

# COUNTRY PROFILE

## Latvia

### I. Data overview

		Data Overview					
<b>Macroeconomic and Demographic Data</b>		2001	2002	2003	2004	2005	2006
Nominal GDP (millions of national currency)		5,219	5,758	6,393	7,434	9,059	11,265
GDP per capita (US \$)		3,492	3,929	4,744	5,865	6,608	8,781
Population (thousands)		2,357	2,343	2,330	2,318	2,307	2,295
Total Labour Force (thousands)		1,106	1,124	1,126	1,136	1,135	ND
Employment rate		87.03	88.03	89.42	89.56	91.27	ND
% population over 65		15.30	15.53	15.86	16.19	16.52	16.80
Dependency Ratio		32.63	32.38	32.82	33.04	33.59	ND
Life expectancy at birth		ND	ND	ND	ND	71.40	ND
	Women	ND	ND	ND	ND	76.80	ND
	Men	ND	ND	ND	ND	65.60	ND
Fertility rate		1.21	1.23	ND	ND	ND	ND

	2001	2002	2003	2004	2005	2006
<b>Assets</b>						
Total investments (National currency millions)	13	26	45	74	119	179
Total investments, as a % of GDP	0.24	0.45	0.71	0.99	1.31	1.59
<i>Of which Assets overseas, as a % of Total investment</i>						
• Issued by entities located abroad	8.00	5.00	13.00	16.00	32.00	32.00
• Issued in foreign currencies	ND	ND	ND	ND	ND	ND
<b>By pension fund type (as a % of Total investments)</b>						
• Pension funds (autonomous)	100.00	100.00	100.00	100.00	100.00	100.00
• Book reserves (non autonomous)	ND	ND	ND	ND	ND	ND
• Pension insurance contracts	ND	ND	ND	ND	ND	ND
• Other financing vehicle	ND	ND	ND	ND	ND	ND
<b>By pension plan type</b>						
• Occupational assets	10	14	19	26	37	52
• % of DB assets	100.00	100.00	100.00	100.00	100.00	100.00
• % of DC (protected and unprotected) assets	ND	ND	ND	ND	ND	ND
• Personal assets	3	12	26	48	82	127
<b>Structure of Assets (as a % of Total investments)</b>						
Cash and Deposits	33.00	29.86	28.29	34.65	28.59	28.58
Fixed Income	62.44	65.28	66.42	51.90	47.21	49.94
<i>Of which:</i>						
• Bills and Bonds issued by the public and private sector	ND	ND	ND	ND	ND	ND
• Loans	ND	ND	ND	ND	ND	ND
Shares	3.04	3.24	2.15	2.10	2.48	1.16
Land and Buildings	ND	ND	1.14	2.60	4.14	3.55
Other Investments	1.52	1.62	2.00	8.75	17.58	16.77
<b>Contributions and Benefits</b>						
Total Contributions, as a % of GDP	0.13	0.23	0.39	0.44	0.56	0.66
• Employer Contributions, as a % of Total contributions	99.00	99.00	96.00	89.00	69.00	63.00
• Employee Contributions, as a % of Total contributions	1.00	1.00	4.00	11.00	31.00	37.00
<b>Total Benefits, as a % of GDP</b>						
• % of benefits paid as a Lump sum	ND	ND	0.01	0.01	0.01	0.01
• % of benefits paid as a Pension	ND	ND	97.00	93.00	85.00	83.00
• % of benefits paid as an Insurance premium payable for allocated insurance contracts	ND	ND	3.00	7.00	15.00	17.00
• % of benefits paid as an Insurance premium payable for allocated insurance contracts	ND	ND	ND	ND	ND	ND
<b>Membership (in thousands of persons)</b>						
Total members	292	356	522.00	673	841	1,000
• % of Total active members	ND	ND	80.00	85.00	70.00	80.00
• % of Total passive members	ND	ND	15.00	13.00	23.00	11.00
• % of Total deferred members	ND	ND	ND	ND	ND	ND
• % of Other beneficiaries	ND	ND	5.00	7.00	7.00	9.00
<b>Number of Pension Funds/Plans</b>						
Total number of funds	4	4	5	5	6	6
Total number of plans	15	10	29	31	35	41

Source: OECD, Global Pension Statistics

ND = data not available

NA = data not applicable

## **II. Pension system**

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 system**

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<sup>1</sup> that is based on social insurance contributions. Participants are eligible to receive pension benefits after at least 10 years of insurance and upon reaching the statutory minimum retirement age, which will reach 62 for men and women by 2009.

Employees contribute 9% of gross monthly earnings. Employers pay 24.09% of employees' gross salaries, of which 16% is attributed to the PAYG system and 4% to the funded mandatory individual account system. The remaining contributions (4.09%) finance other social insurance benefits. The percentage of contributions that is directed towards the funded mandatory individual account system will rise to 10% in 2010. The total contribution amount will however remain the same, as the amount of contributions towards the NDC scheme will decrease correspondingly.

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 (LVL45 in 2006).

### **Funded Pension System**

#### **Mandatory**

##### ***Personal***

#### **Coverage**

The state mandatory funded pension scheme (SFPP) 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. Early 2007, some 900,000 people participated in the mandatory funded pension scheme. It was estimated that as of 2006 78% of the active population was covered.

#### **Contributions**

The contribution rate paid from the employees' gross salary is 4% (2007) and will gradually increase to 8% in 2008, 9% in 2009 and 10% from 2010 onwards. Contributions to the state pension system will decrease from 16% in 2007 to 10% in 2010.

#### **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 payout calculated following a slightly modified

---

<sup>1</sup>  $P=K/G$ , 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 payout, based on estimation of unisex life expectancy of the work's age cohort.

NDC pension formula<sup>2</sup>. Lump sum payments are not allowed. Detailed provisions on the payout phase have not yet been elaborated as the first pension benefits will be paid out in 2014.

### Taxation

Contributions are income tax deductible. Pension benefits are taxed at the ordinary income tax rate of 25% when they exceed LVL 1,200 for the year. 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 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% - 50% according to legislation) The State Treasury manages the default fund (conservative). 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 restrictions. Private asset managers may invest in government and municipal securities; corporate debt and equity securities; open-ended investment funds; bank deposits 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 (except investments in EUR where there are no limits). 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% of total annual contributions. Custodian fees, asset management fees or other fees are not regulated, but should be identified in the prospectuses of investment plans.

### Market

According to IPE, in 2006, Latvia's pension assets in the mandatory pension system totalled almost LVL127m (€180m). As of the end of 2006, SFPS assets were managed by nine investment management companies, with these companies and the State Treasury offering a total of 26 investment plans to participants. Current estimates project, assuming a 4% annual real gross return on capital (net of administrative expenses), that the SFPS assets should attain around LVL 1.3bn (€1.9 bn) by 2014.

### Replacement rate

OECD estimates the gross replacement rate for an average worker from mandatory pensions to be 58.2% (81.8% net).

---

<sup>2</sup>  $P = (K_n + K_f) / G$ , where where P is annual pension under the NDC pension scheme,  $K_n$  is notional pension capital accrued under the NDC pension scheme,  $K_f$  is financial capital accrued under the SFPS and G is expected years for pension payout.

## **Voluntary** ***Personal***

### **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**

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

### **Management companies**

According to the law private pension funds 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, 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**

According to IPE, in 2006, Latvia's voluntary pension assets totalled LVL 51 m (€73 million). There are currently six voluntary pension funds operating in Latvia, among them five are open and one is closed. Only about 5% of Latvian companies offer voluntary private occupational arrangements to their employees. A total of 99 596 members participated in voluntary pension arrangements at the end of 2006.

### **Proposed reforms**

It is expected that government will concentrate 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; deregulating investment regulations in the state mandatory retirement income system; encouraging voluntary pension savings.

### **Legislation and supervision**

The Law on State Funded Pensions regulates the mandatory pension system, while the Law on Private Pension Funds regulates voluntary pension arrangements. 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.ly](http://www.lm.gov.ly).