-by-case analysis.

II.4 Pension Coverage

Social insurance and pension coverage rates in the Arab region are relatively modest—on average approximately 35 percent of the labor force. Coverage is usually limited to the formal sector of the economy, mostly the public sector, with workers in the informal sector and rural areas largely unprotected. The structure of the labor market (as explained above) and institutional arrangements for different categories of workers are the main reasons for differences in coverage between countries.

There is a high correlation worldwide between income per capita and coverage of social insurance and pension systems. Most countries in the region are above the correlation line (figure 15), suggesting that there should be no expectation that coverage will expand substantially through future income growth over the medium term, particularly because most uncovered individuals are in the private sector (including self-employed, rural). So, a significant part of the labor force in the Arab region might not be accumulating the necessary savings for retirement and other contingencies. Hence, innovative mechanisms to cover uncovered individuals is important. As set out in the solutions part of this report, there is significant scope to learn from other parts of the world and a number of World Bank projects that focus on pension coverage for the informal sector.

Figure 15. Relationship between Coverage and Income Per Capita



Source: World Bank Pension Database

II.5 Administration and fragmentation

Administration of pensions in the Arab region is fragmented (table 2). Countries often have two, three, or more schemes. Even in countries where the same scheme covers private sector employees and civil servants (e.g., Algeria), a different scheme covers self-employed individuals, and different institutions collect contributions or make pension payments.

Fragmentation is an important policy concern because it constrains the mobility of the labor force within and between sectors, increases administrative costs, and generates different treatment of different categories of workers. Fragmentation then becomes a source of inequality, because the mandatory pension system treats workers in different sectors differently.

Governance and administration of pension schemes in Arab countries were discussed at length during the conference. Although some speakers noted positive examples of reforms, there was wide agreement that this was an area for significant development to address areas of weakness. In particular, pension reserves are not transparently managed in the best interests of their members as the fundamental strategic driver for the organization. Tripartite boards, with representatives of government, employers, and trade unions, are common. This is not necessarily a problem, but nominated members often lack the expertise necessary to manage large, complex financial institutions, and training programs are not always well developed. In addition, responsibilities—between strategic overview by governing boards and operational execution by a managing board—can be blurred. The result is often that, where there are pension reserves, investment policies are risky, with conference participants highlighting concerns that political influence could govern them more than the interests of pension scheme members. Most reserves are in the form of government debt, in part reflecting the state of development of capital markets, but the debt is rarely formal or marketable. Holdings in private sector enterprises are often in companies that the pension fund manages directly. This can be an effective strategy if there is a high degree of expertise and member-focused governance, with rigorous investment appraisal, transparency, and auditing. Without these features, it can be very difficult to invest well.

ARAB PENSION SYSTEMS

TRENDS, CHALLENGES AND OPTIONS FOR REFORMS

Table 2. Fragmentation of Pension and Social Insurance Schemes in Arab Countries

Country	Modality of Pillars			Is the Civil Service pension scheme integrated?	Fragmented pension systems: pension schemes and institutions
	Pillar 0	Pillar 1	Pillar 2		
Algeria	-	DB	-	Integrated	5 institutions/departments - 3 schemes
Bahrain	-	DB	-	Partially integrated	1 institution - 2 schemes
Comoros		n.a.		n.a.	n.a.
Djibouti	-	DB	-	Partially integrated	1 institution - 2 schemes
Egypt, Arab Rep.	-	DB	-	Integrated	1 institution - 2 schemes
Iraq	-	DB	-	Planned to be integrated	2 institutions - 2 schemes (+ same in KRG)
Jordan	-	DB	-	Integrated	1 institution - 1 scheme (+ 2 old phasing-out)
Kuwait	-	DB	-	Integrated	1 institution - 1 scheme
Lebanon	-	DB	-	Only Civil Service & Military	1 department - 2 schemes
Libya	-	DB	-	Integrated	1 institution - 1 scheme
Mauritania	-	DB	-	Separated	1 institution 1 department - 3 schemes
Morocco	-	DB	-	Separated	3 institutions - 3 schemes (2 public planned to be integrated)
Oman	-	DB	-	Separated	10 institutions/departments -10 schemes
Qatar	-	DB	-	Partially integrated	1 institutions -2 schemes (+ 1 old phasing-out)
Saudi Arabia	-	DB	-	Separated	2 institutions/department -3 schemes
Somalia		n.a.		n.a.	n.a.
Sudan	-	DB	-	Separated	1 institution 1 department - 3 schemes
Syrian Arab Republic	-	DB	-	-	-
Tunisia	-	DB	-	Separated	2 institutions - 7 schemes
United Arab Emirates	-	DB	-	Integrated	2 insitutions -2 schemes (Abu Dhabi + Dubai&others)
Palestine	-	DB	-	Separated	1 institution - 4 schemes (3 of them phasing-out)
Yemen, Rep.	-	DB	-	Separated	3 institutions - 3 schemes

Source: World Bank Pension Database

Table 3. Social Insurance Programs in Arab Countries

Country	Old-age Disability & Survivors	Sickness & Maternity	Work Injury (employer)	Unemployment	Family Allowances
Algeria	x	x	x	x	x
Bahrain	x		x	x	
Comoros	n.a.	n.a.	n.a.	n.a.	n.a.
Djibouti	x	x	x		x
Egypt, Arab Rep.	x	x	x	x	
Iraq	x	x	x		
Jordan	x	x	x	x	
Kuwait	x				
Lebanon		x	x	x	
Libya	x	x	x		
Mauritania	x	x	x		x
Morocco	x	x	x		x
Oman	x		x		
Qatar	x				
Saudi Arabia	x		x	x	
Somalia	n.a.	n.a.	n.a.	n.a.	n.a.
Sudan	x	x	x		
Syrian Arab Republic	x		x		
Tunisia	x	x	x	x	x
United Arab Emirates	x				
Palestine	x				
Yemen, Rep.	x		x		

Source: World Bank Pension Database

III. Challenges for Pension Schemes in the Arab Region

Following the high-level review of Arab demographic characteristics, labor markets, and current provisions that was discussed extensively during the January 2017 conference, this section sets out the critical challenges that the AMF and the WBG believe need attention most urgently. To evaluate which reforms are the most important, it is useful to set out an outcomes-based framework based on international best practices that can help drive the long-term vision for a pension system. This is described in the next few paragraphs. In the next section, options for reform are presented.

International experience shows that there are no easy solutions for public pension reform. A simple model for pension reform cannot—and *should* not—be uniformly applied to all countries, but there are clear principles and long-run outcomes that can provide useful guidance to policy-makers as they craft solutions that are appropriate for a country's culture, political system, economy, and labor force structure. These principles should be carefully considered when designing a new pension system or reforming an existing one.

Whatever design is chosen, it is essential that it be suitable given a country's initial conditions and capacities. It should be appropriate for—and consistent with—its policy objectives. In addition to promoting good incentives, countries should be aiming to expand coverage of good-quality public and private pensions. The quality of the system depends on being sustainable; delivering adequate income; being efficient in terms of costs, investment returns, and impacts on the labor market; and being secure so that assets invested will be available in the coming decades when people retire and the system can withstand the inevitable political and economic shocks that will occur over the lifetime of a pension system.

Badly designed pension systems are not just a technical issue. When flaws are allowed to persist, a pension system can not only negatively affect the public finances, but also the economy as a whole. Such is the position in which many countries in the Arab world find themselves today, and others are very likely to be in the same position soon unless appropriate reforms are implemented in time. *Time for Change* was the subtitle of the World Bank 2005 report on pensions in the Middle East and Northern Africa. It is disheartening to see how little has changed in the intervening decade. The need for pension reform in the region is even more urgent.

Equity is a General, or Cross-cutting, Principle

Pension systems can and should redistribute income—for example, with social pensions funded by taxation—to affect the lifetime poor or revenues from natural resources being used to deliver minimum pensions where member contributions over a lifetime are not high enough. There is no requirement for a strict rule across the whole system that one will always and only get back what one pays in, but it is important that the mechanisms be transparent, and it makes sense to attempt any redistribution through explicit mechanisms. A number of countries have effectively “hidden” redistribution within “first pillar” benefit formula so that, over time, minimum benefits rise, and the link between higher contributions and higher

benefits is weakened as the pillar produces more flat-rate benefits. The problem is that the incentive for higher earners to contribute is progressively weakened, which can lead to avoidance and hidden earnings – and leave the funding situation worse off rather than better.

Most contributory pension schemes in Arab countries (and many worldwide) do not follow a principle of equal contribution for equal benefits; the length of contributions, individual earnings, and the choice of age of pension receipt deliver different benefits than the amount contributed. In some cases, the differences are large, which can create inequities and distort individuals' economic behavior.

In general, social insurance systems must transfer wealth from some groups to others within the covered population. Persons who die soon after reaching retirement, for example, typically subsidize benefits for those who live much longer, and all participants who reach retirement subsidize those who become disabled during their working years. If there are systematic differences in longevity, having a single form of payout via an annuity, for example, will be a distribution from the shorter lived to the longer lived, which can be the same as a distribution **from** the poor **to** the rich, which is not likely to be ideal. Hence, it is important to have good data on the mortality of participants and possibly to allow people other options, for example using phased withdrawal of benefits.

Common cases of current redistribution happen as a consequence of benefit formulas based on last salaries and early retirement without proper actuarial reduction. In the first case, workers with steep income career profiles receive disproportionately higher benefits than those with flat incomes, resulting in regressive income redistribution. In the second case, workers with similar careers may receive higher lifelong pensions if they can benefit from early retirement. Finally, permissiveness in the access to disability pensions often results in lifetime benefits for workers who can remain active performing self-employed work or other forms of economic activities excluded from mandatory contributions to pensions.

Other outcomes and design principles to drive reforms include:

- **Affordability:** A pension system is affordable only if it can be financed without heavily compromising other social or economic objectives. Affordability is a factor of the spending side of the pension system.
- **Sustainability:** Policy-makers often mistakenly conclude that a pension system is financially healthy simply because it is generating cash surpluses (contributions to the scheme exceed benefits). This typically happens when populations are young, and the number of persons contributing to the scheme is far larger than the number of beneficiaries. As populations age, this situation will slowly but inexorably reverse. As stated earlier, public pension schemes are vulnerable to gradual changes in the age structure of a country's population, to almost imperceptible shifts in the relative sizes of the formal and informal economies, and to the incremental evolution of macroeconomic indicators. Because of this vulnerability, pension systems must be designed to be sustainable. A pension system is sustainable only when it has the capacity to pay current and future benefits over a long horizon under reasonable assumptions without shifting

substantial burdens to future generations and without having to cut benefits, increase contributions, or change qualifying conditions. This can only be accomplished if pension systems are designed and periodically tweaked using careful actuarial modeling.

- **Adequacy:** Benefits are adequate when they provide sufficient income to protect participants from falling into poverty if they become disabled or after they have retired and provide a reliable mechanism for smoothing consumption between a participant's working years and old age. Moreover, benefits must be adjusted over time so that inflation does not erode their real value. Ideally, this indexation is predictable. There are two criteria against which the adequacy of benefit levels can be judged: some stated *minimum income level* (e.g., ensuring an absolute or relative level of income for people who have always been poor or for those who fall into poverty in old age) or some *minimum level of income replacement* (achieving a particular level of income replacement to sustain a target level of consumption in old age relative to that earned during one's working years). International experience varies considerably.
- **Coverage:** Progressively broader coverage of a country's labor force should be gradually targeted through formalization of the labor market (reducing the size of the informal economy relative to that of the formal economy); better enforcement of contribution compliance of employers and self-employed individuals, including informal sector workers; increases in behavioral incentives; and making access and contributions as simple and automatic as possible to workers in the informal sector through developments in ID, IT, and particularly financial inclusion and payment system improvements.
- **Efficiency:** An efficient pension system achieves social protection objectives without creating adverse behavioral incentives for participants or employers; meets reasonable standards for service delivery and enforcement at reasonable administrative costs; delivers the best-possible net-of-fee returns; and delivers a supply of long-run, stable capital.
- **Security:** A well-run pension system will have a clear set of legal requirements that explains how pensions will be designed and delivered. These will guide retirement income rather than ad hoc political decisions. Moreover, the system will be well designed so that it delivers retirement income in the face of shocks—for example, when there are assets, that investment strategies move away from volatile investments as an individual gets closer to retirement. It is also important to ensure that there is a clearly identified regulator and supervisor which will be legally required to monitor at least the private pension system and ideally social security institutions as well when they are investing assets. These supervisors should be independent and have clear goals and the powers and resources to safeguard pension promises that are made each day but may not be paid out for many decades.

The above principles are not necessarily always in harmony with one another. On the contrary, they are often in tension; steps to raise benefit adequacy, for example, may reduce affordability (encouraging migration from the formal to informal economic sector) and

undermine a scheme's sustainability over the long term. Resolution of these sorts of trade-offs is the central—and inherently difficult—challenge facing policy-makers in each country.

In the context of this long-run framework, the main and general challenges of the social insurance and pensions programs in the Arab region can be summarized as:

- **Data gaps:** *A severe lack of data with which to develop policy but also to undertake the day-to-day and strategic operations of pension funds, as well as lack of rigorous benchmarking to best practice on costs.*
- **Sustainability and affordability:** *A range of trends including design of pension schemes and population aging mean that social insurance programs, particularly pensions (old-age, disability, and survivor benefits), have **sustainability and affordability problems** and are a **large and growing financial burden** on national finances, crowding out support for other deserving policy programs and creating inequalities. **Population aging**¹⁹ and risks to future old-age poverty exacerbated by **weakening informal care** make these preexisting challenges more difficult.*
- **Low coverage of the private sector:** *The role of the employer is critical in all countries, but with most Arab countries needing to develop solutions that reach workers in the informal sector and for countries with higher degrees of formality such as the GCC, there is a need to develop solutions for the high percentage of the labor market made up of resident foreign workers.*
- **Inefficiency of labor market, high costs, inequities, and bad incentives:** *Significant cost, investment, and labor market inefficiencies due to social insurance programs that are **fragmented** and cover different programs (old age, invalidity, survivors, work injury, family allowances, sickness and maternity, unemployment) create considerable administrative and economic inefficiencies and inequalities, particularly between public and private sector employees. **Badly designed schemes in most countries in the region are leading to adverse behavior and increasing inequities**; the economic and behavioral impact of many current pension scheme features have been overlooked and not well assessed, which affects all programs, including disability and survivorship pensions.*
- **In many countries in the region, social security institutional capacity is facing considerable challenges** as scale, expertise, and governance lag best practices.
- **Security, regulation, and supervision:** *Many countries, particularly those with fragmented pension systems, have underdeveloped or lack regulatory and supervisory structures to ensure proper oversight of pension funds and retirement promises.*

Capital market efficiency, investment, governance challenges and solutions are addressed in section V.

¹⁹ See population projections in section II.1

III.1 Data Gaps

Many countries in the Arab region need to generate more and better data and promote open access to the data. A critical priority is investing in good-quality IT systems that provide for efficient management of processes, integration of multiple business operations, effective monitoring, and easy processing of and access to data. This is essential for a proper policy discussion on pension and pension reform in any country, as well as for effective ongoing operations.

Different countries in the Arab region face different data challenges. Some countries are in the early stages of reform and have considerable gaps even in the baseline data necessary to conduct a proper first assessment of the financial and equity problems facing their pension schemes. Without such a baseline, it is not possible to have proper discussions about the costs and benefits of alternative reform packages. Other countries are in the process or have already built some reliable pension databases, but there are considerable data gaps in most of the region. In most instances, administrative data are available for analysis not as individual records but only in certain distributions or as aggregate figures. Reliable and recent household surveys are limited. As participants in the conference noted, this makes it difficult to run the current pension system, let alone improve policy and delivery.

On various occasions, resources have been mobilized to prepare evaluations of the financial situation of some pension schemes, but the tasks had to be delayed because poor record keeping made it difficult to generate the data necessary to conduct the analysis. There seems to be a tendency to underestimate the magnitude of the importance of having proper and reliable databases (good evidence) for proper pension reform policy discussions.

This is why one of the first actions recommended for the AMF is a detailed survey of key participants in the systems, including members, employers, regulators and supervisors, and governments to understand the current situation and to have a baseline against which to measure progress from actions taken under the planned partnership between the AMF and the WBG.

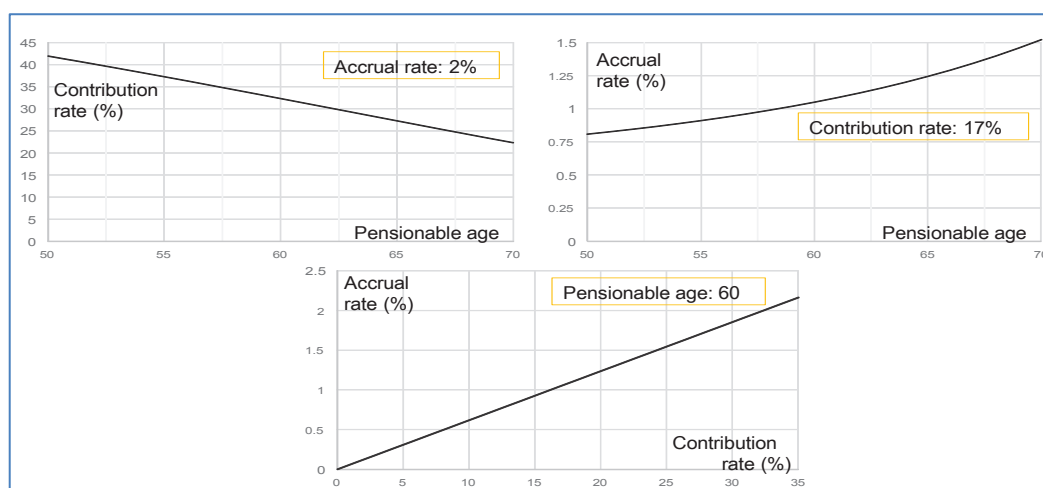
A second area in which a regional or AMF-wide approach could make contributions to improving comparability and understanding is benchmarking of costs and investment returns. This needs to be done rigorously to ensure proper comparability. This is possible, and the region could benefit from the example of Latin America, where the International Association of Pension Funds Supervision recently undertook a detailed regional benchmarking exercise of this nature²⁰. This exercise was needed even though some of the countries have good data, because they realized that true understanding of what drives net-of-fee returns requires detailed and rigorous comparisons. This kind of benchmarking is important for defined-benefit plans (for which it can reduce the costs of achieving a given funding target) and Defined Contribution plans (for which it can increase the size of a pension that can be created from a given level of contributions).

²⁰ See [presentation by CEM Benchmarking](#) that produced the results.

III.2 Sustainability, Affordability, and the Growing Financial Burden

As mentioned earlier, pension spending in the Arab region is high, despite low coverage. In addition to the unfavorable system demographics²¹, social insurance schemes in the region have important structural problems. Primary challenges for the pension systems of most Arab countries are affordability and sustainability²². Benefit promises are not in line with contribution rates and retirement ages. Basically, there is a fundamental misalignment of the contribution rate and benefits paid at various retirement ages; the rules that guarantee the financial sustainability of a defined benefit pension scheme financed on a pay-as-you-go basis are not respected. Figure 16 illustrates modelling performed on a recent project to illustrate the range of viable combinations of parameters to deliver sustainability—allowing the authorities to choose the combination most likely to be politically feasible in their country.

Figure 16. Sustainable Pension Possibilities



The schemes were supposed to be designed to be financially self-sustainable. Most were designed as earnings-related, pay-as-you-go schemes, which include a financing mechanism by which current contributors pay for current beneficiaries, and the pension is calculated according to a formula that relates such retirement income benefits to individual earnings, but in most schemes, if not all, such benefit promises are mostly not in line with contribution rates and retirement ages, and eventually the schemes rely on the general budget.

When these types of schemes run into deficit (or even before), resources are transferred to them from the general budget, but even if deficits are modest, the use of public resources to subsidize pensions of formal sector workers, civil servants, and the military is unfair and very regressive to the majority of workers in the informal sector, who often have little or no pension. An international best practice is to use general revenues only to provide targeted

²¹ Most pension schemes in the region are increasing their system dependency ratio (number of beneficiaries divided by number of contributors) considerably and consequently decreasing the system support ratio (number of contributors for each beneficiary).

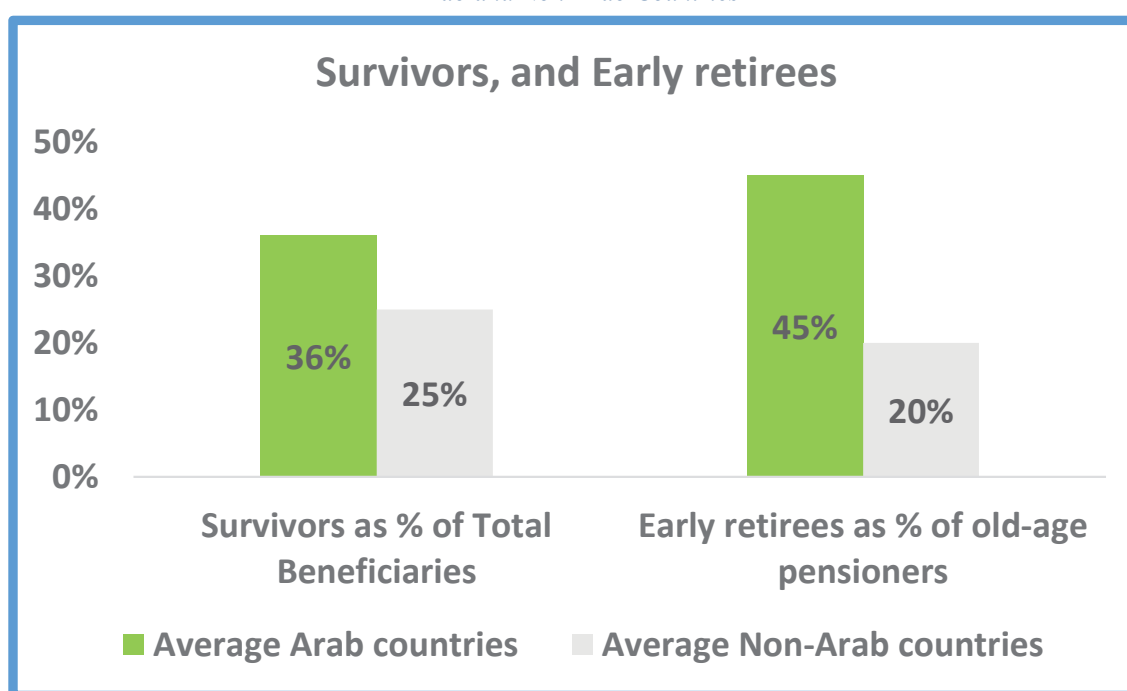
²² Affordability involves only the costs of pension benefits, whereas sustainability is a function of retirement benefits and contributions paid to earn pension rights. Most contribution rates of pension schemes in Arab countries cannot sustain promised pensions.

benefits for poor people or those with low or no savings capacity. Even then, with many challenges to achieving better human development indicators (e.g., job creation, enrollment rates, mortality), any country needs to be selective in allocating its budget to social protection, labor policies, education, and health programs. This is a challenge in most Arab countries.

Revenues from contributions exceed pension expenditures in many of the national schemes covering general workers, but the majority of the schemes covering civil servants and the military are running deficits.

Another source of unsustainability is the high and growing system dependency ratios (number of beneficiaries vs number of contributors), particularly because early retirement and survivorship pension provisions are generous in general in the Arab region. Figure 17 illustrates such provisions (on average) in Arab and non-Arab countries.

Figure 17. Survivors and Early Retirees
Arab and Non-Arab Countries



Source: World Bank Pension Database

Early retirement in many Arab countries is provided with even no reduction in pension amount and sometimes for fiscal or economic policy decisions (e.g.: downsizing of public sector or companies), disregarding the effects of such decisions or ignoring the fact that other instruments may be more effective to achieve the expected results. In other cases, early retirement is justified as a mechanism to increase job opportunities for young workers, although abundant empirical evidence shows that retirement age is not a relevant determinant of youth employment.

There is also a wide range of people eligible for survivorship benefits in addition to spouses, including single, widowed, and divorced daughters; students up to age 25; parents; and single

sisters. Inclusion of these beneficiaries greatly extends the length of time for which benefits are paid to multiple decades. Such entitlements are common in Arab countries, whereas in Europe and North America, benefits are mostly limited to surviving spouses.

Pensions paid to spouses of working age tend to be limited (in value, duration, or both). Account is also usually taken of the value of the surviving spouse's own pension entitlement. In Latin America, for instance, pre-reform pension systems tended to offer benefits to an extended range of survivors, but reforms have circumscribed this in ways similar to policies in high-income countries. The survivor's pension is 100 percent of the deceased's entitlement in many of the pension schemes in Arab countries, which is significantly higher than the norm in Europe, for example, of 50 percent to 70 percent, which may be even smaller once the survivor's own entitlement is taken into account.

Dependency ratios tend to be even higher in special schemes (covering civil servants, military, and others), and benefits are usually even more generous than those provided in national schemes (covering mostly private sector employees). In most countries, the financial position of the national (private sector) pension schemes is better than that of the special schemes, although in the long run, the financial position of the national schemes is also expected to deteriorate. (In some of the countries in the region, they are already in deficit.) Even in schemes with a high level of funding (some schemes still have reserves), the present value of expected liabilities for the next 30 to 40 years surpasses the present value of total reserves²³.

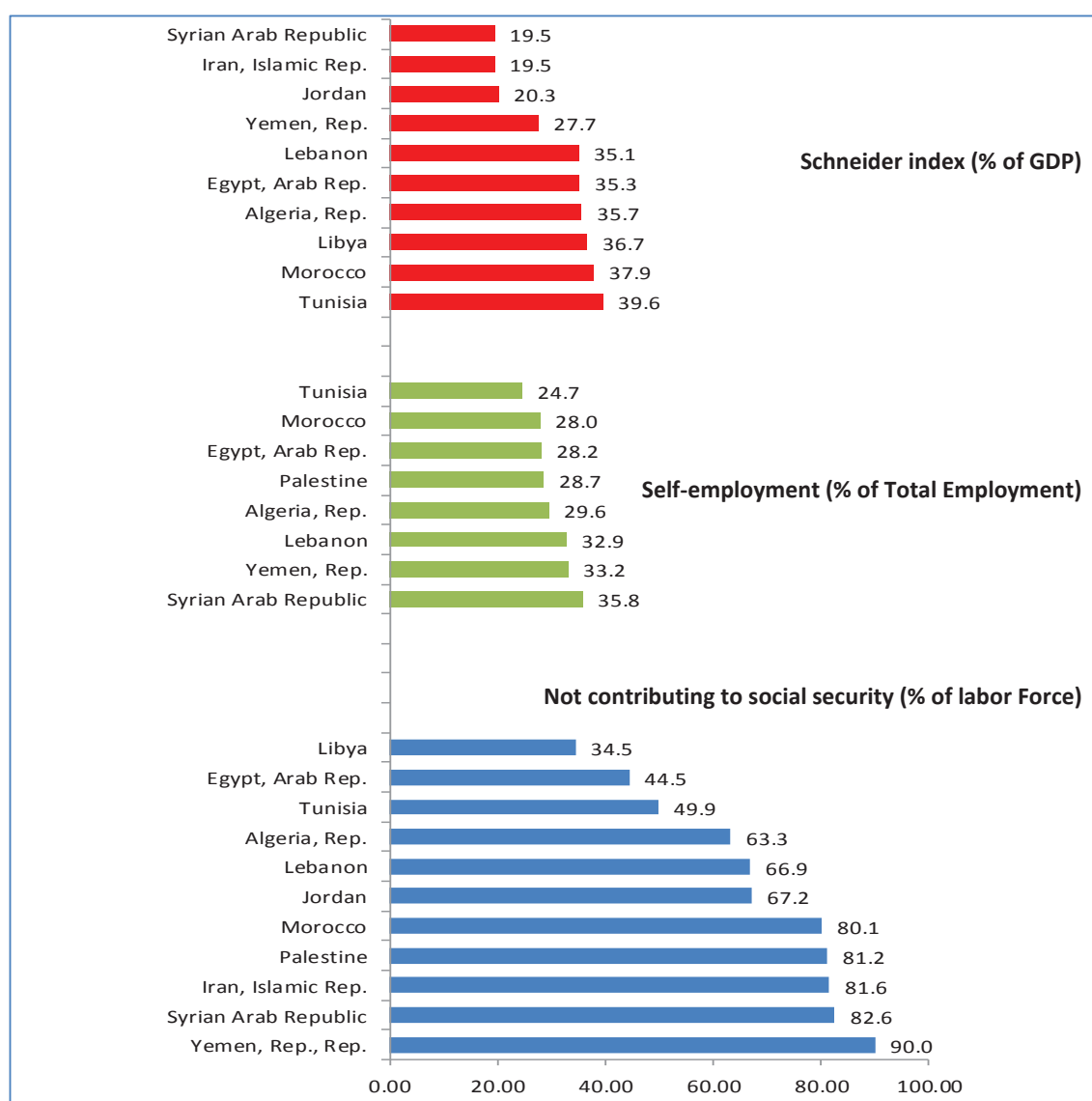
III.3 Coverage

An important reason for low coverage rates in the region is the large informal sector. A large part of the agricultural sector is informal, and informal jobs in nonagricultural sectors in most of the countries in the region account for more than half of the total private sector labor force. Approximately 40 percent of the labor force on average has formal access to contributory social security schemes in Arab countries (figure 18).

A second reason for low coverage is evasion of pension contributions because of high contribution rates and pessimistic expectations about future benefits.

²³ There are several measures of long-term financial sustainability of pension schemes. One commonly used measure is implicit pension debt. Most schemes in the Arab region have accumulated large implicit pension debts, ranging from 30 percent to more than 100 percent of gross domestic product. This debt is related to the promises made to current retirees and contributors and is often larger than the explicit government debt. This implicit pension debt is seldom taken into account when macroeconomic and monetary policies are being set, biasing policy choices and affecting the credibility of the fiscal framework. In the absence of rapid interventions, this debt will continue to grow, threatening the welfare of future generations.

Figure 18. Size of Informal Sector in Selected Arab Countries, 2010



Source : Gatti, R. et al. 2014. "Striving for Better Jobs. Informality in MENA." World Bank.

There are several reasons why people do not contribute, including mistrust of the institutions and designs of pension schemes. For instance, most schemes in the region do not have a formal pension indexation mechanism, so inflation and discretionary adjustments affect real benefits. This increases the level of uncertainty about the real value of future pensions and can induce workers to view contributions as an additional tax rather than savings, thus promoting evasion.

Given that coverage has not been expanding, the support ratio (number of contributors per beneficiary) has been decreasing. Although demographic characteristics in the Arab region remain favorable, the system demographics of social insurance (mostly pensions) schemes are rapidly aging. Short vesting periods and low retirement ages and weak penalties on early retirement also contribute to higher dependency ratios.

Countries such as Libya, Tunisia, Egypt, and Jordan have the highest coverage rates in the region, although careful consideration should be given to the definition of pension coverage for active workers. This active coverage rate refers to active contributors (of the labor force) to a mandatory social insurance pension scheme. Many people contributing are perhaps benefiting from various social insurance programs (e.g., work injury, sickness, maternity). However, they will not be able to qualify for a pension if they do not comply with the minimum number of years of contribution, so coverage of pensioners can be much lower than active member coverage. Comparison of contribution densities and labor mobility of the formal and informal sectors is important to consider in assessing coverage rates properly. The social security institutions that cover private sector workers often have a considerable number of “dormant accounts”—people who have been affiliated in the system and have contributed at some point but do not necessarily contribute at present.

Only an average of approximately 10 percent of people aged 60 and older receive a pension in the Arab region. Most of the older population in the region must rely on family and other types of informal care or state transfers. With falling birth rates, rising life expectancies, changes in urbanization, migration, and family structures the reach and scope of these informal arrangements have been weakening in recent years and will weaken further unless new policies to protect older adults are implemented.

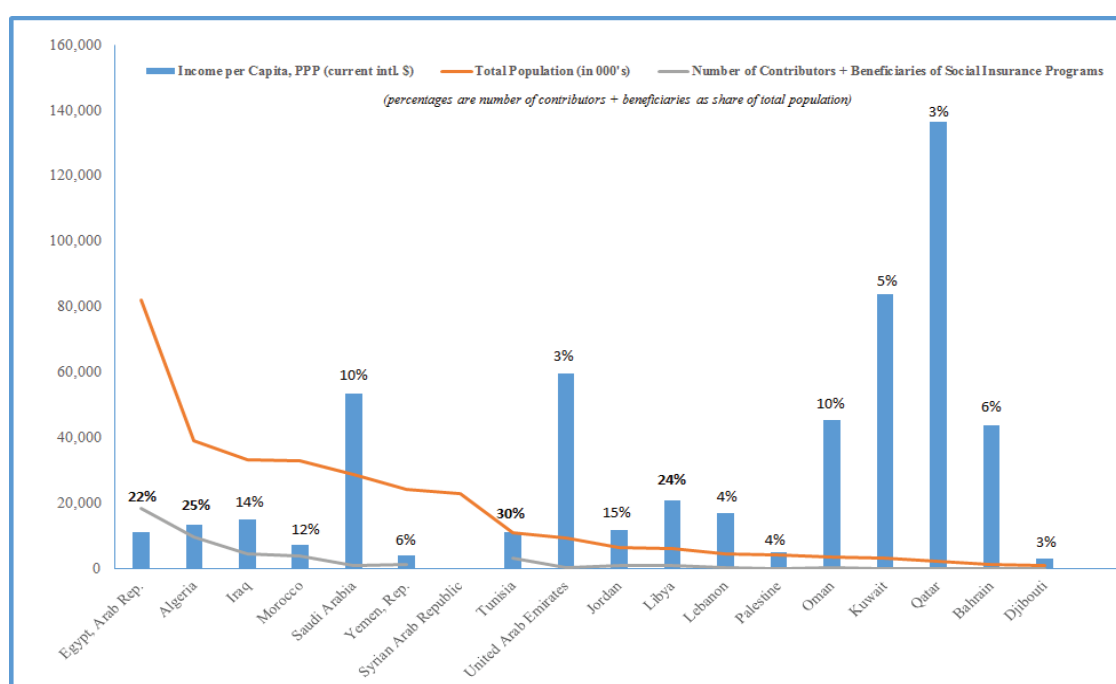
Foreign-Born Resident Workers

A distinctive feature of labor markets in certain Arab countries is the large number of foreign-born resident workers—up to 90 percent of the labor market in some countries. These workers will predominantly retire in their home countries rather than the host countries where they are employed. The percentage who stay in the host country is perhaps larger than might be expected²⁴, but coverage is needed for these foreign resident workers, which is a particular priority for the WBG, given the importance of these workers to countries particularly in South Asia and East Asia Pacific. As set out in the policy recommendations section, improvements in pension systems in the home countries that could allow workers to contribute directly to their home country pension system and send remittances for other family members to pension accounts so that the windfall of temporarily much higher wages not only boosts short-term consumption, but also helps secure their old-age income security and that of their families, are creating some exciting potential opportunities.

This solution may be preferable for host country governments, employers, and providers, too, because they do not need to enroll many workers who may be only temporarily in the host country pension system, although the assets will be leaving the region, so there will be a lower level of growth in domestic capital markets. A mix of solutions may be useful so that some workers can be included in host country saving and pension vehicles, but the large number of foreign resident workers, many of whom have no coverage, are now potentially much more easily directed into pension schemes in a way that will cost much less for host country governments and employers than before (figure 19).

²⁴ See presentation by Edward Whitehouse at the AMF – World Bank Pension Conference in Abu Dhabi, January 25-26, 2017.

Figure 19. Coverage of Pension Contributors and Beneficiaries in the Arab World



III.4 Inefficiency of Labor Market and High Costs caused by fragmentation

Most countries in the region have fragmented pension systems, with more than one scheme covering different type of employees (mostly private sector workers and civil servants but also other special schemes). Most countries, as indicated in table 1, have more than one compulsory pension scheme. Different types of schemes, with different qualifying conditions, different benefit formulas, and other different characteristics, cover different types of employees. Some countries in the region have been integrating (or have been trying to) their different schemes gradually into a unified national scheme, with the objective of having the same social insurance system cover all employees in the country. Bahrain and Iraq²⁵ have integrated administratively, but civil servants and private sector employees are still subject to different rules. Jordan has accomplished pension scheme integration reform. Civil servants hired before 1995 and military staff hired before 2003 are still covered under the old civil and military pension laws, but civil servants and military hired after such dates are already covered under the same national pension law (which covers all other employees in the private sector as well). Palestine has also effectively integrated its schemes, although effective parametric reforms have not been implemented, and the integration included not schemes for civil servants and private sector employees but only schemes that cover geographically different civil servants and security service personnel.

Some Arab countries have special schemes for civil servants and other special schemes for armed forces and other type of employees. Self-employed and casual workers are not covered under social insurance programs in most Arab countries, although self-employed workers in

²⁵ A current new integrated pension law with both public and private sector employees covered by the same scheme.

Algeria, for instance, have their own fund (called Caisse d'Assurance Sociale des Non-Salariés), according to law, although in practice, fewer than 30 percent of self-employed workers are effectively covered. In Egypt, Tunisia, and Yemen, the same scheme that covers all private sector employees also covers self-employed workers (according to law). In practice, a high percentage of them are not covered either.

As mentioned above, this fragmentation of pension systems in the region produces considerable administrative and economic inefficiencies. Transparent, efficient rules to transfer rights across schemes are rarely in place, so the mobility of the labor force is restricted, preventing efficient allocation of resources. Fragmentation also increases administrative costs and is a source of inequities, with some segments of the labor force receiving preferential treatment from the public pension system. This is an area where data are particularly lacking, hence the suggestion for a regional cost-benchmarking exercise in the recommendations, which could be useful for all who run funds in the public and private sectors.

Other aspects of the current design of many of the social insurance (mostly pension) schemes in the Arab region unnecessarily distort the economy and are a source of adverse distributional transfers and behavioral incentives. Beyond the problem of fragmentation, the current designs of many of the pension schemes in the region create economic inefficiencies and income inequalities (usually favoring middle- and high-income workers at the expense of low-income workers, and favoring current beneficiaries at the expense of future generations).

The problems related to fragmentation in the broader pension system risk being re-created in private pension funds if there is not an active policy to create a market structure that can deliver the benefits of economies of scale that are so powerful in pension markets. There is not much evidence that an individual-choice model that relies on ordinary people actively choosing to join a pension plan and then being able to choose their investment strategy and negotiate or shop around for low fees is the optimal way deliver mass market pension coverage.

A recent example of the benefits of improving the market structure in conjunction with sensible regulations is a reform in Turkey that introduced auto-enrollment into pension plans via employers. This has cut costs from the existing individually based private pension market (known as the BES) by more than 50 percent. The weighted average of total costs in the new auto-enrollment system is approximately 0.75 percent per year (75 basis points) for administration and investment management, compared with 1.7 percent (170 basis points) in the individual market (and even higher in previous years despite the system having been set up in 2003). In the first 6 months of the new policy, over 2.5 million workers were added to the system—all of whom could have chosen to take out a pension before—for which there had been a generous 25 percent government match of contributions (up to a limit). This shows how important it is to have a proactive policy to expand coverage rather than relying on individuals being able to navigate the options without assistance.

Turkey is another good example of the need to improve the demand and supply dynamics in the pension market. On the supply side, it is important to develop a model that does not rely on large sales forces chasing individual subscribers because this is expensive for companies to operate and can lead to “churning” of accounts from one provider to another, which increases costs and forces more-liquid investment strategies because companies face high levels of redemptions to transfer assets to alternative providers (Stewart et al. forthcoming). It can also be tempting to mis-sell because sales agents paid up-front commissions push products inappropriately, with scandals being seen in countries such as the United Kingdom, the United States, and India. The demand side is equally important because there is a large body of evidence showing that it is difficult to understand the choices involved in creating a good-quality pension product. There need to be high-quality default funds for the accumulation and decumulation phase so that members do not need to become investment experts. Improving both elements can be beneficial because providers can deal at scale and gain scale without having large sales forces, which increases competition in asset management from companies that do not rely on traditionally dominant bank-based distribution models.

The section below on potential policy reforms explores how some of these challenges can be avoided as pension markets are developed in the region. One additional benefit is that if scale providers of pensions are created, an economy more quickly reaches the point where it can have large, long-term providers who can invest successfully in longer-term and illiquid investments from real estate to private equity to infrastructure that many countries in the region are desperate to fund.

The fragmentation outlined in the previous section as a common feature in the pension schemes of Arab countries is one of the clearest challenges to address. Most countries in the region have more than one pension scheme, with schemes covering public and private sector workers typically separated (table 4). The separation of the schemes responds to historical legacy rather than to a rational justification for different treatment of private and public sector workers. Bringing these elements together and using common platforms will deliver important benefits because this will tackle (i) Diseconomies of scale, resulting in high costs associated with duplication of administrative processes (collection, investment) and management of separate databases in parallel; (ii) Unfair treatment of workers in different sectors, with high returns on contributions in one sector (usually public servants) and very low benefits/low coverage (private salaries) or simply no coverage (self-employed); (iii) Lack of central databases limits supervision and law enforcement capacity, resulting in important groups of the population excluded from pension benefits because employers evade social security contributions; (iv) Lack of portability of pension benefits, resulting in limited flexibility to move between jobs.

Table 4. Pension Schemes in Selected Arab Countries

Country:	Number of Funds	Integrated Regimes Civil Servants & Private Sector	Contractual Workers in Public Sector Join	Military Join	Workers in SOEs Join	Self- Employed & Others Join
Algeria	2	Yes	General	General	General	Own Fund
Bahrain	2	No	Public Sector	Public Sector	Public Sector	Not covered
Djibouti	3	No	Private Sector	Own Fund	Private Sector	Not covered
Egypt	3	No	Private Sector	Own Fund	Private Sector	Private Sector
Iraq	2	No (Yes under new law)	General (new law)	General (new law)	General (new law)	Not covered
Jordan	2	Yes	General	General	General	Not covered
Lebanon	2	No	Public Sector	Public Sector	Public Sector	Not covered
Libya	1	Yes	General	General	General	General
Morocco	3	No	Own Fund	Public Sector	Contractual W	Not covered
Tunisia	2	No	Public Sector	Public Sector	Public or Private	Private Sector
Palestine	2	No	Public Sector	Public Sector	Public Sector	Not covered
Yemen	4	No	Public Sector	Own Fund	Public Sector	Private Sector

Source: Robalino et al. 2007. "Pensions in the Middle East and North Africa: Time for Change" and some updates from the Middle East and Northern Africa Pension Database

In spite of strong arguments for the merger of different schemes, Arab countries face several difficulties before they can consolidate their pension schemes. From the experience of countries that have merged, some of the challenges to address include

- **Administrative barriers:** Different organizations have different procedures, organizational structures, and technologies to perform the same administrative processes.
- **Consolidation of records:** Centralizing information is essential as part of the consolidation process, but it may be complex if there are different types and sources of data or IT.
- **Organizational cultural barriers:** In addition to written administrative manuals and organizational structures, different organizations have generally accepted and usually unwritten codes of practices; integrating these common practices is sometimes more complex than adopting unified manuals of procedures.
- **Asymmetries:** Organizations to be merged are normally different, and although the merger process may improve synergies and complementarity, it is also possible that the consolidated institution will inherit the weaknesses of both organizations. There may also be asymmetries in definitions of key problems and priorities; although increasing administrative capacity is a common need of pension schemes, public pension schemes in some Arab countries face critical challenges of sustainability, and the top priority for the schemes for private sector workers is usually extension of coverage and greater compliance.
- **Rights of individuals that the merger will affect:** Consolidation would require significant changes to define the rules of the new merged institution, affecting the rights (or expectations) of individuals in one or both of the schemes. This adds to the difficulties of ongoing reform processes in each of the schemes separately.
- **Resistance to change:** Mergers are usually perceived as major changes and therefore encounter resistance, particularly in existing institutions, whose staff members perceive

change as risk of losing their jobs or the power they have in their respective organizations.

These challenges are stronger obstacles to merger if the schemes to be consolidated are similarly developed and strong. In this case, both public and private sector schemes would resist the merger.

In addition to these challenges, as in any reform process, two critical aspects are of paramount importance and should not be disregarded: the need for a strong, proactive reform champion to lead the process, educate and bring together the political groups, and push the process forward and an effective public information campaign, particularly targeted at private sector workers and employers, to raise awareness of the importance of enrolling in pensions and making regular contributions to the scheme.

III.5 Efficiency and Governance Constraints in Pension Institutions

Other common challenges facing social insurance and pension systems in the Arab region are related to weak institutional capacity to monitor expected revenues and expenditures and to manage reserves. In many cases, social insurance systems have been used as mechanisms to finance and provide social assistance services. In general, benefits are not in line with contributions, leading to actuarial imbalances. Also, the systems are often financed through high payroll taxes that contribute to the distortion of labor markets, and as mentioned earlier, their financial position is deteriorating or expected to deteriorate in the near future.

The Arab region faces a compelling challenge in improving governance and management outcomes for public pension schemes. There is a serious gap between governance structures and management of public pension systems in the Arab region and the best international standards and practices for good governance and sustainable management.

Other structural constraints include a legal framework that makes it difficult to apply best-practice models, governance problems at the macro level, limited administrative and institutional capacity in many of the countries in the region, and the level of financial sector development. There are major shortcomings in governance (particularly financial governance) and administrative structures.

Lack of appropriate information systems to monitor and track contributions encourages evasion. Inappropriate governance structures also lead to discretionary adjustments of contributions and benefits, which are often arbitrary and driven by political pressures that compromise the financial sustainability of the systems.

Improving governance and investment of social security funds, but also of other public and private pension funds, is a critical part of the future success of pensions in the region. This is addressed in section V on how to improve overall performance of the capital market and pensions. There is a high degree of overlap in governance between good practices for social security funds—as highlighted for example in the Governance Principles of the International

Social Security Institution²⁶ and the standards of the OECD for Private Pensions²⁷—and assessment frameworks that aim to bring together the core lessons of these and other attempts to improve governance, such as Outcomes-Based Assessments for private pensions²⁸.

III.6 Security, Regulation, and Supervision

The long-term nature of pensions means that safeguarding benefit promises or the assets backing those promises over many decades is of critical importance. This is not a problem simply for Arab countries but for any country seeking to build a multi-pillar or diversified pension system that will combine public and private pensions, pay as you go with funded pensions and Defined Benefit type pensions with savings and Defined Contribution pensions.

The area of regulation and supervision has grown in importance over the years as more countries have developed this multifaceted way of delivering pensions. Some countries in the region have well-established regulators and supervisors. Some have them for part of the pension system but not all parts—for example the Egyptian Financial Supervisory Authority, which supervises voluntary private plans but not public pension schemes. It is an open question whether a pension supervisor should cover both public and private pensions, but it is perhaps an emerging trend to give supervisors broader scope as the costs of lack of transparency in public pensions and social security institutions become clearer. For example, in the United States, private employer based pensions are regulated by the Department of Labor and have to follow a set of regulations aiming to increase the likelihood of full funding in the case of Defined Benefit plans, or achieving good standards in the case of Defined Contribution plans. Public or state pension plans are governed by different (and weaker) rules and many are now very significantly underfunded. Over the course of many decades many of these plans at state level have accumulated deficits, that if measured on the same basis as the private pension plans, would often be 5 times higher than the explicit debt of the states²⁹.

The potential to create very large deficits in public pension plans which will ultimately be extremely difficult to fund can be partially avoided by having greater scrutiny by an independent regulator who can monitor the assumptions and the funding situation greater scrutiny even if the government retains the policy role to determine the right level of contributions and benefits. This arrangement is broadly what has recently happened in the UK where many public service pension plans have now been transferred under the supervision of The Pension Regulator³⁰.

For regulation and supervision to be effective it is important that the supervisors have the necessary degree of independence and resources to do their job. The resources are: the legal powers to take action in the case of problems; the number and quality of the staff; and the

²⁶ See [ISSA Guidelines for Good Governance](#).

²⁷ See the [2016 revised OECD Core Principles of Private Pension Regulation](#).

²⁸ See [2016 Outcomes Based Assessments for Private Pensions: A Handbook](#) by William Price, John Ashcroft and Michael Hafeman.

²⁹ See “[An Options Pricing Method for Calculating the Market Price of Public Sector Pension Liabilities](#)” by Andrew G. Biggs, American Enterprise Institute

³⁰ New duties were introduced in 2013, with the Pension Regulator setting out its first code of conduct for public pension schemes in 2015.

willingness of the staff to take action, which is the ability to deal with difficult decisions and the experience and insight to know that problems can and do emerge in the delivery of pensions – in both the public and private sector. These behavioral characteristics are best supported by effective design of the pension market value chain – so that those investing assets do so for example using a custodian, which is a way of hard-wiring anti-fraud protection into a system.

Security of the pension benefits also relates to avoiding assets being reduced by market volatility just before someone retires and needs to use the assets. So, this means that investment plans are needed that can move away from riskier assets as someone approaches retirement. One option is to focus on matching the asset allocation used by insurers providing annuities so that members will not suffer from volatility. Another element of security is trying to move to a situation where benefits are paid until someone dies so that people do not outlive their pension assets or promises and face poverty in old age (or relative poverty). Many defined benefit plans aim to deliver an income until death – but not all – see for example the case of Egypt where plans pay out lump sums from Defined Benefit plans. But some plans only guarantee a nominal level of income which can be quickly eaten up by inflation. This can make an initially adequate pension become increasingly inadequate if a person lives for many years – though correspondingly it is a way in which under-funded plans can re-achieve sustainability.

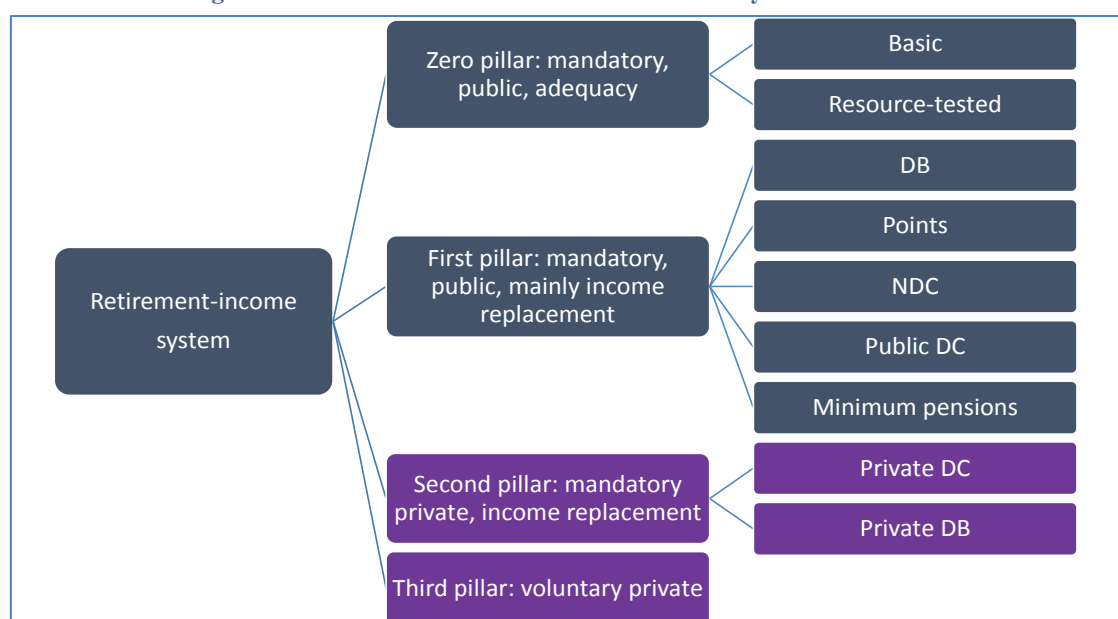
IV. Options for Reforms

IV.1 Systemic: Adapting the Multi-Pillar Pension Design to the Arab Region

Countries worldwide have been moving towards multi-pillar pension systems.

The World Bank classification system proposed in 2005 differentiates pension system components into 5 pillars: 1) a non-contributory “zero pillar”, 2) a mandatory earnings-based “first pillar” (publicly managed), 3) a mandatory savings-based “second pillar” (privately managed), 4) a complementary voluntary “third pillar” (privately managed), and 5) a nonfinancial “fourth pillar,” which includes access to informal support, other formal social programs (e.g., health and housing), and other financial and nonfinancial assets (e.g., home ownership and reverse mortgages where available). Four pillars are shown schematically in figure 20. It is important to note that such classification does not imply that all countries should have all pillars. The recommendations of pillars would depend on the country specific overall development objectives, and country specific institutional and policy environment. However, avoiding a mono-pillar system is a key recommendation.

Figure 20. Retirement Income Pillars as defined by the World Bank



During the 1980s and 1990s, the number of countries with mandatory privately managed defined contribution schemes (second pillar) increased from one to more than 30 (two countries in Latin America and the Caribbean, although Argentina, and Bolivia closed the second pillar in 2008 and 2010, respectively, and one in the Europe and Central Asia region, Hungary, also closed the second pillar). During the 2000s, the focus on new developments is shifting to the zero (social pensions) and third pillars (DC-voluntary pensions).

The main area where some tailoring of the model is needed for Arab countries is certain distinctive features of the labor market highlighted earlier. The first is the high rate of foreign resident workers in some countries, particularly GCC countries. This was an area of particular

focus at the January conference, with a session dedicated to the topic. For these workers, most of whom will retire in their home countries, it may be more effective to link their pension provision to that of their home country. In this case, one could have a mandatory private pension (a second pillar), but the pillar is in the home country, and the GCC employers would need to develop systems only to ensure that workers were making contributions. If the home pension system is not effective, it is important to explore the concept of mobility saving accounts discussed at the conference and below.

The other main area for tailoring is informal sector workers, which is an important consideration for many countries in the world. Here the tailoring is not so much in the pillars themselves but because the concept of mandatory provision is nonbinding when there are no contracts or legal requirements to pay a regular salary. In these cases, the model relies on innovations to make it simpler and more automatic to link informal workers into a pension system and make payments simple and regular, without needing an employer—examples of which are discussed later in this chapter.

Role of Mandatory, Voluntary Private Pensions as Complements to Public Pension Schemes

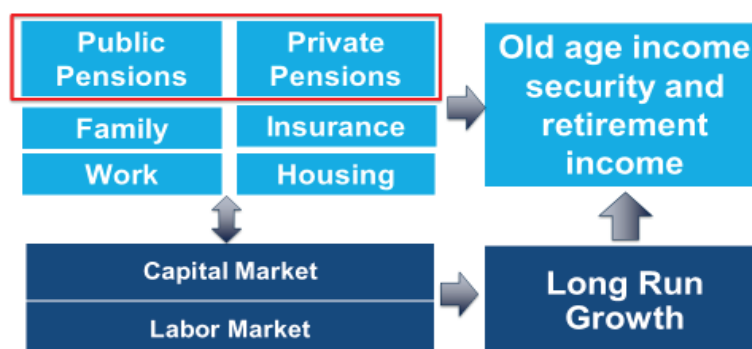
A central message of this report is the benefit of a multi-pillar or multidimensional pension system to meet and balance the multiple and sometimes conflicting objectives of a pension system. No one pillar or tier can bear all the weight of delivering adequate income with broad coverage in a sustainable, efficient and secure way. There is no example of a country globally that manages to achieve high levels in each of these outcomes with a single pillar.

Overall then mandatory and voluntary private pensions have a strong role to play in helping to diversify a pension system. They can help to improve labor market efficiency, particularly if pensions are portable between the public and private sectors – even if there are some differences in rules.

This diversification also helps to emphasize another important message – which is that delivering decent income in old age is not just a pension issue – it is a retirement income issue. People can and should find multiple ways in which to do this – not only through public and private pensions, but also through continued work if needed, using family ties, using insurance products and the benefits of housing – either to reduce the need for income in old age if a house is owned – or co-residence with relatives is possible – or providing an extra source of income if it is possible to rent out a room or even a separately owned property.

Figure 21 shows how this integrated thinking can help solve the old-age income problem with a combination of policies rather than thinking there is a magic bullet that can solve all problems. The figure also shows how the labor and capital markets are critical influences on the pension system and how the pension system influences them. Proactive policy is needed in both directions to ensure maximum policy returns.

Figure 21. Good Old-Age Income Requires Diversification and Good Labor and Capital Markets



IV.2 Parametric: What Combinations of the Key Parameters (Accrual Rate, Pensionable Age, and Contribution Rate) Deliver Financial Sustainability?

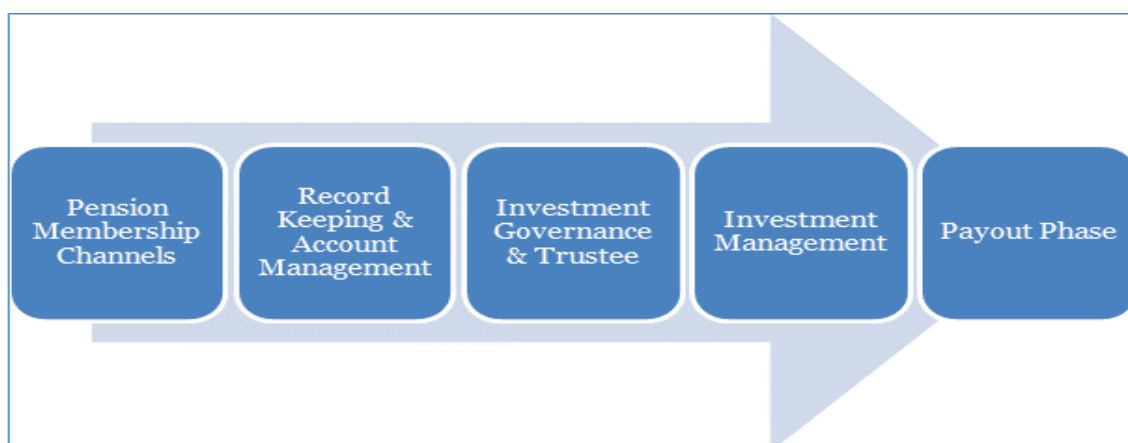
Policy-makers, sometimes view actuarial modeling as a purely technical task and overlook its importance. It is crucial that policy-makers subject the existing scheme—and any proposals for reform—to detailed actuarial modeling and analysis to properly set the individual parameters of the reformed scheme. The long-term nature of public pension schemes makes it impossible to adequately understand the implications of any policy choices in the absence of such modeling. Only on the basis of careful actuarial modeling can the individual parameters of a pension scheme be properly set. Moreover, actuarial models must be maintained as an ongoing priority; no matter how carefully modeling is performed, forecasts will need to be updated. For this reason, models must be maintained, which requires active involvement and support of senior managers, and the parameters of the reformed pension scheme must be periodically updated to safeguard its long-term fiscal balance.

When there is a Defined Contribution system in place or planned, the modelling shifts toward a focus on likely replacement rates—the share of pension income as a proportion of wages—or the size of assets that may be accumulated by a particular age. It is important to set a clear, achievable target; there is no point asserting that everyone will receive two-thirds of their final income as a pension if total contributions are only 5 percent of salary. It is also critical to be clear about the range of potential outcomes. If there are no guaranteed investment returns, there will be a range of likely outcomes depending on investment returns and volatility over the life of each investor.

IV.3 Extending and Financing Coverage: The Role of Employers

The analysis so far has illustrated the heterogeneity of the Arab area, as well as some of the unique features of individual countries, including often-high levels of foreign-born resident workers. It is important to think carefully about how to deliver the pension value chain from start to finish in the most appropriate way in different countries. The key parts of the value chain are shown in figure 22.

Figure 22. The Pension Value Chain



However, a common feature in all of the markets is of course the existence of employers. The employer channel is hugely important in terms of helping to improve coverage. However, employers come in many shapes and sizes – and in the case of informal employment workers are either hidden by employers, or the employer may not even formally exist at all. In this case, it is important to have a strategy that tries to map the role of the employer to the type and nature of employment. An example is shown in figure 23.

Figure 23. Matching Role of Employer to Scale and Potential Engagement



IV.4 Extending and Financing Coverage: Addressing Informality

Two major challenges to expanding pension coverage in the Arab world are the large number of workers in the informal sector and the large number of foreign-born resident workers in the labor force, especially in the GCC countries.

Informality, Self-Employment, and Casual Work

The traditional approach to extend pension coverage to informal sector workers has focused on formalization through the introduction of specific regimes for self-employed or casual workers, and increased enforcement of regulations. While efforts from both approaches are commendable, they have not produced good enough results. Special regimes for self-employed or casual workers face difficulties defining the contributory base and have to rely

on self-declaration of income. The low levels of benefits which result is socially unacceptable. In addition, regular contributions to a scheme is challenging vis-à-vis the irregularity of incomes among these groups.

A less traditional approach with fairly successful results is the adoption of simplified regimes for low income self-employed workers. The focus of this approach is to reach informal sector workers who have some potential capacity to enroll in a contributory scheme, but who face difficulties to join existing schemes given the high administrative costs and burdensome processes entailed in mainstream contributory schemes. A simplified regime for small contributors consisting of lump sum (in lieu of salary-based) contributions was adopted in Argentina in the 1990s with successful initial results, although the scheme had implementation and compliance shortcomings in the longer term. Similarly, the experience of Morocco with mobile units was a creative initiative of the Moroccan Social Security Fund to reach potential contributors in rural areas.

Once an effective system has been established using employers that are part of the formal system, it is possible to look creatively at ways to focus on **incentives** to encourage workers in the informal sector to participate in the pension system rather than regulations or enforcement. The organizations that provide routes into the system are unlikely to be those who should be managing pension accounts and investments over the multiple decades required to deliver effective pensions, but if they are, it is important to make the different systems interoperable. This separation though between entry and then delivery can be a natural one and can work effectively because the administration and investments can be done at scale even if the outreach is done at a more local level. The Indian National Pension System is a classic example of this model, with a variety of routes into the system (and they are growing) but two large-scale central records agencies (private companies that have won competitive tenders to deliver the service) managing the accounts. Asset management is then done at scale by large asset managers who again have to bid to be part of the system (as well as be licensed to ensure a credible level of quality). The World Bank has been working in a number of countries to develop systems that can expand coverage to the informal sector and could use similar approaches in Arab markets. Recent pilots in India for example have delivered increases in enrolment of 500% and more by introducing digital and paperless enrolment and linking pension enrolment to the delivery of government programs such as Direct Benefit Transfers.

Developing Pension Schemes for Resident Workers in Home and Host Country

The large number of foreign workers without access to pensions deserves particular attention in the Arab countries. On a reciprocal basis, international agreements for pension provision may exempt expatriate workers from social security contributions in the host country, provided they are covered under and pay contributions to their home country's social security system. Alternatively, the agreements may grant exportability of pensions for workers who have made social security contributions in the host country. Rules for totalization of services are applicable at the time of retirement of workers who have accumulated contributions in more than one signatory country. These agreements are global among OECD countries,

following principles designed on the basis of International Labor Organization conventions, although they remain the exception rather than the rule in most of the world, and their applicability is complex when there are asymmetries in the design of pension schemes.

Some Arab countries allow their citizens to remain enrolled in home pension schemes while working abroad. Beyond the equity consideration of who bears the costs, this is an effective option for Arab workers emigrating to GCC countries, although these countries also receive many expatriates from other parts of the world, and access to such coverage is therefore limited in scope.

Although bilateral agreements are a possible instrument to totalize contributions (and accrue benefits) for workers who have been enrolled in the pension schemes of more than one country during their careers, such agreements do not exist in many cases. In addition, even if there are bilateral agreements, pension benefits are not portable, and procedures to access to them are complex, particularly when records in at least one of the countries are not automated.

One exciting new way in which pension coverage could be expanded in many countries in the region relies simply on setting up a collection and payments channel and does not need any pension infrastructure. This is possible when there is an effective pension system in the home country of a foreign-born resident with clear and effective identification that would allow some of the labor income in the host country to be diverted to the home country pension system in which they could already have an individual pension account or in which an individual account could be opened for them. Foreign workers could also make payments to the pension accounts of family members if they wanted to send a portion of their remittances to a source that would be locked for later to use to make sure that the ‘windfall’ of higher earnings would be transformed into a more-permanent source of better living standards rather than just boosting temporary consumption. This also has macroeconomic benefits for the home country because such flows would reduce a current account deficit or reduce reliance on capital account flows if domestic savings were not sufficient to fund investment.

The mechanics for such an approach already exist for Indian-born workers, for example, and the Indian Pension Regulator has initiated some information campaigns to raise the profile of this option, including visiting some countries in the region, although it is unlikely that this option will be widely adopted on a purely voluntary basis for employers and employees because voluntary pension provisions typically do not achieve broad coverage. The policy debate on improving pension coverage is a timely one because it allows for the possibility of establishing some mandatory requirements for employers to add people to a pension plan but provides some flexibility for this to be a plan in a ‘home’ country for foreign-born workers. Even if they stay for many years in the host country, it is likely that they will retire in their home country. The tenure of many workers will be much shorter than a typical job, and the host country can avoid the complexity and expense of establishing and running many short-term accounts. This is an option that should be actively explored as part of the AMF-WGB planned support for pension system improvement.

Box 1. Overview of Some International Expatriate Retirement Schemes

In the Philippines, the Overseas Employment Workers' Pension Fund requires all overseas Filipino workers registered with the Philippine Overseas Employment Administration and the Committee on Filipinos Overseas to remit 5 percent of their gross monthly income to the fund for at least five years. If the overseas employee dies, his or her primary beneficiaries are entitled to a monthly pension and dependents' pension, provided that the deceased has made at least 36 monthly contributions in the semester before his or her death. In addition to this service, there is a voluntary flexi-fund for overseas workers that has flexible payment terms. Members who reach the age of 60 are entitled to retirement benefits in the form of a monthly pension or a lump sum payment. The beneficiaries of a pensioner who has died shall receive a lump sum benefit equivalent to the cash value of the remaining pension. An overseas Filipino worker-member may withdraw his or her contributions with interest at any time, especially in times of need (instituted in 2008).

In Kerala (India), there is a welfare fund scheme that the Kerala government runs (Kerala Non-Resident Keralites Welfare Board) to which members contribute Rs 300 per month. Members are nonresident Keralites (living abroad) or those who have lived abroad but returned. Each nonresident Keralite member who has returned and settled permanently must pay the state Rs 100. The board can agree the fund grants, loans, or advances from the government of India, the state government, the local self-governing institutions, or any other institution or organization. The board can attract donations from any individual or any organization in India or abroad, any government agency in India or abroad, or any other sources.

In 2010, Bahrain's Keralite community was urged to join this government-backed pension fund for expatriates. People must pay a fixed premium every month to the India-based Kerala Non-Resident Keralites Welfare Board to receive a pension from the government when they reach the age of 60. An awareness campaign in Bahrain took place in May 2010. Although the registration fee is fixed (Rs 200), pension amounts vary according to whether the person lives outside Kerala but in India, lives outside India, or has returned after working outside Kerala. In 2010, the monthly premium was Rs 300 for those living outside India and Rs 100 for others. Any member who has paid the premium for five years or longer is eligible to receive a pension when they reach age 60. As proof of their membership, they receive an identity card with their picture on it (instituted in 2009).

In addition to an old-age pension, the fund also provides financial assistance upon the death of a member from illness or accident; financial assistance for medical treatment of members with serious illnesses; financial assistance for marriage of female members and daughters of members; maternity benefits to female members; financial assistance, loans, or advances to members for construction of a house or purchase of land and building or maintenance of a house; financial assistance for education, including higher education, for children of members; and financial assistance to members unable to work because of permanent physical disability. As of April 30, 2011, 67,557 applications had been received to join the fund, 40,102 members had been accepted as members of the welfare fund, and 27,455 applications were being processed.³¹

In Sri Lanka, the Bureau of Foreign Employment and the Sri Lanka Social Security Board introduced a pension scheme for expatriate workers that provides a monthly pension to individuals from the age of 60 until death if the expatriate worker contributed to the scheme regularly. Members pay a minimum monthly premium of SR5 or a lump sum of SR600 to be entitled to a monthly pension of SR250 when they reach 60 years of age. The worker contributes only 40 percent of the costs for the pension scheme, and the state subsidizes the rest (instituted in 2007). Sri Lanka announced in 2015 it would be developing a new system.

In Western countries, because of the lack of quality pension products and investment funds for some expatriates in the country where they work, offshore pension arrangements are becoming increasingly popular. Expatriates increasingly invest in international funds. Offshore providers have more-sophisticated administration systems than local markets, including online access to provide investment switching and viewing of account balances. Such plans also promote mobility because expatriates can continue to increase their pension amounts while working in different locations for the same employer.

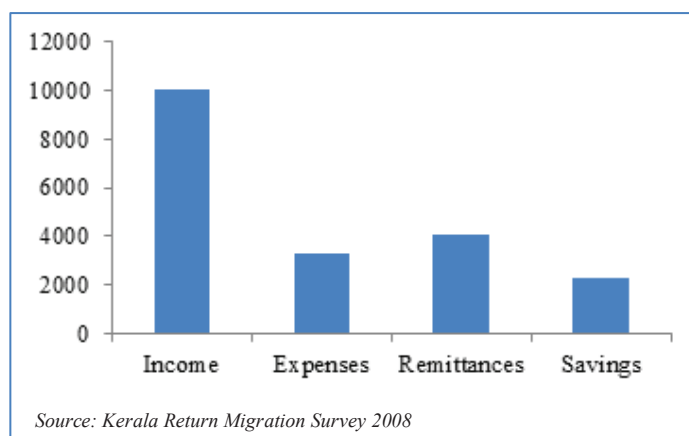
³¹ Data obtained from the office of the Kerala Non-Resident Keralites Welfare Fund Board.

Developing Pensions for Resident Workers in Host Countries

Countries with large inflows of immigrant workers, like those of the GCC, have been considering adopting saving schemes that would allow workers to save for retirement, transition to new jobs, and return home.

Although the absolute amount of expatriate savings depends largely on earnings, low-wage expatriates remit and save a larger share of their monthly earnings. Data from the Return Migrant Survey in Kerala (2008)³² show that the average income of return migrants while working abroad was approximately Rs 10,000 a month. Approximately 32 percent of monthly earnings was spent on consumption and 41 percent on remittances (money sent home), and 23 percent remained in savings or account balances (figure 24).

Figure 24. Average Earnings, Expenses, Remittances, and Savings of Return Migrants While Abroad



The only mandatory benefit for expatriate workers in GCC countries is the end-of-service indemnity, paid as a lump sum at the end of the contract, but this benefit is not enough to provide the necessary resources to manage the social risks of expatriate workers (notably old age) and therefore needs to be complemented with other programs. The need to introduce a retirement savings scheme for expatriates and increase take-up rates in the case of a voluntary scheme depends largely on the attractiveness of the scheme and on available alternatives.

The attractiveness of saving in the home versus the host country depends on a number of factors, including trust in institutions, ease of access of family members, return on savings, and (transaction) costs; the United Arab Emirates ranks relatively low in terms of the cost of sending remittances abroad.

Among possible options, Mobility Savings Accounts (MSAs), which the WBG developed, have attracted attention as a possible option and good substitute for the inefficient end-of-service indemnity currently in place. MSAs are retirement savings schemes funded through mandatory or voluntary contributions of employers and employees. Individual savings would not only allow workers to finance old age pensions, but would also provide the necessary financial resources to transition between jobs or resettle upon return to the home country.

³² To initiate policies for return of migrants, the Department of Non-Resident Keralite Affairs, Government of Kerala, requested that the Centre for Development Studies undertake a special study on return emigrants (Return Migrant Survey) identified in the Kerala Migration Survey. These 2,037 return emigrants identified in 2008 were visited again for this study (Zachariah and Irudaya Rajan, 2010).

For expatriates, the question of whether a proposed scheme should be mandatory or voluntary needs to take the following two considerations into account: expatriates' savings capacity and their preferences for saving in the host country versus their home country (e.g., via remittances or retirement schemes that their home country government offers, as discussed above).

A mandatory scheme for employees may lead to unintended externalities if the contribution rate is set too high and exceeds expatriates' savings capacity. A voluntary scheme will minimize or reduce negative reactions if the scheme provides incentives to employers or employees. In the absence of any incentives, a voluntary pension scheme is unlikely to be successful because of poor understanding of the advantages of long-term savings and strong competition from other (more flexible) saving instruments.

Excluding tax incentives, which are irrelevant for GCC countries, other types of incentives include matching contributions or matching benefits for employees and any form of cost savings associated with joining the scheme for employers. Matching contribution schemes are increasingly gaining attention as a way to promote a retirement-saving culture. In a scheme with matching contributions, employees may decide to contribute, usually on a voluntary basis, and employers (or in some cases the government) will contribute a certain percentage of payroll for every 1 percent contribution of the employee.

In the broad sense, a mandatory or voluntary saving mechanism may therefore serve the purpose of financing retirement or transition between jobs. MSAs may introduce the idea of more-fungible saving schemes that may be applied to different medium- or long-term objectives of worker protection: finance pensions, transition between jobs, or resettlement upon return to the home country.

MSAs should not be very different from other forms of savings, except that the funds should be unavailable while the person is still working. At the end of the appointment, the funds accumulated in these accounts could be used to add to the pension fund or end-of-service indemnity or to allow the worker to be a "self-sponsor" when the balance in the account reaches a certain minimum threshold. If this condition is verified, the worker might be authorized to stay in the country for a period of time to be defined in a specific migratory regulation. The main advantage for the worker is that the savings can be applied for a specific purpose that is not contemplated in current migration regulations. In addition, institutional investments may offer higher returns, lower administrative costs, and higher security standards than other forms of savings, given the relative immobility of this type of saving. From the public policy perspective, other forms of savings (e.g., normal bank accounts) cannot offer equivalent guarantees of solvency because MSAs are illiquid while the worker has a job, so there is no way to artificially replenish it with short-term borrowed money.

IV.5 Improving Efficiency through Consolidated Administration

Typology of Pension Schemes Merger

The problem of fragmented pensions was highlighted extensively in earlier sections of the report. Countries have adopted different strategies to move from fragmented to consolidated pension schemes. The main differences have to do with the scope of the merger (Does it involve only institutional mergers or also harmonization of rules?) and gradualism versus fast implementation approaches. Figure 25 proposes five modalities reflecting different combinations of these factors. Merger of institutions appears as a common feature in most of the examples, whereas concomitant harmonization of regulations (gradual or fast), although a desirable feature of pension scheme consolidation, has been used less frequently.

In theory, consolidation could happen at the level of regulations, although we do not report examples of the last two types of mergers.

Figure 25. Typology of Mergers

Type	Institutions	Regulations	Timing	Examples
1			Gradual	Djibouti, Bahrain
2			Gradual	Jordan
3			Fast	Argentina
4			Gradual	
5			Fast	

Harmonizing Pension Schemes: Learning from Experience

Institutional mergers involve two main dimensions: administrative merger and harmonization of regulations. Both dimensions complement each other, and the process risks being incomplete or ineffective if one of the aspects is addressed but not the other. International experience is full of such incomplete reforms, with some notable examples.

- Bahrain consolidated its pension scheme for civil servants and private sector workers, but the administrative merger was not completed, and the consolidation of rules has not been put into effect; this is a typical example of political will being in place but implementation not being adequately addressed. The preexisting institutions have survived the merger almost without any changes.
- Djibouti also tried to take advantage of externalities and efficiency gains through the merger of preexisting pension institutions; in this case, the administrative merger took place, but the rules and procedures have not been consolidated, resulting in the survival of the preexisting schemes as departments of the newly created Caisse Nationale de la Sécurité Sociale.
- In Egypt, the existing pension funds for the public and private sectors were consolidated into a single institution, but in practice, both schemes remain separate.

- In 2005, Palestine consolidated its preexisting fragmented schemes for civil and security services in West Bank and Gaza inherited from Jordan and Egypt, respectively. The consolidation was comprehensive, including administration and new common rules, but administration of a common database of members and beneficiaries has not been completed.
- Jordan is the best case in the region, where integration of public and private pension schemes has been in place since 1995. The Social Security Corporation of Jordan has been increasingly strengthened as the central administrative and regulatory institution in charge of pensions in the country.

One important element to be defined is the rule of gradualism. Although an administrative merger may be adopted at once, there are different approaches to the application of the rules for the new merged institution. There are several possible options.

- New common rules are applicable to all active members at the time the merger is implemented. The main advantage of this radical option is that the positive effects of the merger will occur more quickly, but resistance can be expected from individuals whose expected rights will be significantly affected;
- New rules are applicable to all members, but their rights associated with past contributions will be respected under the old rules. This may reduce resistance, but it will require complex administrative processes to implement a system that will provide a complex mix of old and new rules for each new pensioner or beneficiary.
- New rules are applicable to new entrants only. This is the preferred option to minimize resistance to change, but the coexistence of different schemes may lead to different treatment of workers in the longer term, in addition to the administrative complexities of the coexistence of different rules. In addition, the positive results of the merger will only become effective in the very long term. Jordan used this option.
- New rules are applicable for younger cohorts of workers only. In this case, workers under a certain age will be in the new merged system while older workers remain in their original schemes. Some countries have found this an acceptable “trade off” between gradualism and rapid effectiveness. West Bank and Gaza is an example of such approach, with newly consolidated rules being applicable to workers younger than 45 at the age of retirement.

The faster option has advantages.

- *Rapid results:* The consolidation will take effect immediately, and the visibility of the advantages will strengthen the reform, although the costs of transition will happen at once, and the government should be prepared to face them, as well as resistance from groups that will see their expected rights being affected.
- *Efficiency:* Managing a consolidated system is simpler than having two or more schemes with different rules in parallel, even if for only part of the labor force.

- *Equity and labor mobility:* Applying equal rules for all encourages shifts between jobs, reducing labor market inflexibility.
- *Benchmarks for members and beneficiaries:* Expected pension benefits are part of career planning, which is easier and more effective if all workers can preview their future benefits which follow simple rules that allow comparison with the benefits of other workers or pensioners.

Reform champions need to be aware of some common reasons that groups involved and stakeholders in general claim to resist fast consolidation. These include: difficulty integrating complex organizations; asymmetries, different implicit pension liabilities, arrears; rights of individuals being affected; and the need to manage workers' expectations. They should also be aware of some common reasons to resist consolidation of schemes: A new organizational structure may imply loss of jobs, power, position, and influence for some staff (particularly managers) in the new organization. Conflicts of legal competence and authority may occur. Staff and members of current organizations experience unspecific or undefined fear of change. The arguments mentioned above may raise legitimate concerns, and reform champions should develop a strategy to address them through public information, public debate, and technical analysis.

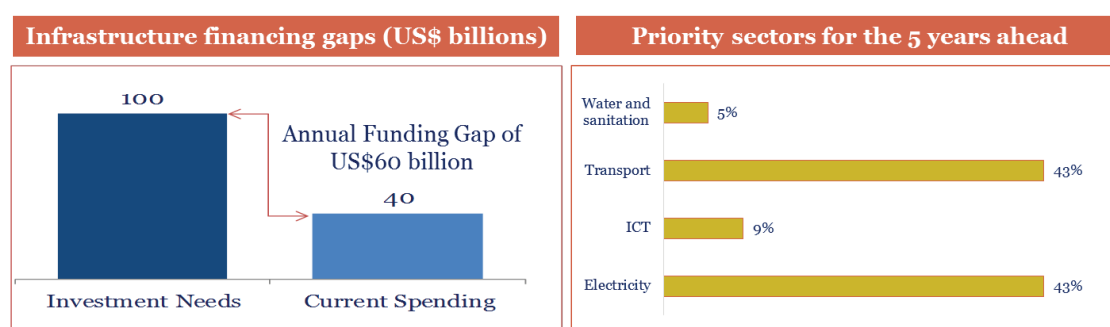
V. Leveraging Investment Opportunities for Pension Funds for Sustainable Growth and Development in the Arab Region

V.1 Investing in Arab Region: International Institutional Investor's Perspective

The Arab region has great economic potential, with approximately 55 percent of global oil reserves and 30 percent of global gas reserves³³. It is also one of the fastest-growing regions in the world³⁴ and has one of the youngest workforces. Despite this potential, certain unfavorable factors, including sluggish recovery of the global economy, declining international oil prices, and internal conditions in some Arab countries, have affected the macroeconomic performance of the region. As a result, the average growth rate of the region has declined to 3 percent during the past three years, compared with 5.5 percent achieved from 2003 to 2013³⁵.

Large investments are also needed to upgrade infrastructure levels and enhance production capacity in many Arab countries. Although current infrastructure spending is estimated at \$40 billion, the Arab world needs to invest between \$75 billion and \$100 billion a year in infrastructure to reach the growth rates highlighted above (5–6 percent annually), boost economic competitiveness, and foster job creation³⁶. In relative terms, the infrastructure investment gap represents about 6.5 percent of GDP for non-GCC oil-exporting countries and about 3 percent of the GDP gap for oil-importing countries (IMF 2016) and the financing gap is concentrated largely in the energy (particularly renewable energy) and transport sectors, particularly roads (figure 26).

Figure 26. Growing Demand for Infrastructure Financing in Arab World



Source: Arab Financing Facility for Infrastructure, OPEC Fund for International Development, and Arab Monetary Fund calculation

Investment and rehabilitation needs are likely to be especially high in the electricity and transport sectors, particularly roads. Electricity and transport are each estimated to account for approximately 43 percent of total infrastructure needs in the region, followed by information and communications technology (9 percent) and water and sanitation (5 percent). Mobilizing the necessary funds to satisfy the growing demand for infrastructure investment

³³ AMF, Joint Arab Economic Outlook Report—2016.

³⁴ Its population is expected to reach 469 million in 2025 from 387 million in 2015 according to the Organization of Arab Petroleum-Exporting Countries.

³⁵ AMF, Joint Arab Economic Outlook Report—2016.

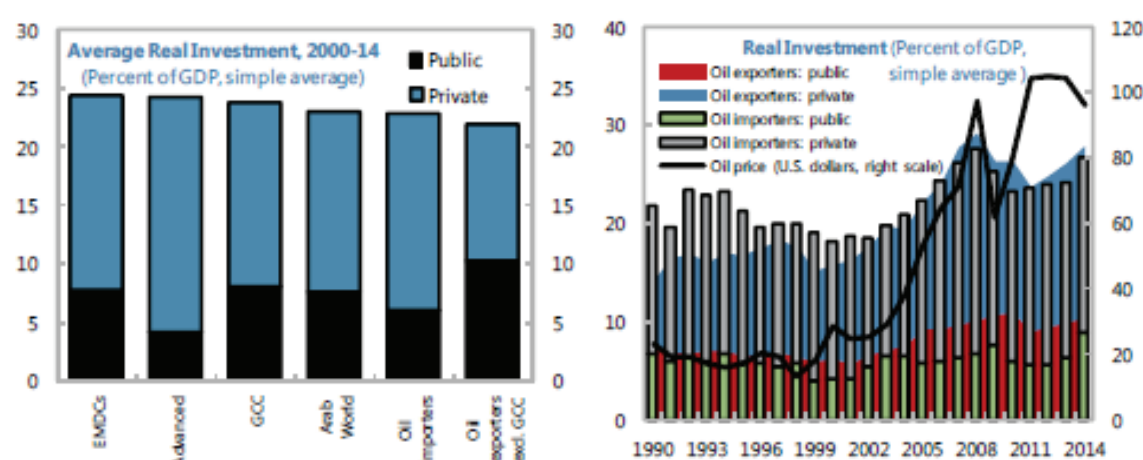
³⁶ According to the Arab Financing Facility for Infrastructure, a joint venture of the World Bank, the International Finance Corporation, and the Islamic Development Bank.

will require new sources and instruments of finance. Governments and commercial banks pay for most of the growth in infrastructure financing in many Arab countries. Banks will remain important financiers, particularly in the early stages of new projects, but banks, although growing, face a more-restrictive environment under Basel III and are not well placed to hold long-term assets on their balance sheets for an extended period, so a much broader group of investors needs to be targeted³⁷.

Overall Trends in Investment in the Arab Region

Although progress has been made on policies and reforms in the Arab region aimed at fostering higher capital spending by public and private entities (see below), in the previous decade, investment also benefited strongly from global conditions. In particular, the significant rise in hydrocarbon prices that started in the early 2000s led to an expansion in public sector investment spending in resource-rich countries, reflecting the strong pro-cyclical nature of public capital expenditure. The spillovers from higher growth in oil-exporting countries, including ample bank liquidity in the region, because of rising government deposits set in motion a marked increase in private investment in exporters and importers. Fast-paced global growth, low inflation, declining global interest rates, and expanding international trade also contributed, although the 2008-09 global financial crisis and the recent development in the region in the past few years, events from which many countries are still recovering, somewhat interrupted these trends (figure 27).

Figure 27. Real Investment Trends in the Arab Region



Sources: IMF, *World Economic Outlook*. Note: Oil exporters excl. GCC excludes IRQ. Oil importers excludes MRT, SOM, SDN, and WBG. Data for SYR to 2010

Despite their increase, investment rates in Arab countries have not reached those of their peers. At approximately 23 percent of GDP, total real investment rates have, on average, lagged those of other Emerging Markets and Developing Countries (EMDCs) by approximately 2 percent points from 2000 to 2014. They have also been lower, on average, than in advanced economies despite a significant decline in public investment rates in these countries over the same period. This gap is smaller than the large intraregional differences.

³⁷ See presentation by Habib Attia at the AMF – World Bank Pension Conference in Abu Dhabi, January 25-26, 2017

Foreign Investors' Perspectives

Foreign investors have been important in developing local currency government bond markets in many emerging market countries. Country cases illustrating their importance can be found in Central and Eastern Europe (Poland, Hungary, Czech Republic), Latin America (Brazil, Mexico), and South-East Asia (Malaysia, Indonesia). Statistics measuring foreign investors' exposure to public debt are not always available or accurate and may differ depending on the source (e.g., central bank official registers, industry data). Comparisons of countries are not straightforward given that, in some countries, investments may be indirect, through structured offshore derivatives, or that domestic investors may be registered as foreign holders.

In general, in the most-advanced emerging market economies (EMEs) foreign investors have supported the lengthening of the yield curve and financial innovations that are necessary to enhance financial sector depth. Since 2005, foreign investors have become a more-stable source of funding of medium and long-term domestic debt and have been active secondary market traders. They have also boosted competition, enhanced the quality of investment analysis, been natural agents for market knowledge transfer between mature and emerging markets, and been instrumental in the development of foreign exchange and derivatives markets as instruments to fund or hedge their investments in local currency.

Nevertheless, foreign investment in domestic public debt cannot be taken for granted, nor can its leverage effect on market development. There are minimum preconditions that need to be in place, aside from a stable macroeconomic environment. Market access should be ensured, and debt issuance needs to follow minimum standards in terms of design, term structure, and critical mass per benchmark, as well as some degree of liquidity.

The GCC is starting to make its name known among foreign-issued emerging market debt. Saudi Arabia's \$17.5 billion foreign debt issue in 2016 indicates that there is investor appetite for Gulf-issued debt. According to Bloomberg, there is \$125 billion in foreign-issued government debt outstanding from the GCC, with \$54.5 billion having been issued in 2016.

V.2 Improving Governance and Scale of Pension Funds in the Region

Good governance is central to good performance in all types of pension funds – public or private. A core requirement is to set a clear long-run retirement income or return objective. A robust investment process is central. Cost control is vital – only paying for things that add value to the bottom line for members – and greatly aided by scale. Good governance is dynamic – the right approach will change over time – but always requires leadership and skills. Good regulation and supervision are important to underpin the achievement of good governance.

There are many definitions of governance International Social Security Association (ISSA) calls it:

“The manner in which the vested authority uses its powers to achieve the institution’s objectives, including its powers to design, implement and innovate the organization’s policies, rules, systems and processes, and to engage and involve its stakeholders.

*Good governance implies that the exercise of the vested authority is **accountable, transparent, predictable, participative and dynamic**”.*

Improving Governance rightly has a central focus in the work of many organizations:

- International Social Security Association – Good Governance Principles
- OECD/IOPS Core Principles of Private Pension Regulation
- Toronto Centre International Program for Insurance and Pensions
- World Bank Outcomes Based Assessments for Private Pensions – which combines country insights and key insights from multiple approaches to governance
- It also receives a strong focus in the Annual Reports of well-respected pension funds – [*see ABP 2015 in Netherlands*](#) or *OPTrust 2015 in Canada for example*.

In the ISSA framework, there are three cross-cutting functions affecting all outcomes.

- Strategic Planning: Guidelines 45-49;
- *Operational Risk Management: Guidelines 50-53;*
- *Internal Audit of Operations: Guidelines 54-57.*

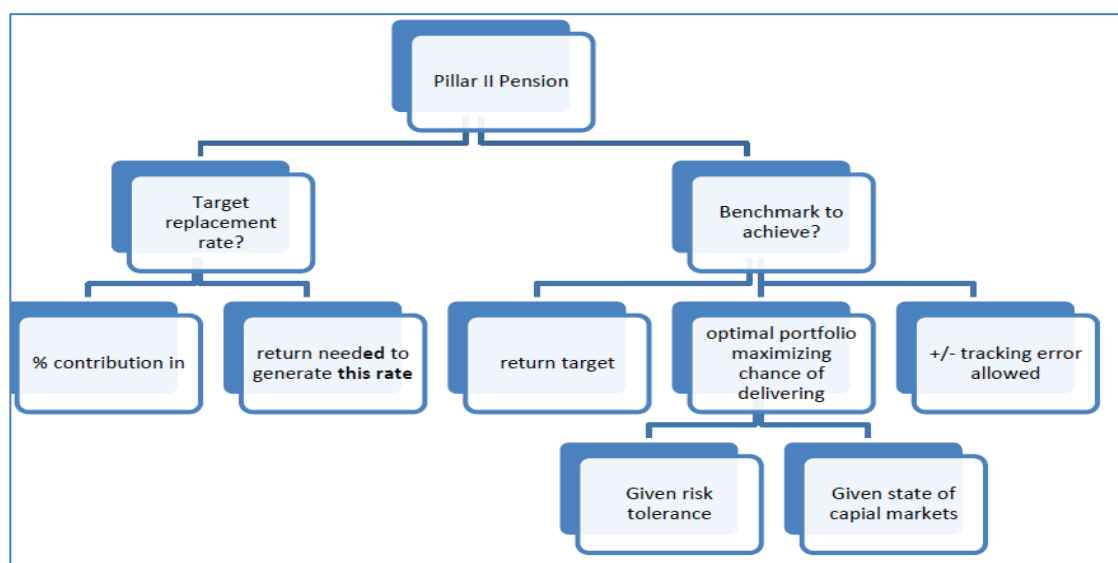
There are then six specific categories.

- *Actuarial Soundness: Guidelines 58-61 (which will deliver financial stability);*
- *Enforcing Prudent Person: Guidelines 62-70 (which will deliver sound investments);*
- *Prevention and Control of Corruption and Fraud, and Service Standards for Members and Beneficiaries Guidelines 71-75 (which deliver Member Coverage, Contributions, Benefits and Services);*
- *HR Policies and Investments in Information and Communications Technology: Guidelines 76-85 (which refer to Resources).*

A clear and consistent process is needed to set a realistic long-term target (figure 28)³⁸:

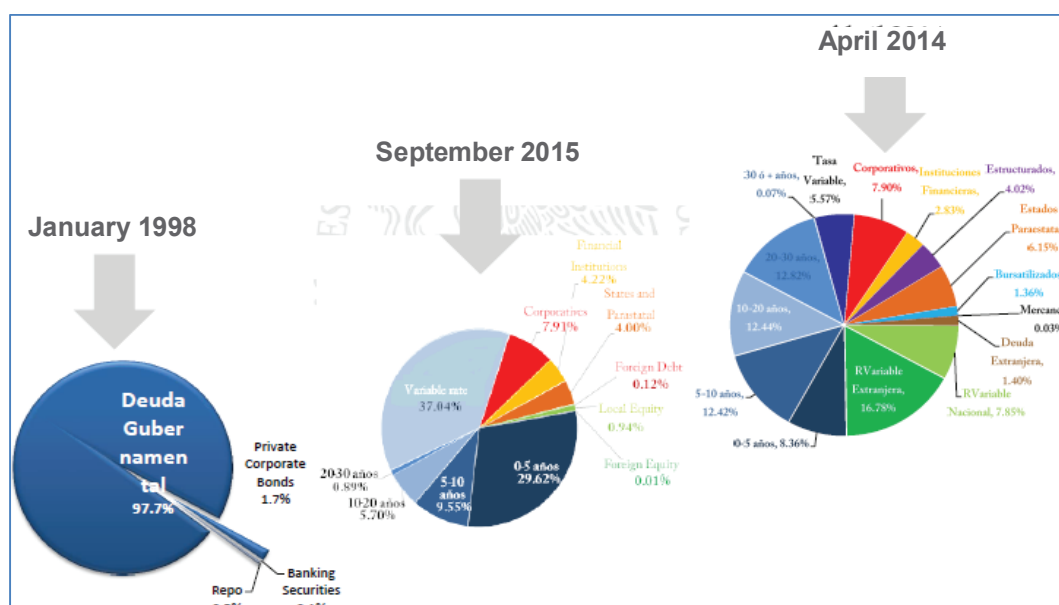
³⁸ See [*Providing Incentives for Long-Term Investment by Pension Funds*](#) by Fiona Stewart, May 2014

Figure 28. Process to Establish a Long-Run Outcome Benchmark



A dynamic approach is needed because (hopefully) the capital market will develop over time as part of a proactive campaign by governments and market participants to broaden and deepen the market. This will improve the instruments available to channel increasing supplies of long-run assets toward those who need long-run finance to deliver enhanced returns for pension members. The need for this dynamic approach is shown using the example of Mexico, which has seen a progressive move away from nearly 100 percent pension fund investment in government bonds into a much more-diversified domestic and international portfolio across multiple asset classes (figure 29).

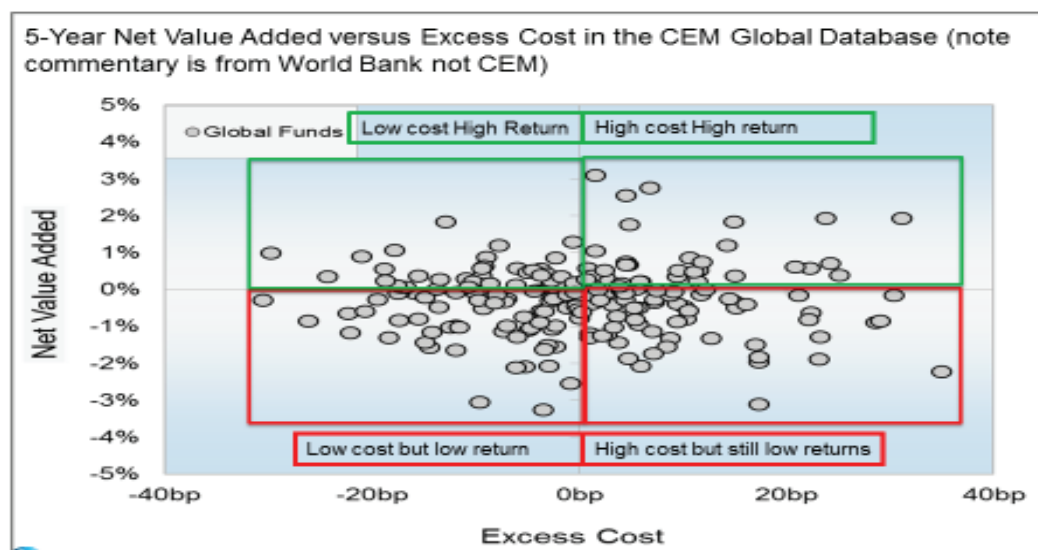
Figure 29. Ensuring Portfolios Adapt and Diversify over Time: Mexico's Example



Cost discipline is essential because not all costs lead to higher net-of-fee returns (or help to achieve the same level of returns with reduced volatility). Benchmarking work shows that if

anything higher costs lead to lower net of fee returns. But the message is not simply that low cost is always good but that pension institutions need to have the expertise to determine if they are paying for something that will add value. The worldwide trend to greater use of index or passive investment (particularly in deep and liquid markets) is a testament to the lack of results in aggregate from active management in these markets. But equally, some of the strongest returns have also been direct investments in private equity and real estate by large funds operating in-house investment teams who enjoy a cost advantage against external funds and in particular fund of-fund structures that add additional layers of fees (figure 30)³⁹.

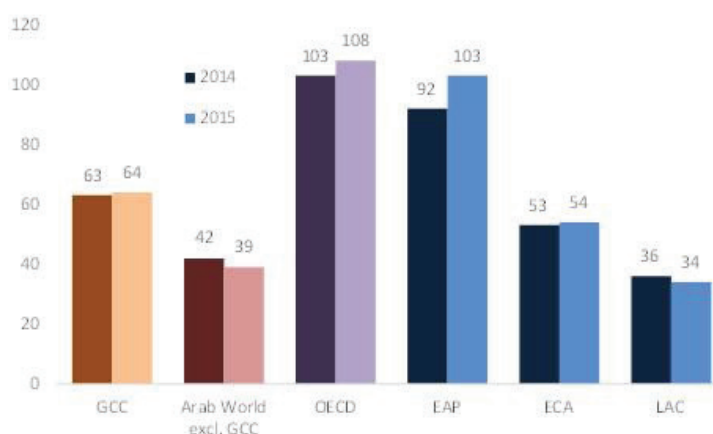
Figure 30. Cost Discipline Is Essential to Improving Long-Term Net-of-Fee Returns



V.3 Strengthening Arab Capital Markets and Opportunities for Pension Funds

There has been less progress in developing long-term finance in the region, as demonstrated by figure 31, using capital market depth as a proxy for the availability of long-term finance. There are wide disparities in the Capital Market Development (CMD) between Arab countries and when excluding GCC, the depth of capital markets in the region falls far short of that of other developing regions⁴⁰.

Figure 31. Market Capitalization of Listed Domestic Companies (Percentage of GDP)



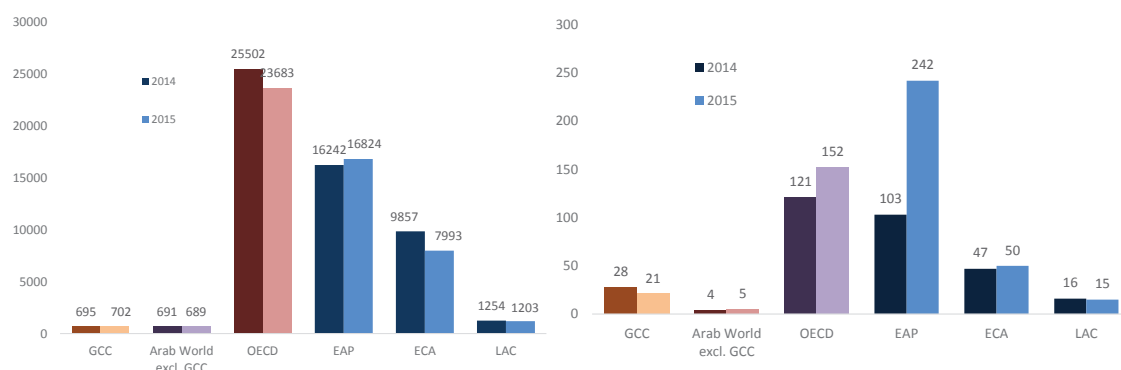
Source: Arab Monetary Fund (AMF) calculation based on World Development Indicators, 2016 and AMF Arab Countries Database 2013-14

³⁹ CEM Benchmarking.

⁴⁰ AMF staff calculation, based on World Development Indicators, 2016 and AMF Arab countries Database 2013-2014

The limited numbers of issuances of equity, bonds, and syndicated loans in the Arab region—with fewer than 1,200 listed domestic companies—or the value of shares traded, compared with those of other regions illustrates a similar profile (figures 32 and 33).

Figure 32. Total Listed Domestic Companies Figure 33. Stocks Traded, Total Value
(Percentage of GDP)



Source: Arab Monetary Fund (AMF) calculation based on World Development Indicators, 2016 and AMF Arab Countries Database 2013-14

As mentioned above, recent developments have affected Arab countries by increasing their financing needs and widening their budget deficits. This has prompted many Arab countries to set up bond issuance plans such as Saudi Arabia, Kuwait, United Arab Emirates, and most recently Algeria, but domestic bond markets are still in the development stage in many Arab countries, and lack of a critical mass of local companies that are candidates for public listing or issuance of rated bonds constrain them (see figures 32 and 33 above). Sukuk⁴¹ markets, corporate bonds, and PPP schemes are also in a nascent phase.

Arab capital markets, especially in GCC countries, can play a major role in supporting Arab infrastructure projects; there are signs that project bonds could play an increasingly important role in infrastructure finance deals, most likely as a post-construction refinancing tool. The perception persists that project bonds are not likely to be a viable solution for the initial funding requirements of most regional Greenfield projects because of the limited appetite in the project bond market for construction risk, the volatility of the debt capital markets, and the “cost of carry” associated with debt capital markets issuances. That said, project bonds offer a valuable pool of additional liquidity in certain situations, such as post-completion re-financings and expansions, and using project bonds in this way should help free up liquidity in the bank markets that could then be redeployed in other Greenfield projects in the region.

The World Bank recently launched the ‘Cascade Decision Making Approach’ which provides guiding principles to support infrastructure finance. As the document sets out: “The guiding principles for projects deemed as presenting development benefits and value for money would be as follows:

- Prioritize non-governmental guaranteed, cost effective commercial financing, broadly defined as financing that subjects the borrower to the discipline of the market;

⁴¹ Sukuk is the Arabic name for financial certificates, also commonly referred to as “sharia compliant” bonds

- Where commercial financing is not cost effective or viable due to perceived risks or market failures ... focus support on addressing these market failures through upstream reforms to strengthen country and sector policies, regulations, and institutions, and, where justified, well-targeted subsidies;
- Where risks remain high, raising the cost of commercial capital beyond that afforded by project or corporate revenue generation, explore the potential for lowering the financing cost by deploying concessional and public resources in risk-sharing instruments;
- Where commercial financing is not cost-effective or viable for needed public infrastructure services despite sector reform and risk mitigation, public and concessional resources will be applied.⁴²

The development of Arab capital markets, within a sound regulatory framework, requires a number of institutional and structural reforms including a macroeconomic environment that is conducive to increasing the private sector share in the economy and the strengthening of market forces through improving the flow of information, accounting standards, property rights, pricing efficiency and tax reforms. Some institutional reforms which are necessary are set out below.

Leveraging Institutional Investors as Funding Base

Pension funds and insurance companies typically play a major role in the development of government securities markets. These institutions help reduce the predominance of banks, alleviate the occurrence of one-way markets in volatile periods, and stimulate the demand for long-term instruments, especially during the accumulation phase of pension funds.

What is lacking so far in Arab capital markets to increase their depth is the full range of institutional investors, mostly represented by pension funds and insurance companies. The investor base is generally small in Arab countries. There are many opportunities to increase the role that pension funds and insurance companies in the region play because, except in GCC countries, pension funds and insurance companies account for less than 5 percent of GDP.

A number of public pensions operate under a hybrid of partly prefunded and partly pay-as-you-go systems, such as in Egypt, Morocco, and Jordan, making their reserves a high proportion of GDP (33, 29, and 30 percent respectively). This ranks them as the largest institutional investors in each country, yet their public nature and the absence of alternative investments place them in the position of captive investors, with a less-important role in creating competition in debt markets. In Morocco, for example, public pension funds play a more-active role in public debt markets, particularly the Caisse de Dépôt et de Gestion, which holds 9 percent of public debt. It is the most-important participant in the primary market and the second largest in the secondary market for government securities. This has raised concerns about its potential to influence public debt market prices.

⁴² A Cascade Decision-Making Approach, World Bank Group, Washington, DC, 2017.

What successful savings markets have in common is a regulatory framework for pensions and insurance that includes prudential investment guidelines to ensure safety and liquidity of investments. Portfolios, whether publicly or privately run, would have to adhere to regulations that would include minimum portfolio allocations for highly rated or risk-free assets, including Sukuk. Regulators and market participants should deepen their cooperation on sharia-compliant money market instruments and hedging. Arab countries should improve the basic requirements for institutional investors in the region for conventional and sharia compliant. What is needed is a comprehensive look at private savings and a commitment to promoting them.

Ongoing reforms in the pension sector of a number of Arab countries, including making sure that adequate funds are set aside for future pension commitments, has resulted in rapid growth of the institutional investor base. These reforms have in turn accentuated the need to provide local institutional investors with domestic investments that match their long-term investment horizons, focusing the attention of governments in the Arab region on deepening the local institutional funding base.

Increasing Corporate Transparency: Disclosure, Investor Relations, and Ratings

Arab corporates have long been criticized for lack of transparency and shortcomings in corporate governance. Family companies continue to avoid the capital markets and seek other means of financing for the usual reasons of maintaining confidentiality and flexibility. As nonrated, largely non-listed entities, they do not need to respond to shareholder demands to maximize return on equity.

Moreover, the owners of such companies may find it difficult to realize value from their investments. These factors, among others, limit transparency and disclosure standards, in particular, and corporate governance practices in general. Although the corporate governance framework is already in place in many Arab countries, there is room for improvement in transparency, disclosure, protection of non-controlling shareholders, directors' independence, qualifications, and compensation. The challenges the region is facing regarding legal and regulatory frameworks and property rights can also be considered barriers to proper corporate governance

Improving Secondary Market Liquidity and Transparency: Need to Accelerate

The regional primary markets, conventional and Islamic, have generated sufficient scale to justify greater expectations for the secondary market; although strides have been made, liquidity and price transparency could be boosted. There is a broad view that there is room for better indices to serve the buy side. Greater price transparency and index inclusion will further enhance the value proposition and go a long way toward drawing more global investors to this rapidly evolving new market, including Sukuk.

Large Investment-Side Challenges

Rather than the availability of funding being the constraining factor, the main constraints may lie closer to the investment side. Especially in the infrastructure sectors, an important constraint may be that there is no pipeline of “investible projects” that could form the basis of corporate bond issuances and be suitable for pension funds to invest in once a suitable number of such issues are available. There is a dearth of well-structured, viable projects and project structuring skills among local sponsors. Thus, a case can be made for facilitating investment by providing risk mitigation to pilot projects that also can be used to strengthen the institutional infrastructure in terms of project preparation and with a view to strengthening the facilitating legal and regulatory framework.

Looking Ahead

The trend of successfully introducing new products to the market should continue and help shape the market in the future. The trend to diversify issuer types should continue as smaller companies become more familiar and comfortable with the market and what is required to access it.

If the markets are to realize their potential, a vision has to be developed and implemented. The single most important thing that could be done to underpin a debt capital market would be action by the states to develop government yield curves in their own currencies. Bond markets contribute to the region’s development, and recent years have seen tremendous growth. There needs to be consensus on a regional vision and an organized official commitment involving the states, central banks, and national regulators, with help from industry.

VI. How the AMF and the WBG Can Support Policy and Institutional Reforms by Governments, Employers, and Regulators

This report has set out a broad-based analysis of the key challenges facing countries in the Arab region. The AMF and the WBG stand ready to support countries, particularly ministries and regulators within countries, to develop and improve their pension systems where good quality projects have secure funding to proceed.

The first step on this journey was to convene the conference held in Abu Dhabi in January 2017. This report is the next step. It provides insights to the issues and the potential solutions that will be useful to countries committed to analyzing the issues and creating the political will to deliver meaningful reform. Simply doing more studies will not be enough to tackle the growing issues faced in all Arab members.

The aim is to improve the coverage of good quality pensions – where good quality means sustainable and affordable pensions that deliver adequate income in old-age in a way that is efficient in terms of costs, investment returns and impact on the capital and labor market, overseen by expert regulation and supervision that can ensure assets and accrued rights are secure. It is important to note that the recommendations would pursue what is best for the individual countries given their specific overall development objectives, as well as each country specific institutional and policy environment. It is equally important to emphasize that the needed pension reforms should be considered in the context of the current overall trends and reforms regarding Labor Markets policies, and Social Protection systems (e.g.: efforts to promote private sector employment, labor mobility, and more efficient welfare state/wealth redistribution mechanisms).

The first recommendation is for the development of *adequate data to understand the pension system*. Without good data, it is not possible to use powerful tools such as **microsimulation** of pension entitlements or **income distribution analysis** to support equity in delivery or use the **World Bank Pension Database** to benchmark countries against sub-regional, regional and global peers.

Secondly, the *national identification and information technology systems to support delivery of public and private pensions need to be reviewed*. Without good ID and IT even a perfectly designed pension scheme will fail to deliver. The WBG has tools to review both elements, which could be used by any country with gaps in these areas.

Third is the need to focus on *improving the sustainability, equity and affordability*⁴³ of pensions. For most Arab countries, sustainability issues are similar to the rest of the world. For GCC countries the pensions are also facing sustainability challenges in the sense that contributions will cover benefits due to government contributions but now with lower oil

⁴³ The concept of affordability examines only the costs of pension benefits, whereas the concept of sustainability compares retirement benefits with contributions paid to earn pension rights. Most contribution rates of the current pension schemes in Arab countries cannot sustain the promised pensions—even before factoring in future adverse demographic changes.

prices such payments are increasingly unaffordable – or will crowd out other priority areas of spending. In all cases, there is a need to look at parameters such as accrual rates, contribution rates and retirement ages as well as survivorship and disability pensions. The WBG PROST tool can analyze the situation and develop reform options.

Fourth is a focus on *expanding coverage of pensions in a way that improves the diversification of public and private pension provision*. In all countries, the role of the employer is critical in improving access to pensions. For countries with high levels of informality in the labor market (nearly all non-GCC countries) the focus on the employer needs to be supplemented by building systems that can be accessed by people without a formal employer. For those countries with very high participation of foreign born resident workers who are likely to retire in their home country, the debate should focus on mobility saving accounts and linking workers automatically to their home country pension systems if this is high quality. The Outcome Based Assessments for Private Pensions (OBA) tool can be used to develop implementable recommendations across private pensions.

A fifth group of issues relate to *improving the efficiency of pension systems – reducing costs and fragmentation, improving investment strategy and governance and improving the capital market*. It is important to address fragmentation of schemes, improve governance, investment expertise and execution to improve returns to members, or to improve asset-liability matching. Developing the capital markets in Arab countries is an important milestone. Reforms are needed to corporate governance, to improve liquidity in secondary markets. The new ‘cascade’ approach from the World Bank can enhance the ability of capital markets to support infrastructure finance.

The sixth and final area of focus on *enhancing the security of pension systems through developing or creating regulators and supervisors that can successfully supervise pensions*. Among other tools that can be used is the introduction of Outcomes and Risk Based Supervision (ORBS) that ensures a regulator looks at the long-run outcomes a system is aiming to provide and prioritizes action against the biggest risks to these outcomes – by choosing the most effective tools – from new regulations, to training or communication through to on-site supervision and enforcement.

The AMF and the World Bank have come together to create the initial pension conference and this report to set out the challenges and the potential solutions that can be deployed. They stand ready to support countries, sub-regional groups or the whole AMF membership where viable projects can be created and financed. As well as the six key areas highlighted above, perhaps the most important message to reiterate is the need to develop the political and social case for change – and the commitment of the AMF and the World Bank to support willing partners in their journey to improve their pension systems now and in the future. The initial priorities and road maps will differ between countries, but it is hoped that the commitment to improve pension outcomes in the long-run is shared broadly.

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