



ANNEX 79

STUDY VISIT REPORT ON LATVIA BY BC OFFICIALS

Latvian pension system: learning the experience

General statistical data:

Number of Latvian population is 2 023 825 on 01.01.2013. 926 580 persons (45,8%) out of population are men and 1 097 245 persons (54,2%) are women. 63,2 % of population is population of working age, 22,4% is persons over working age. Rate of natural increase of population is (-) 4,5. Number of the death exceeded the number of the birth more than 9 000 persons last two years. Fertility rate is 1,44.

28,4 percent of population or 565 319 persons received pensions in August 2014. 36,4 percent out of this number constitutes men, while 63,6 percent constitutes women. Number of old age pensioners is 468 041 which makes up 82,8% of all pensioners, and the number of disability pensioners is 71 710 which constitutes 12,7 % of all pensioners. 5 276 persons out of disability pensioners have I group of disability, 36 991 persons – II group, 29 443 persons – III group. Survivor pensioners (SP) constitute 3,0 percent of all pensioners and other pensioners – 1,5 percent. Over 40 thousand pensioners join the pension system every year, 70 percent of which constitutes old-age pensioners.

Average monthly pension amount in July, 2014 was 249,62 EUR, which is in amount of 32,4% of average monthly salary in related period. Average monthly amount of pension in July, 2014 was 265,74 EUR for old-age pensions, 163,83 EUR for disability pensions, 129,90 EUR for survivors pensions.

In 2014, the budget incomes of State Social Insurance Agency of Latvia constituted 2 206,7 mln EUR out of which 90% or 1 984,5 mln EUR are social contribution payments. Budget expenditures are 2 074,3 mln EUR of which 1 641,6 mln EUR or 79,1% is pension expenditures and 401,1 mln EUR are disability, maternity and sickness expenditures. Pension expenditures account for 8 percent of GDP. Administrative expenditures are in amount of 0,7 percent of all expenditures.

Social insurance events:

1. Attainment of pension age
2. Unemployment
3. Professional disease and work injuries
4. Disability
5. Maternity and sickness
6. Child care (up to one year) (parents insurance)

Minimum monthly wage in Latvia is EUR 320 from January 1, 2014.

Minimum amount of old-age pension may not be less than social benefit (EUR 64,03 (45 Latvian lats), EUR 106,72 (75 Latvian lats) for those disabled from childhood, ratio:

- 1) 20 years insurance record – 1,1;



- 2) 21 - 30 years insurance record – 1,3;
- 3) 31 - 40 years insurance record – 1,5;
- 4) 41 years and more insurance record - 1.7.

Minimum old-age pension is calculated based on state social insurance benefit multiplied by the ratio specified.

Minimum old-age pension, with 10 - 20 years insurance record	EUR 70,43 for those disabled from childhood - EUR 117,39
Minimum old-age pension, 21 - 30 years insurance record	EUR 83,24 for those disabled from childhood - EUR 138,74
Minimum old-age pension, more than 30 years insurance record	31 - 40 years - EUR 96,05 for those disabled from childhood - 160,08
	41 years and more - 108,85 ; for those disabled from childhood - 181,42

Social insurance contributions distribution

Social insurance contributions rate under general circumstances 34,09%

On the account of employer 23,59%

Employee 10,50%

1. Pension 25,16%
2. Unemployment 1,63%
3. Professional disease and work injuries 0,46%
4. Disability 3,21%
5. Maternity, sickness certificate, 2,46%
6. Child-care up to 1 year 1,17%

For working pensioners: 29,12%

On the account of employer 20,16%

Employee 8,96%

1. Pension 25,16%
2. Professional disease and work injuries 0,46%
3. Maternity, sickness certificate 2,33%
4. Child-care up to 1 year 1,17%

For self-insured 31,06%

1. Pension 25,16%
2. Disability 2,36%
3. Maternity, sickness certificate 2,37%
4. Child -care up to 1 year 1,17%.



Latvian pension system: learning the experience

Because of pension reforms conducted with support from World Bank, a system started operating which is based on personal accounting of mandatory state social insurance contributions upon adoption of the Law “On State pensions” as of January 1, 1996. Within the frame of reforms measures conducted, non-state pensions funds started operating in the country from 1998, and funded component applied from 2001.

In general, Latvian pension system comprises three pillars:

I pillar – insurance part (16%) / notional defined contribution pension scheme and PAY GO scheme

II pillar – funded part (4%) / state mandatory funded defined contribution pension scheme

III pillar – voluntary (non-state pension funds) / private pension funds

First pillar of pension system – is based on PAYGO principle of mandatory state social insurance contributions. That is, mandatory state social insurance contributions paid by the insured serve for the purpose of both the determination of future pension amount of the insured, and the execution of payments to current pensions.

Information on the person starting labour activities for the first time in Latvia is transferred to State Social Insurance Agency. Individual accounts are opened for the citizens in the info center of State Social Insurance Agency and the data entered are regularly collected and processed. Centralized collection for information allows every insured to have an opportunity to apply for pension and benefit, to any branches office of State Social Insurance Agency.

System of personal accounting of mandatory state social insurance contributions was applied in Latvia from 1996. For the purpose of protecting the pension rights obtained until the application of personal accounting system, pension amount is determined in line with the average wages of 1996, 1997, 1998 and 1999. According to Latvian legislation, the insured attained the age of 62 are entitled to old-age labour pension if they have 15 years of insurance record. It should be noted that the age limit of the insured increases by 3 months per year from 2014 to 2024.

Currently, the rate of mandatory state social insurance contributions registered in the I pillar is 16 %. For 2014, social tax - mandatory state social insurance contributions is 34,09%, 23,59%- of this is paid by employer, 10,50% by employee. There are certain tax privileges for working pensioners and self-insured persons. That is, social tax paid by the working pensioner is 29,2%, and social tax paid by self-insured persons - 31,06 %.

At the same time, it should be noted that, the part above EUR235 of pension paid to pensioner in Latvia is subject to 24% of income tax. In addition, bank accounts should also be opened by the citizens for payment of funds during pension granting.

II pillar of pension system - funded part was applied from 2001. It is worth to note that since private pensions institutions operated in Latvia much earlier in 1998, there already existed favourable conditions for introduction of the funded element. Within the first nine years of reforms (2001-2010) it was expected to increase the interest rate of funded part from 2% to 10%, world financial crisis of 2008 changed the development strategy of pension system and today interest rate of funded component is equal to 4% of social insurance contributions paid for the citizens. It is planned to increase the mentioned interest rate to 5% in 2015, and to 6% in 2016. This system is carried out mandatory for those born after 1971, and voluntarily for those born between 1951-1971. Division of the system into voluntary and mandatory groups serves for more efficient operation of the system. It should be noted that the number of citizens participating in second pillar of Latvian pension system increases. According to date for



31.12.2013, some 1 225 137 persons are registered in the system. Citizens wishing to participate in the second pillar, should file an application to State Social Insurance Agency. Every citizen newly entered into System is allowed 4 month period in order to select the relevant pension scheme, if within this period, the insured did not apply to Agency with regard pension scheme selected, he is included among the participants of conservative scheme automatically.

If the amount collected by the persons granted pension in the second pillar, exceeds EUR 4500, then they may joined the first pillar or use the advantages offered by life funded insurance, as they wish. The inheritance of life funded insurance (if concluded for 20 years) offers opportunities to switch to receiving the funds regularly.

Participants of the second pillar of Latvian pension system are the following institutions: State Social Insurance Agency, State Depository Service, State Treasury, Custodian Bank, Management Company. Financial and Capital Market Commission, Life Insurance Company.

Since the budget of State Social Insurance Agency was not sufficient during introduction of funded component in Latvia, it was decided to collect date on this pillar, in the State Depository Center. In this regard, Depository Center plays a kind of subsidiary of State Social Insurance Agency.

Three kinds of pension schemes are offered to participants of second and third pillar:

- I. Conservative scheme (minimum risk and income) – funds are invested in stable, trusted securities, usually they are government or corporate debt obligations. Though this scheme is no so profitable, there do not exist fluctuations as in the shares. According to date for December 31, 2013, this covers 28,5% of the insured, its average profitability is 1,22%. From the viewpoint of less change, this scheme is usually recommended for persons with less than 10 years left to attainment of pension age.
- II. Balanced scheme (balanced risk and medium income) – funds are placed in the financial market so that the generated income and existing risks keep the balance of pension capital security, storage and investments. In line with legislation, there is real opportunity to place up to 25% percent of funds in the balanced schemes. It covers 9,7% of the insured, average profitability is 1,48%. This scheme is recommended for persons with less than 10 years left to attainment of pension age.
- III. Active plan (risk and high profitability) – funds are invested in the shares of different institutions. That is, traditionally shares ensure higher profitability in long-term perspective. In line with legislation, there is real opportunity to place up to 50% percent of funds in the balanced schemes. It covers 61,8% of the insured, average profitability is 1,68%. Since active schemes are linked to more significant changes and risks, this scheme is recommended for persons with less than 10 years left to attainment of pension age.

These schemes offer a variety of choices to insured. Participants of funded component, are entitled to change pension scheme twice a year and Management Company once a year. At the same time, citizens are entitled to control over assets of pension plans selected on a day-by-day basis.

As mentioned, obligations of persons joining II pillar are directed at securities, bank deposits so that certain part of social insurance contributions are profitable. Legislation allows making 70% of investments in EUR, and 30% in other currencies.

Management of funds in II pillar is carried out by management companies that are registered in the state register and that obtained special license from Financial and Capital Market Commission. At request of management company with which Agency entered into



agreement of management of funds, Agency directs funds in the second pillar directs from State Budget to Custodian Bank with which the company entered into agreement. And the custodian bank in its turn, directs such funds towards relevant investments as per decision of Management Company. Legislation sets certain requirements on the investment portfolio of the Management Companies:

- the investments in securities of one issuer may not exceed 5 per cent of the assets of the investment plan and concurrently 5 per cent of the equity capital and number of voting stocks of the relevant issuer;
- investment in securities of one issuer may not exceed 10 per cent of the assets of the investment plan and concurrently 10 per cent of the debt securities of one issuer
- deposits in one credit institution may not exceed 10 per cent of the assets of the investment plan:
- the investments in one investment fund may not exceed 5 per cent of the assets of the investment plan and 10 per cent of net assets of such investment fund

Financial and Capital Market Commission shall carry out control over all of these processes.

State Social Insurance Agency makes deductions from payment made to the second pillar in order to perform its duties. Maximum amount of deductions may not exceed 2,5% of annual payments in lien with legislation. In 2013, deductions for Agency were determined at the level of 0,37%. The maximum amount of the reward for Management Company was determined at the level of 2% of average annual payments. For 2013, reward for Management Company was determined at the level of 1.25%-1.87% of the average annual value of assets, and at the level of 0,2% for Custodian Bank.

III pillar of pension system – the third pillar of Latvian pension system is carried out on voluntary basis. In accordance with legislation, pension age in this pillar is 55 people may join this pillar personally or through their employer. The person wishing to join III pillar applies to selected private pension fund, and concludes an agreement with the fund. It should be noted that, tax privileges are applied to insured and insurers making payments to 3rd pillar. That is, in case funds paid to 3rd pillar make up 10% of annual incomes, then such funds will not be subject to social and income taxes.

Citizens apply to the Fund one month prior to the pension age and enter into agreement on the conditions of granting of pension. Participants of III pillar may receive pension capital accrued in this pillar as lump-sum, monthly, quarterly and annual payment. If the pensioner dies, pension capital in this pillar, may be given within 20 years from conclusion of agreement.

Non-state pension funds have two forms: open and close forms. Presently, there are 6 private pension funds in Latvia, five of them are open pension funds, and one of them is close pension fund. Participants of close pension funds, may be only the employees of the fund's founder (for example, rail way employees, power engineering specialists), and the participants of open pension funds may be any persons. Close pension fund of Latvia is joint - stock companies combining 23 large enterprises. In general, management of investments in III pillar, is carried out by joint stock companies. They are financial companies obtained special license for management of funds of citizens in order to provide them with money when they attain pension age.

Participants of the third pillar of Latvian pension system are the following institutions: non-state pension fund, Financial and Capital Market Commission, Life Insurance Company, Management Company, Custodian Bank.

SEB non-state pension fund which is one of leading private pension funds of Latvia has already been operating in Latvian market for 15 years. Its legal-organizational form is joint-stock company. 100% of shares of the company belong to SEB Bank. Organizational structure of SEB private pension fund is as follows: Supervisory Board (shareholders and customer 6



members), Board (3 members), Chairman of the board – Executive Director, Finance-accounting, Sales support, legal and corporate business departments.

Unlike the second pillar, there is no restriction on the process of change of pension scheme by the citizens in private pension funds. There are 2 kinds of pension schemes in SEB private pension fund:

- 1) SEB balanced scheme (investment limit 25%),
- 2) SEB active scheme (investment limit 50%),

84% of SEB non-state pension fund participants comprises insured, and 16% - organizations. The Fund has Supervisory Board consisting of shareholders and members. 0.8% of assets of private pension funds shall be used in the reward of asset management company, 0.2% - in reward of Depositary Bank, and 0,04% - in reward of Financial and Capital Market Commission.

Management companies – investment management companies are companies received special license form Financial and Capital Market Commission which manages pension schemes. Management company should organize management of funds entrusted so that consequently, pension capital increase while it is reserved. Management company controls financial market and makes decision about more profitable places to invest the fund. It should be especially noted that management company should carry out this in line with the predetermined pension scheme conditions. The main principle of operation of management company is that investments are different and diversified. For the purpose of reducing the risks, it is more reasonable to invest funds in different securities so that it has no negative impact on the investment portfolio for citizens for long term in general. Every management company has 2 to 4 pension schemes.

According to the decision to be newly adopted, incomes of asset management company will be balanced in line with its principle of operations (low and medium income from investments 1%, high income from investments 2%), and this will give a large impetus to increase the motivation of the company.

Authorized capital of management company is regulated as follows:

- 1) company whose level of managed assets is up to EUR 50 000 000 – authorized capital EUR 500 000;
- 2) company whose level of managed assets is up to EUR 50 000 000- EUR 100 000 000 - authorized capital EUR 1 000 000;
- 3) company whose level of managed assets is up to EUR 100 000 000 - EUR 200 000 000 - authorized capital EUR 2 000 000 ;
- 4) company whose level of managed assets is more than EUR 200 000 000 - authorized capital EUR 3 000 000.

In case Financial and Capital Market Commission identifies discrepancies with the law in the activities of the Management Company, it is authorized to pass a decision to withdraw or cancel its license.

Financial and Capital Market Commission - Financial and Capital Market Commission exercises control over the second and third pillar of Latvian pension system. Financial and Capital Market Commission was established as a result of merger of Latvian bank, Insurance Control and Financial Market Supervision services on July 1, 2001. Financial and Capital Market Commission carries out control over private pension funds, assets management company, banks, credit organizations, insurance companies. Commission conducts office and mobile inspections. Mobil inspection is conducted once a year, office inspections – regularly.



Main functions of commission:

- 1) supervision;
- 2) licensing;
- 3) regulation of rules.

Custodian bank – is a bank with which management company enters into agreement for custody of funds and controls management company on a daily basis. That is, Custodian Bank inspects if orders prepared by the Management Company are executive in line with investment plan, and in case any instruction or decision is not inline with the investment plan, then it is entitled not to follow the decision. Otherwise, Custodian Bank would have assumed responsibility regarding any losses.