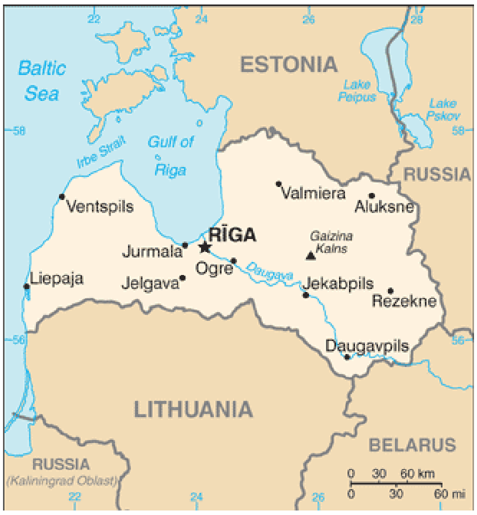
IOPS COUNTRY PROFILE: LATVIA



Demographics and Macroeconomics

GDP per capita (USD)	32 194
Population (000s)	1 927
Labour force (000s)	971.4
Employment rate	93.7
Population over 65 (%)	20.1
Dependency ratio	31.5

Source: OECD data from 2019 or latest available year

1. Old age dependency ration (65+/(15-64)), OECD 2018.

LATVIA: COUNTRY PENSION DESIGN

Structure of the Pension System

Public pensions

- Earnings-related pension financed on a pay-as-you-go basis through notional individual accounts (NDC PAYG)
- Basic pension
- Minimum pension

Private pensions: mandatory

- Mandatory state funded pension scheme, fully funded, DC in design

Private pensions: voluntary occupational and personal plans

- Voluntary closed or open private pension plans, DC or DB or hybrid in design

Source: OECD/IOPS Global Pension Statistic

LATVIA: THE PENSION SYSTEM'S KEY CHARACTERISTICS

The Latvian pension system consists of a state pension scheme composed of an earnings-related pension financed on a pay-as-you-go basis through notional individual accounts (NDC PAYG); a fully funded, defined contribution, mandatory pension scheme; and private voluntary occupational and individual pension arrangements.

PUBLIC PENSION

The NDC PAYG system has been in operation since 1996 and covers those aged 50 and over at the time of introduction in 1996. Those between 30 and 49 could choose whether to operate under the NDC system or to join the funded pension system, while those under 30 had to join the funded system (see below). Pensions are calculated according to a pension formula[1] that is based on social insurance contributions. Participants are eligible to receive pension benefits after at least 15 years of contribution record and upon reaching the statutory minimum retirement age, which reached 63 years old and 6 months for men and women by 2019 (retirement age and minimum contribution period will increase to 65 years and 20 years respectively in 2025).

Employees contribute 9% of gross monthly earnings. Employers pay 24.09% of employees' gross salaries, of which 14% is attributed to the PAYG system and 6% to the funded mandatory individual account system. The remaining contributions (4.09%) finance other social insurance benefits.

Social insurance benefits are adjusted in line with the CPI in April, and in line with the CPI and changes in average contributory earnings in October of each year.

Since 1997, benefits paid under the state pension scheme are subject to income tax. However, old age pensions attributed before January 1996, when the new law came into force, are not subject to taxation.

A state social security benefit is paid to those who do not qualify for old-age pension benefits.

MANDATORY FUNDED PENSION SCHEME

Coverage

The state mandatory funded pension scheme (SFPS) has been in operation since 2001, participation in the scheme is mandatory for new labour entrants and those who were younger than 30 when the reform came into force.

Contributions

The contribution rate paid from the employees' gross salary is 6%.

[1] [1] P=K/G, where P is annual pension under the NDC pension scheme, k is accumulated life-time notional pension capital for insured person that is recorded in the individual notional account ; G is expected years for pension pay-out, based on estimation of unisex life expectancy of the work's age cohort.

Benefits

Retirees can purchase an annuity from an insurance company or choose the "refunding" option: i.e. moving their capital to the NDC pension scheme and receiving a pay-out calculated following a slightly modified NDC pension formula[2]. Lump sum payments are not allowed.

Taxation

Contributions are income tax deductible. Pension benefits are taxed at the ordinary income tax rate. Pensions are not subject to social security contributions. Investment income is exempt from tax.

Asset management companies

The main entities involved in the administration of the state mandatory funded pension scheme (SFPS) are the State Social Insurance Agency, investment management companies and custodian banks. Participants may change their asset manager once a year and change investment plan under the same manager twice a year free of charge. Members are free to make a choice of investment plan and can choose a conservative investment plan, a balanced investment plan or an active investment plan. The investment policy of these investment plans varies mostly by the weight of equities in their portfolio (could be 0% - 75% according to legislation) The State Treasury has been managing the default fund (conservative) at the beginning of the SFPS. The State Treasury has completed the activities in management of SFPS assets as per November 2007 and the assets of State Treasury investment plan has been distributed between conservative investment plans of private asset managers according to special decision of Cabinet of Ministers.

Investment legislation sets both quantitative and qualitative investment restrictions. Private asset managers may invest in government and municipal securities; corporate debt and equity securities; open-ended investment funds; bank deposits, AIF, risk capital and derivatives. There is no maximum limit to investments abroad, provided they are listed on the official list of stock exchanges registered in a Baltic, EU or EFTA countries. The law does however stipulate a 70% currency matching rule. Assets may not be invested in real estate (except investments through investment funds) or financial instruments issued by the asset manager of the investment plan (except investment funds managed by the asset manager if there are no commissions charged for buy/sell of investment fund certificates), nor are managers permitted to take loans with the assets. Investments in risk capital markets are also limited to 5% of the investment plan assets.

Fees

Entry or exit fees may not be charged. Administration fees may be charged but are capped at 2.5% (actual deduction for 2018 was 0.16%) of total annual contributions. Custodian fees, asset management fees or other fees are capped at 0.85% for investment plans that do not invest in equities and at 1.1% for other investment plans.

[2] P=(Kn +Kf)/G, where where P is annual pension under the NDC pension scheme, Kn is notional pension capital accrued under the NDC pension scheme, Kf is financial capital accrued under the SFPS and G is expected years for pension pay-out.

MARKET INFORMATION

On 31 October 2019, Latvia's pension assets in the mandatory pension system totalled EUR 4,357 millions. The SFPF assets were managed by eight investment management companies, with these companies offering a total of 31 investment plans to participants.

OCCUPATIONAL/PERSONAL VOLUNTARY

Coverage

Voluntary pension funds may be closed or open and they may offer one or more pension plans. Plans can be DB or DC in nature, or hybrid (DC with a guaranteed investment return or cover against biometrical risks). Pension plan participants may participate directly or with the involvement of their employer.

Contributions

No contribution rates are prescribed in the law. Employers typically contribute between 5-10% of the employee's salary, while employees contribute around 5%.

Benefits

Pension plan participants can receive benefits from age 55 or continue participating and receive capital in parts. Benefits are paid out as an annuity, a phased withdrawal or a lump sum.

Taxation

Employer contributions are tax exempt up to 10% of the employee's annual employment income. Benefits are tax exempt, while investment income is taxed.

Asset management companies

According to the law private pension funds that provide only pure DC pension schemes are not allowed to manage assets of pension plans themselves but should contract out the asset management of the pension plans to the external asset managers. According to the law credit institutions, life insurance joint stock companies, investment brokerage companies and investment management companies which are allowed to provide services in Latvia can be contracted as the asset managers of pension plans. Investment rules are largely the same for DB and DC schemes, though some minor differences exist. There are no restrictions on switching funds: a written application sent to the pension fund one month in advance suffices.

Fees

Fees are unregulated and their level is laid down in the pension plan. Private pension funds charge their fee for administration of pension plans. There are also fees to asset managers and custodian banks and may be charged other fees, too.

MARKET INFORMATION

Personal voluntary

On 30 June 2019, Latvia's voluntary pension assets totalled EUR 526 millions. There are currently six voluntary pension funds operating in Latvia, among them five are open and one is closed. A total of 348 134 members participated in voluntary pension arrangements as of 30 June 2019.

PROPOSED REFORM

It is expected that government will focus on the following issues in the near future: further strengthening of the regulatory and monitoring framework of private pension arrangements; improving the financial literacy of participants; monitoring fees and charges.

REFERENCE INFORMATION

KEY LEGISLATION

The Law on State Funded Pensions regulates the mandatory pension system, while the Law on Private Pension Funds regulates voluntary pension arrangements.

KEY REGULATORY AND SUPERVISORY AUTHORITIES

Supervision of both systems is carried out by the Finance and Capital Market Commission: http://www.fktk.lv/eng

The Ministry of Welfare is charged with the development of policy in the social security system, including the pension system: www.lm.gov.lv.

The State Social Insurance Agency, under supervision of the Ministry of Welfare, is responsible for administering the state funded pension scheme (SFPS) and conclusion of contracts with the SFPS asset managers. The State Social Insurance Agency ensures the establishment and updating of accounts of participants in the SFPS by registering contributions made and the funded pension capital accrued as well as the transfer of the contributions of the SPFS participants to the SFPS asset managers. https://www.vsaa.gov.lv/en; https://www.vsaa.gov.lv/en/services/for-employees/2-nd-tier-mandatory-state-funded-pension-scheme/

KEY OFFICIAL STATISTICAL REFERENCE AND SOURCES ON PRIVATE PENSIONS

OECD, Global Pension Statistics project: www.oecd.org/daf/pensions/gps.

Source map: Central Intelligence Agency, The World Factbook, Latvia