

Overview of the Saudi Labor Law

2020



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The main legislation governing employment in the Kingdom is the Labor Law issued under Royal Decree No. M/51 dated 23/08/1426H (corresponding to 26 September 2005) (the “**Labor Law**” or the “**Law**”). The Law has been amended, by Royal Decree No. M/24 dated 12/05/1434H (corresponding to 24 March 2013), Royal Decree No. M/46 dated 05/06/1436H (corresponding to 25 March 2015) and Royal Decree No. M/134 dated 27/11/1440H (corresponding to 30 July 2019).

Some of the major points to highlight regarding the Saudi employment regime include:

- There is no minimum wage;
- There is no collective bargaining mechanism, and worker participation in management is not provided by law;
- The Law sets out specific obligations in respect of working hours, holidays, overtime, health care coverage, and employer contributions to the social insurance regime;
- An employee cannot waive by contract any right established in his/her favor under the Law before such right accrues;
- There are detailed rules governing the employment of foreigners, who comprise an important segment of the labor force;
- There are rules requiring the employment of Saudi nationals;
- There is no concept of "at will" employment and termination of employees may not be as straightforward as in some other jurisdictions; and
- Employers are obliged to pay an end-of-service award to departing employees.

Some of these points are discussed in more detail below.

1. Recruitment

A large proportion of the Kingdom's workforce is comprised of ex-patriate labor, whether at the managerial, professional, skilled, semi-skilled, unskilled or retail levels.

As a general rule, foreigners may not come or be brought to Saudi Arabia to work unless the prior approval of the Ministry of Labor and Social Development (the "**Ministry**") has been obtained and a work permit and residence permit (*igama*) issued. In order for such a permit to be issued, the following conditions must be met:

1. The workman must have entered the country legally;
2. The workman must possess vocational skills or educational capabilities needed in the Kingdom that are either lacking or insufficiently available;
3. The workman must have a contract with a Saudi employer or a non-Saudi employer authorized to do business in the Kingdom; and
4. The workman must be under the sponsorship of his/her employer.

In relation to this last requirement, a foreign employee may not leave his/she position with his/her employer unless he/she obtains the approval of his/her employer to transfer his/her sponsorship to his/her prospective new employer. This rule would govern all foreign citizens working in the country, regardless of their time in the Kingdom.

Foreign employees, particularly those providing managerial, professional, technical or consultancy services, frequently enter Saudi Arabia for short-term periods on business visas without obtaining an *igama* or work permit. Although such visitor visas are in principle to be used for business meetings and the like, they are very commonly used to facilitate the rendering of short term or intermittent contractual services and the practice has been historically tolerated by the Saudi authorities. Moreover, in connection with Saudi Arabia's accession to the World Trade Organization, it agreed to grant "work" visit visas valid for up to six months to employees of non-resident companies having contracts with customers in the Kingdom to enable them to perform such contracts.

2. Saudization

The Labor Law continues a long established rule that the percentage of Saudi workmen in any establishment should not be less than 75% of the total number of the workforce, and their wages should not be less than 51% of the total wages paid. However, the Law also provides that these levels may be waived if the requisite skills are not available in the Saudi workforce, and in fact they have not been strictly enforced in actual practice. However, there is a strong policy to replace foreign employees by Saudis whenever possible.

Pursuant to a 1994 order issued by the Council of Ministers, certain positions are reserved to Saudi nationals only (personnel recruitment, receptionists, security guards, etc.). Under the same order, all employers employing more than 20 workmen are required by this order to increase the percentage of Saudis amongst their workforces by 5% annually. This order has been enforced more aggressively than the Labor Law; however, the annual increases were suspended several years ago when the required percentage had reached 30%. In practice significantly lower percentages of Saudi employees are permitted in a number of industries.

In June 2011, the Ministry introduced a new and more sophisticated system called "*Nitaqat*" which imposes varying Saudization requirements on companies by reference to the size of their work force and the type of business. It is intended that the required Saudization percentages will be adjusted periodically to reflect the Ministry's assessment of realistic Saudization levels in each field. The current Nitaqat percentages came into effect on 3 September 2017. There are seven recognized categories of company sizes, ranging between "Small Category A" of one to five employees, and "Huge" with over 3,000 employees. The new Nitaqat system identifies over 60 categories of businesses. Each company receives a rating (red, yellow, green or platinum) depending on the level of Saudization achieved. Those receiving either the red or yellow rating are subject to penalties, including not only the loss of the right to recruit additional foreign personnel but also the possible loss of the ability to renew existing visas and work permits or to

prevent their employees from transferring their employment to employers in the green or platinum categories. The Minister of Labor and Social Development recently issued a resolution cancelling the yellow category for *Nitaqat* to stimulate entities that were in yellow to move to green or platinum. All companies that were in yellow will be in the red category, effective 26 January 2020.

Employers, even those who are in compliance with *Nitaqat*, must pay approximately SAR 800 per month during the course of 2019 for each foreign employee. This amount is expected to increase in 2020 to SAR 800 per month.

There is another fee, known as a “dependent levy” for each foreign employee’s dependents that reside with him/her in Saudi Arabia. The fee started at SAR 100 per month in July 2017 per dependent and is set to increase year on year to reach SAR 400 a month in July 2020 per dependent.

3. Social Insurance and Healthcare

Under the Social Insurance Law, employers are required to enroll their Saudi and non-Saudi employees in a Government administered scheme that provides medical coverage and disability benefits in respect of work-related injuries. An employer must contribute an amount equal to 2% of each employee’s wage (including the value of any in-kind benefits) to the General Organization for Social Insurance (“**GOSI**”). GOSI also operates a pension scheme for Saudi employees only. The employer and employee each contribute 9% of the employee’s wage to GOSI for this purpose. In 2014 GOSI implemented an unemployment insurance scheme for Saudi employees, whereby the employer and the employee each contribute an amount equal to 1% of the employee’s wage. The employee’s pension and unemployment insurance contributions are deducted by the employer from the employee’s monthly salary and paid to GOSI on the employee’s behalf.

In addition, the Cooperative Health Insurance Law requires that an employer provide medical insurance coverage to its employees and their families. The law provides that the insurance policy shall be paid for entirely by the employer and the employee cannot be required to pay any part of the premium.

4. Working Hours; Overtime; Vacations and Holidays

A normal work week consists of five or six days with Friday and Saturday (in the case of a five day work week) being considered the day(s) of rest. The maximum number of hours actually worked in a work week will normally be 48 and the maximum number of hours worked in a work day will normally be eight. If the employee is a Muslim, the working week during the month of Ramadan is shortened to 36 hours and the work day is shortened to six hours.

Employees generally may not be required to work overtime except in limited circumstances outlined in the Labor Law. Overtime is compensated at 150% of the normal hourly salary.

An employee is entitled to 21 days of paid annual leave. If an employee completes five continuous years of service, he/she is entitled to 30 days of paid annual leave. In addition to the paid annual leave, an employee is entitled to the official holidays

designated as such by the Minister of Labor. There are currently nine such holidays, which correspond to the two Islamic Eid holidays and the Saudi national day on 23 September each year.

5. Terminations

The Labor Law does not recognize an "at-will" employment relationship. The law recognizes definite term and indefinite term contracts and the rules governing termination differ depending on the type of contract.

Definite term contracts

Under the Labor Law non-Saudi employees are required to have definite term contracts. If the relevant contract does not specify a definite term then the period of the employee's work permit is considered to be the term of the contract. Generally speaking, a definite term contract is terminable only for "cause" prior to the expiration of the defined term. Cause, in the case of a termination by the employer, is defined in the Labor Law, which contains an exhaustive list of the permissible bases to terminate an employment contract without notice or an end-of-service indemnity; these bases largely require the fault or misconduct of the employee in question, and include acts of misconduct, non compliance with the employment contract, non-compliance with legitimate employer orders, fraud, conduct intending to cause the employer a material loss, and divulging commercial or industrial secrets. The termination of an employee who is on probation is also treated as a termination for cause. (A recent amendment to the Labor Law provides that the probation period shall not exceed 90 days, but may be extended pursuant to a written agreement between the employer and the employee, provided that the total probation period shall not exceed 180 days. The probation period is exclusive of public holidays and sick leaves.)

Indefinite term contracts

Saudi and Gulf Cooperation Council ("**GCC**") nationals can either be employed on a definite or indefinite term contract. If the individual is employed on a definite term contract and the contract is renewed for three consecutive terms or if the original contract term and the renewal period(s) amount to four years, whichever is less, and the two parties continue to implement it, the contract shall become an indefinite term contract.

Indefinite term contracts are terminable either for "cause" (as discussed above) or, upon 60 days prior written notice, for any "legitimate reason". The term "legitimate reason" is not defined in the Labor Law. The issue of whether a "legitimate reason" exists is therefore determined on a case-by-case basis. Since the Saudi labor courts have no system of binding precedent or case reporting system it is often difficult to predict with certainty whether a "legitimate reason" for termination may exist in a given case. However, it is clearly intended to be a less stringent standard than "cause", and in the case of termination by the employer, could include reasons not involving any fault on the part of the employee, including in proper circumstances economic reasons such as the employer's loss of business or contracts. Employment contracts sometimes cite specific examples of

"legitimate reasons" for termination but these will not necessarily be considered binding by a labor court.

If the party terminating the employment contract does not observe the 60-day notice period required by the Law, such party is required to pay the other compensation equal to the employee's wage for the duration of the notice period, unless the parties agree on a higher amount.

Redundancy

Recent amendments to the Labor Law introduced new grounds for terminating an employment contract: (i) where the establishment is being wound-up; or (ii) there is a cessation of the business activity in which the employee works. There are no other redundancy related grounds for termination and no statutory requirements to inform or consult employees in advance about planned redundancies, although as a practical matter, employers typically consult employees a few months in advance. Termination for either of these reasons may be treated as lawful termination for a "legitimate reason", although this would be assessed by a labor court on a case-by-case basis.

Compensation

If a termination is unlawful (in other words not in line with the termination methods mentioned above), an employee would be entitled to compensation, the calculation of which depends on the type of employment contract the employee is hired on. Employees on definite term contracts (which by law include all foreign employees who are not citizens of GCC states) are entitled to their wages for the remainder of the term of their employment contract. Employees hired on indefinite term contracts, such as Saudi and GCC nationals, are entitled to compensation of 15 days wages for each year of employment. In either case, the compensation cannot be less than two months wages. These amounts are in addition to the statutory end-of-service award, pay for unused vacation, any outstanding unpaid wages, any unpaid approved expenses, and in the case of indefinite term contracts, notice pay.

Post-termination restrictions

If the work gives the employee access to the employer's confidential information, the employment contract may provide that the employee may not divulge confidential information after the completion of the contract. For such provision to be valid, it must be in writing and be limited in respect of time, place and type of work.

If the employee's work allows the employee to become acquainted with the employer's customers, the employer may insert a non-compete provision in the employment contract. Any such provision must be in writing, limited in respect of time, place and type of work in such a manner as to protect the employer's legitimate interests, and shall in no event have a term of more than two years from the date that the employment relationship terminates

6. End of Service Awards

Upon termination of a (definite or indefinite term) employment contract otherwise than for "cause", an employee is ordinarily entitled to an end of service award equal to half a month's "wage" for each year of employment for the first five years, and a full month's "wage" for each subsequent year. "Wage" is broadly defined to include not just base salary but also the value of every cash or in-kind allowance or benefit payable to the employee on a regular basis pursuant to his/her contract or as an "acquired right". The only elements of the "wage" that it is permissible to exclude by contract from the end of service award calculation are commissions "and similar elements of the wage that by their nature are subject to increase and decrease". Housing allowances that are paid in cash or in-kind are ordinarily included as part of the wage. Certain officials at the Ministry have taken the view that a transportation allowance is considered to be in the nature of expense reimbursement rather than compensation and therefore should not be included in the wage, but labor court decisions on this issue have been inconsistent.

If the employment relationship ends due to the employee's resignation, the end of service award is calculated as follows:

- if the employee resigns before completing two years of service: no end of service award;
- if the employee resigns after completing two but before completing five consecutive years of service: one third of the normal end of service award;
- if the employee resigns after completing five but before completing ten consecutive years of service: two thirds of the normal end of service award; and
- if the employee resigns after completing ten years of service: the full end of service award.

There are three exceptions to the above rules on reduction of the end of service due to resignation:

- The employee will be entitled to the full end-of-service award if he/she abandons the work because of a force majeure that is beyond his/her control.
- A female employee is entitled to the full end-of-service award if she resigns within six months of her marriage or three months of giving birth.
- An employee is entitled to his/her full end-of-service award if he/she resigns due to misconduct by the employer.

Upon termination of a non-Saudi employee, the employer is generally required to repatriate him/her at the employer's expense; in addition, all terminated employees are to be paid all outstanding wages and entitlements.

7. Employment of Women

Women are forming a larger part of the Saudi work force. Historically, due to cultural sensitivities and the prevailing interpretation of Islamic Law (*Shariah*), Saudi labor law required that women be segregated from men in the work place. The current version of the Labor Law does not do so although it does say that such employment should take account of a general provision in the Law which mandates that employers and employees should observe *Shariah* rules when applying the Law. This is still widely interpreted to require segregation. The Labor Law also prohibits women from being employed in hazardous occupations or at night. The recruitment of female employees from abroad may be difficult except in certain fields (for example nursing).

8. Dispute Resolution

Labor disputes are subject to the jurisdiction of labor commissions operating under the auspices of the Ministry, although as part of Saudi Arabia's judicial reform program a new labor court system has been established under the auspices of the Ministry of Justice. Domestic arbitration of labor disputes is also permitted under the Labor Law but is rarely resorted to in practice. The Labor Law is applied in all cases.