



ANNEX 49

Twinning Project AZ/13/ENP/SO/24

Support to the State Social Protection Fund on the introduction of funded element within the insurance-pension system, establishment of non-state pension funds and development of legal framework for regulating their activity

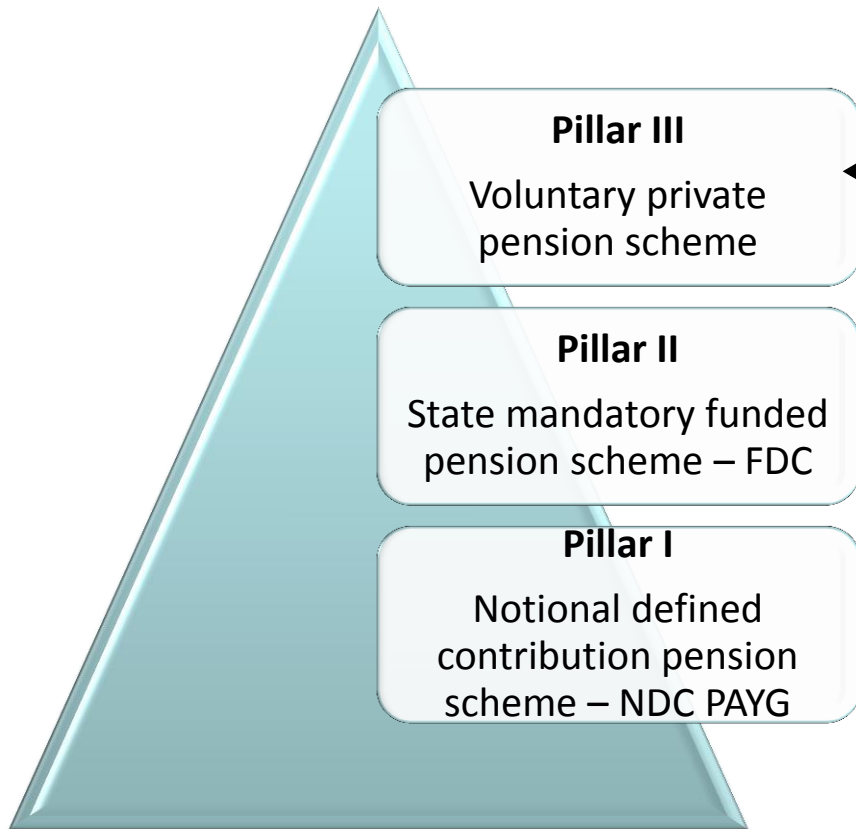
Pillar III – Private Pension Funds in Latvia

Activity 4.1. In-depth presentation of the state pension system of the EU MS to relevant SSPF staff and other stakeholders

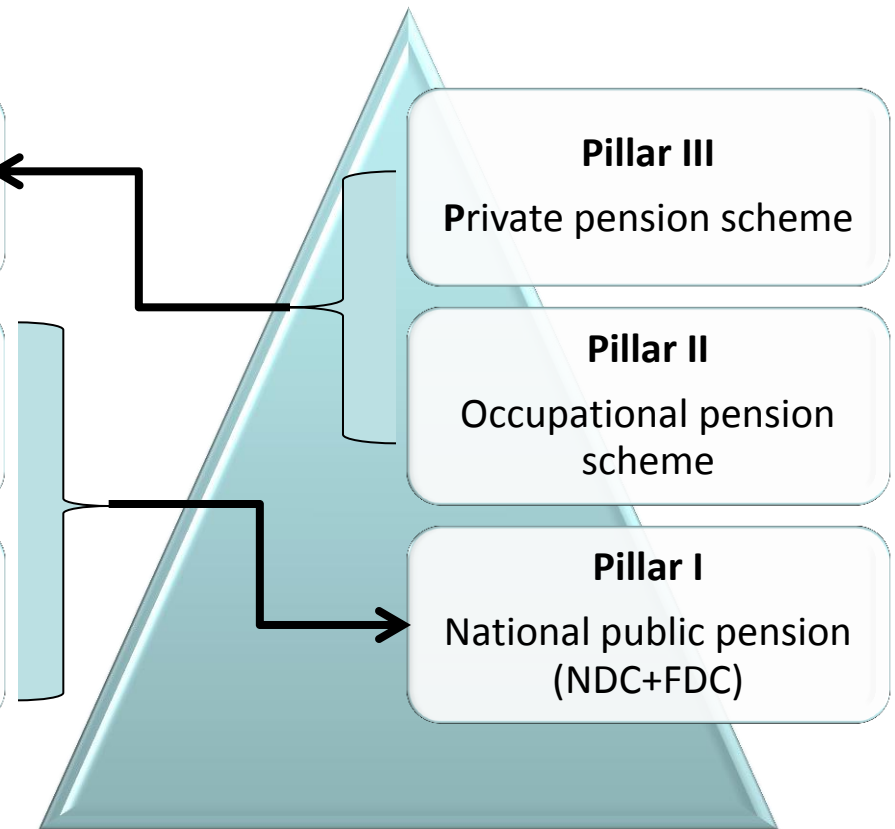
Dace Brencena
Expert, MoW of Latvia
22nd July, 2014

New Pension Systems

Latvia (1996)



Sweden (1999)



Administration of Private Pension Funds

Pillar III

Latvia

Legislation for Private Pension Funds



Law on Private Pension Funds (1998)



**Rules of Cabinet of Ministers on
Special professions (1998, 2014)**



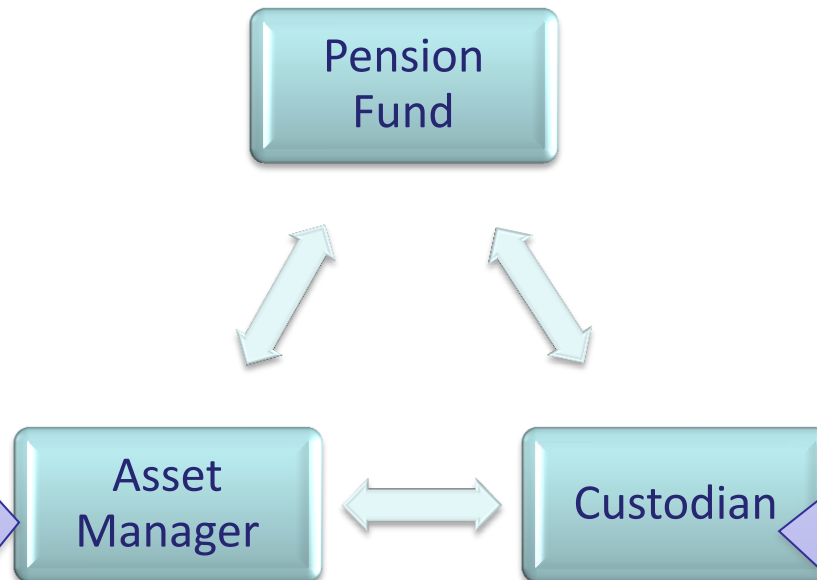
**Rules of Financial and Capital
Market Commission (FCMC)**

**Supervisor of all Financial and Capital market
participants**

General scheme of Pillar III Private Pension Funds

- 1) **Accumulate all contributions** and provides investments to participants regarding to pension plans rules
- 2) Provides administration of **Individual accounts of participants** & provides them with all information
- 3) Attracts **new participants to pension plans** (individuals & corporates)
- 4) **Operates on competitive market** with other pension funds
- 5) All assets of pension plans belongs to participants and they are kept outside of Pension Fund, Asset manager and Custodian balance sheets – **no guaranty fund necessary**

- 1) Takes tactical & strategic investment decisions
- 2) Makes investments regarding to Investment policy
- 3) Gives investment orders to custodian
- 4) Calculates Investment return



- 1) Servicing Contributions in & benefits out of participants
- 2) Controls AM on investment limits regarding to Investment policy
- 3) Keeps all investment documents
- 4) Performs all Investment orders
- 5) Reports to pension fund on limit breaches

Types of Private Pension Funds

Open Pension Funds (OPF)

5
OPF

Commercial banks

Life Insurance
companies

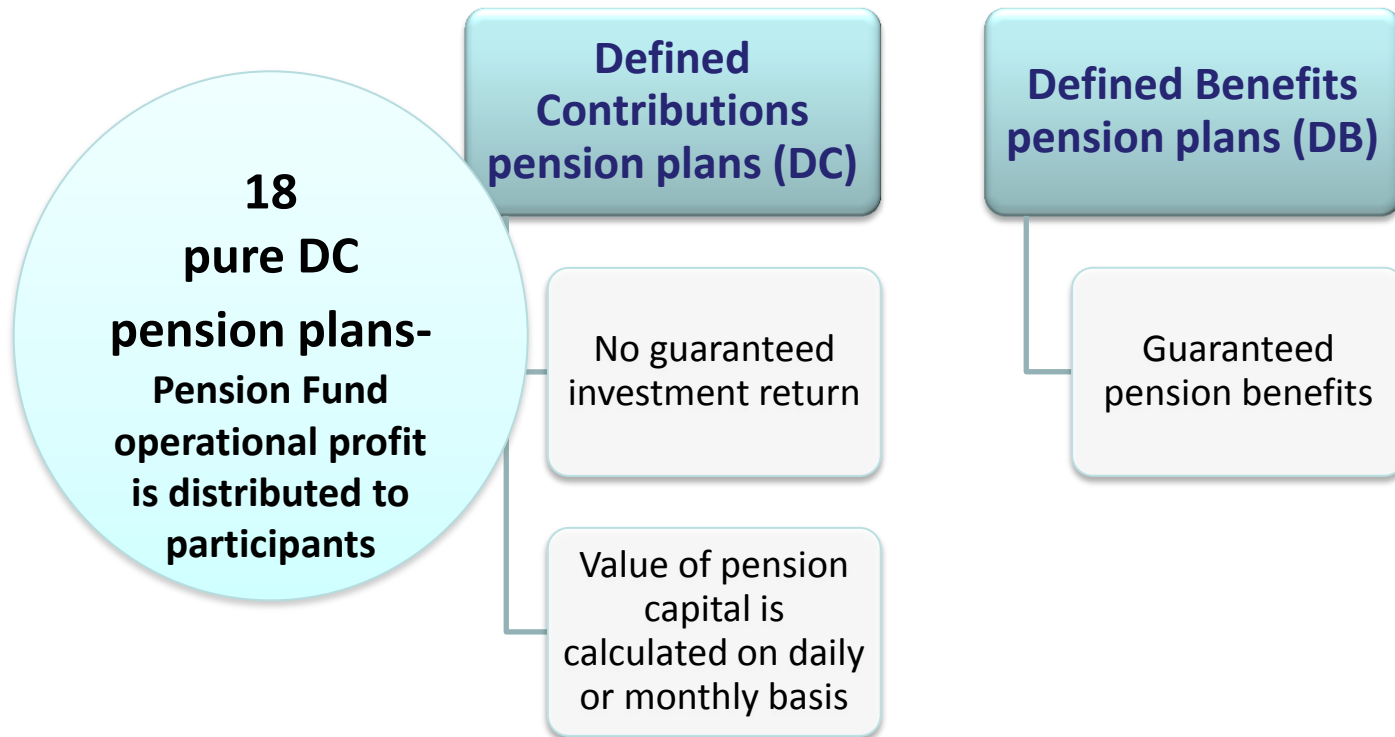
Closed Pension Funds (CPF)

Only private
companies for
their employees

One or **several
companies** can be
shareholders for
one pension fund

1 CPF
for 7
companies

Types of Pension Plans



**Biometric risk coverage / guaranteed investment return
3 M EUR shareholders capital needed**

Types of Pension plans by strategy & currency

Investment strategies

Contribution currencies

① CONSERVATIVE

0 PP

- 0% Equities
- Shortly before pay-out period or during payout period

② BALANCED

5 PP

- Up to 35% Equities
- During Savings period
- During Pay-out period

③ ACTIVE

13 PP

- Above 35% Equities
- During Savings period up to 45 years

① EUR

16 PP



② USD

2 PP



How to become as participant in Open Pension Fund?

Individual Agreement

- Choose pension plan
- Choose regularity of contributions
- Choose the way of receiving information
- Choose beneficiary

Group agreement

- Company Chooses pension plan (usually balanced or by the choice of employees)
- Choose regularity of contributions
- Register employees in pension fund

Contributions

Individual contributions

- Only with bank transfer (regular or single)
- Through employer accountancy – tax benefits receiving on contribution day
- No obligation to pay on regular basis – free choice

Employer contributions

- Only with the bank transfer (regular or single)
- In lump sum and redistribution to employees by information table
- No obligation to pay on regular basis – free choice

Employer's contributions or occupational pension schemes

Employment contracts or collective agreements of labor unions

- Selection criteria for contributions should be based on **objective criterion** – profession, work experience, position and others objective criteria
- **No discrimination** on origin, property status, race, gender, or attitude to religion

Pension Plan Committees in Company – controls pension plan execution regarding to agreement between Pension fund and Company

- Number of members on equal representation from employees and employer side
- If number of employees are below 100 – committee is not mandatory

Tax advantages for contributions up to 10% from gross salary

Individual contributions

- are tax exempt from personal income tax (24%)

Employer contributions

- Company - are included in deductible expenses and no object of corporate income tax (15%)
- For individuals and company – no state social insurance contributions needed for this type of personal income (Employer – 23,59%, Employee-10,50%)

How to receive Personal Income Tax benefits from Individual contributions

Pension Funds annually (in February) reports to State Revenue Service all individual contributions

1

Make contributions in pension funds

Submit Annual Income Declaration in State Revenue Service (from March.)

State Revenue Service transfers tax benefits to individual bank account in 3 months

2

Submit application to employer book keeping to make contributions in pension fund

Employers book keeping deduct these contributions from applicable income & reports to State Revenue Service

Employer calculates tax benefits and transfers to individual bank account together with monthly salary

Individual accounts in Private Pension Funds

Individual contributions

Employer contributions

Income from investments

All fees (pension fund, asset manager, custodian, FCMC)

Discounts if applicable

Benefits paid out

Start and End balance of account

Auditor of Annual Accounts, Asset manager, Custodian

**Annual
report to
participant**

Rules for Individual accounts

From Law on Private pensions
and Rules of FCMC

Contributions should be registered on Individual accounts **no later than on next day** when payment is received on pension plan account

Value of pension capital can be calculated:

- 1) On daily basis (NAV)
- 2) On monthly basis (Capital accounting method)

Communication Channels with Participants

Industry web pages	Pension Fund web page	Pension fund Internet bank	Post & e-mail & sms & telephone
Pension Funds Industry results	Pension plans and changes	Statement of accounts	Statement of accounts
Pension calculator	Investment policy for each pension plan	Individual agreement in pension fund	News & letters & campaigns
www.bankasoc.lv	Investment results	Regular payments	
www.manapensija.lv	Practical information and news	Application for pay-out and change of pension plan	
	Annual reports	News & letters & campaigns	

Industry web pages

Results of Private Pension Funds (Pillar III) on 31st of May, 2014

Name of Pension Plan	Currency of Pension Plans	Max limit on investments in equity	Inception Date of Pension Plan	Value of Assets (mil. EUR)	Number of Participants	RATE OF RETURN AFTER ASSET MANAGEMENT AND CUSTODIAN FEES %%*						
						YTD***	1 Y**	2 Y**	3 Y**	5 Y**	10 Y**	From inception
Pension Plans of Open Pension Funds												
Balanced Pension Plans												
Citadele Sabalansētais	EUR	līdz 20%	30.09.99	21,870	27 142	3,08	4,19	6,02	3,72	6,39	3,93	5,83
Nordea sabalansētais pensiju plāns	EUR	līdz 25%	18.10.11	3,150	3 049	3,08	1,28	4,15	n/d	n/d	n/d	4,51
"SEB - Sabalansētais" pensiju plāns	EUR	līdz 25%	31.07.00	62,303	41 307	2,53	1,78	4,46	2,99	4,57	4,44	4,96
Swedbank pensiju plāns Stabilitāte+25	EUR	līdz 25%	14.07.03	16,200	22 877	2,99	3,56	5,38	4,21	6,19	2,91	2,94
Total: Balanced Pension Plans	EUR			103,523	94 375	2,53	2,73	4,96	3,46	5,39	4,41	5,73
Active Pension Plans												
Citadele Aktīvais	EUR	līdz 50%	21.03.00	7,467	20 606	3,08	4,74	7,30	4,44	6,05	3,77	5,63
Citadele Aktīvais EUR	EUR	līdz 50%	12.10.07	4,705	3 955	2,34	3,59	5,38	3,27	4,74	n/d	3,30
Finasta plāns "Dzintars - Konservatīvais"	EUR	līdz 30%	23.10.98	0,514	541	6,15	7,20	7,59	5,38	5,94	n/d	5,56
Finasta plāns "Jūra - Aktīvais"	EUR	līdz 80%	00.01.00	0,064	108	3,73	5,22	6,86	3,92	3,66	n/d	4,50
Finasta plāns "Saule - Sabalansētais"	EUR	līdz 50%	07.03.08	0,640	1 782	3,24	5,07	6,00	3,82	4,97	n/d	5,41
Citadele plāns "Rumba"	EUR	līdz 30%	08.01.05	0,269	1 641	1,03	0,24	1,73	1,15	2,56	n/d	1,83
Citadele plāns "Twists"	EUR	līdz 50%	10.04.07	0,040	219	0,55	0,15	2,12	0,76	0,37	n/d	0,36
Nordea progresīvais pensiju plāns	EUR	līdz 75%	18.10.11	2,049	2 371	3,38	4,01	6,15	n/d	n/d	n/d	5,56
"SEB Aktīvais" pensiju plāns	EUR	līdz 50%	15.09.04	31,017	35 148	2,63	2,83	5,99	3,40	4,81	n/d	5,21
Swedbank pensiju plāns Dinamika+60	EUR	līdz 60%	01.08.03	29,814	36 236	3,45	4,40	8,84	5,02	7,18	3,86	3,73
Swedbank pensiju plāns Dinamika+100	EUR	līdz 100%	27.12.06	8,370	13 976	3,47	5,25	12,76	4,52	9,28	n/d	-1,37
Active Pension Plans	EUR			84,949	116 583	3,06	3,89	7,74	4,19	6,22	3,84	3,97
Citadele Aktīvais USD	USD	līdz 50%	01.04.06	0,891	701	2,15	2,24	5,39	2,68	4,36	n/d	4,91
Swedbank pensiju plāns Dinamika+(USD)	USD	līdz 60%	14.07.03	1,678	1 563	4,16	6,17	6,50	2,68	5,12	2,53	2,37
Active Pension Plans	USD			2,569	2 264	3,47	4,81	6,12	2,68	4,86	2,53	3,25
Total: Active Pension Plans				87,518	118 847	3,07	3,92	7,69	4,14	6,18	3,80	3,95
Total: Pension Plans of Open Pension Funds				191,041	213 222							
Closed Pension Plan												
"First Closed Pension Plan" (only for employees of shareholders of "First Closed Pension Fund")	EUR	līdz 30%	01.12.99	57,044	12 181	2,17	3,04	5,02	3,65	5,69	5,00	7,40
TOTAL: ALL PENSION PLANS OF PRIVATE PENSION FUNDS				248,085	225 403							

* Rate of return is calculated after asset management and custodian fees as annual rate of return.

** Historical rate of return is not guaranteeing the same return in the future

*** Absolute Growth of rate of return from the beginning of year

Pay-out rules

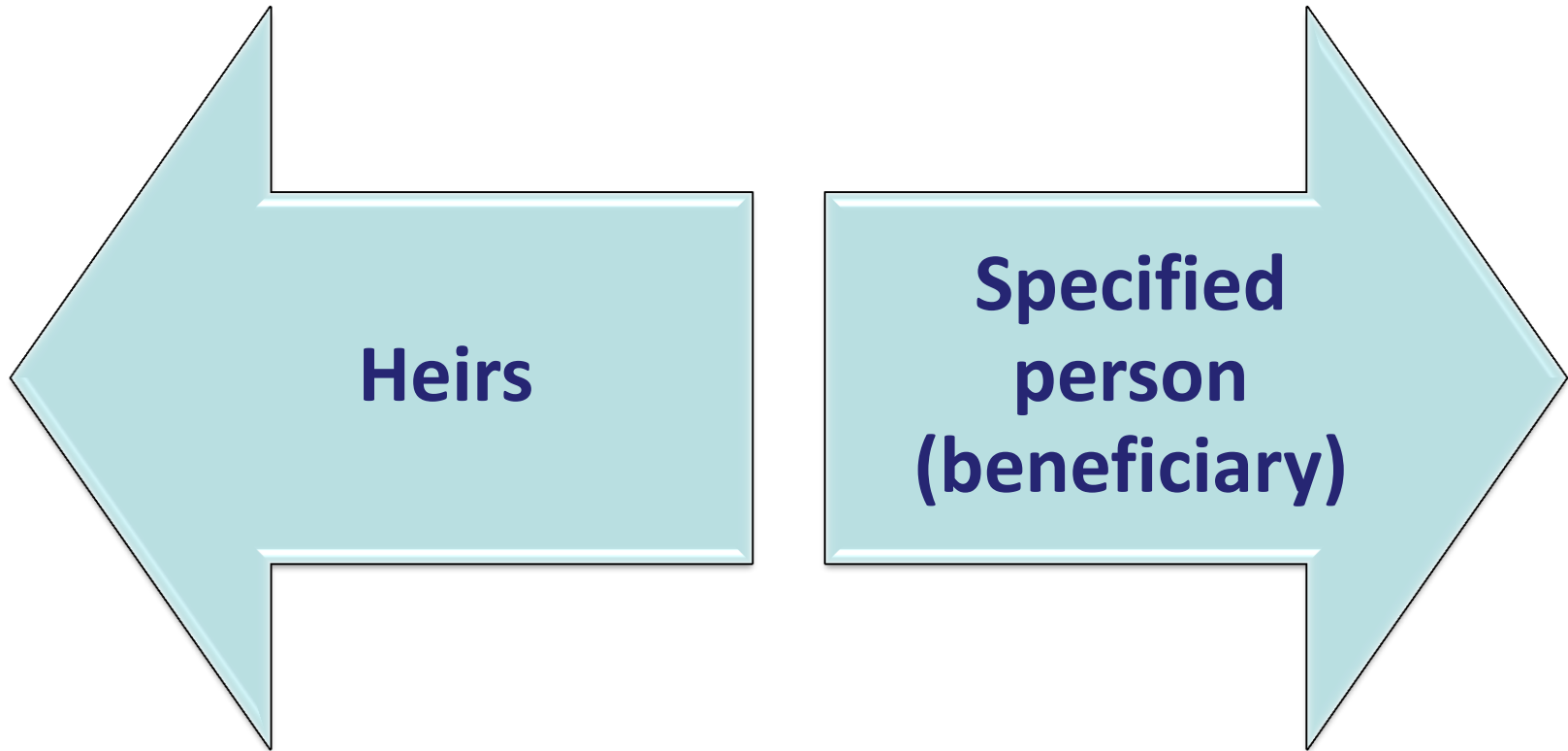
Not earlier than 55 years age

- In lump sum
- In regular installments
- In parts on the demand of participant
- It is not obligation to receive pension capital on 55 – keep up to choice at any age above 55 years.

Below 55 years age

- In special professions adopted by Rules of Cabinet of Ministers (prepared by Ministry of Welfare)
- When participant becomes disabled person of 1st group for life

Heritage rules of Private Pension Capital



Options for receiving Private Pension Capital



2-5 days

if pension fund using NAV (net asset value) for pension capital valuation

1-2 months

if pension fund using pension capital valuation method on monthly basis

Tax regimes for Private Pension Benefits

Participant

- **Individual contributions** – no personal income tax
- **Employer contributions** – personal income tax 24%
- **Capital gains** – capital gain tax 10%

Heirs or specified person (beneficiary)

- No any tax applicable

Tax rules and advantages for long term savings

Taxation Rules Personal Income Tax 24% Capital Gain Tax – 10%	EMPLOYERS CONTRIBUTIONS		INDIVIDUAL CONTRIBUTIONS	
	Pension Funds	Life Insurance	Pension Funds	Life Insurance
CONTRIBUTIONS 24 % rate	EXEMPT	EXEMPT	EXEMPT	EXEMPT
	Up to 10% of personal taxable income together PENSION FUNDS (PF) + LIFE INSURANCE (LI)			
CAPITAL GAINS 10% rate	TAXED	TAXED	TAXED	TAXED
BENEFITS (contributions part) 24% tax rate	TAXED	TAXED	EXEMPT	EXEMPT

Fees applicable to Pension Fund participants

	FCMC	PENSION FUND	ASSET MANAGER	CUSTODIAN BANK
	State supervision	Individual accounts administration and customer growth	Asset management services	Custodian services
From contributions	0,4%	Up to 2%	n/a	n/a
From Assets under Management	n/a	Up to 1,5% p.a.	Up to 0,9% p.a.	Up to 0,2% p.a.
			Performance fee on investment result can be applied	

Transfers between pension funds & pension plans in the same pension fund

Individual transfers

- Free of charge
- No limit for change

Employers transfers

- To other pension fund - only by permission of FCMC and written consent of employee.

Cross-border transfers of private pension capital

From LV to abroad (EU economic zone countries)

- Pension Benefits must not be paid before 55 years age
- Pension Benefits are heritable or must be paid out to beneficiary in case of death of participant

From abroad to LV

- General rules must fit with rules of LV pension plans
- From UK and Irland – Latvian pension plans should be registered into QROPS (Qualified retirement overseas pension scheme) register of HMRC (Her Majesty Revenue Center)

Guaranties to pension plan participants

Participants without exceptions has rights on all pension capital in his individual account

Funds of pension plans, financial instruments and other property of pension plans has to be kept, accounted and managed separately from pension fund, custodian and asset manager own and others under management assets

If pension fund, custodian or asset manager has become insolvent or liquidated, pension plan assets not allowed to include in property of debtor – pension fund, custodian or asset manager

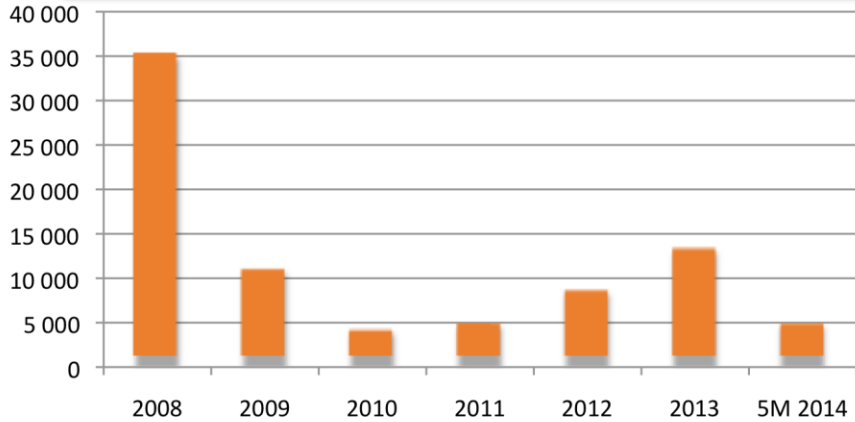
All contributions made by participant or by other person on behalf of participant has to be accounted on individual account not later than on next day when payment is received on pension plan account

Accrued pension capital in individual account of participant can not become as property of asset manager, custodian or employer. Recovery of debt against pension capital of participant can be executed by court decision in case of offense punishable under criminal law to third parties.

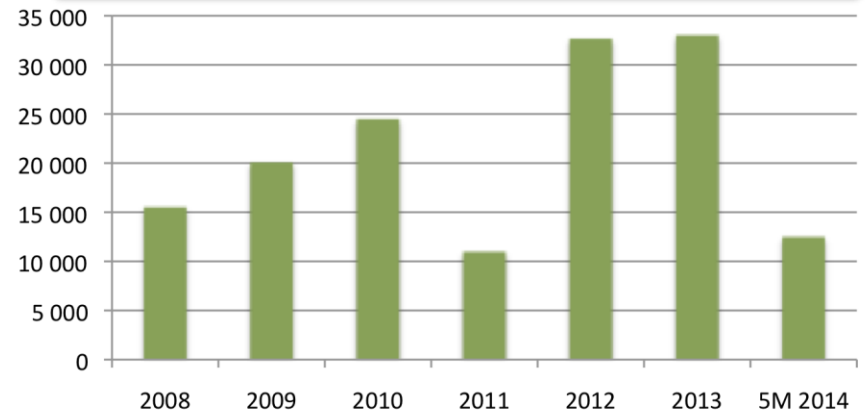
All rights on private pension capital retained in case if participants move abroad

PII growth data

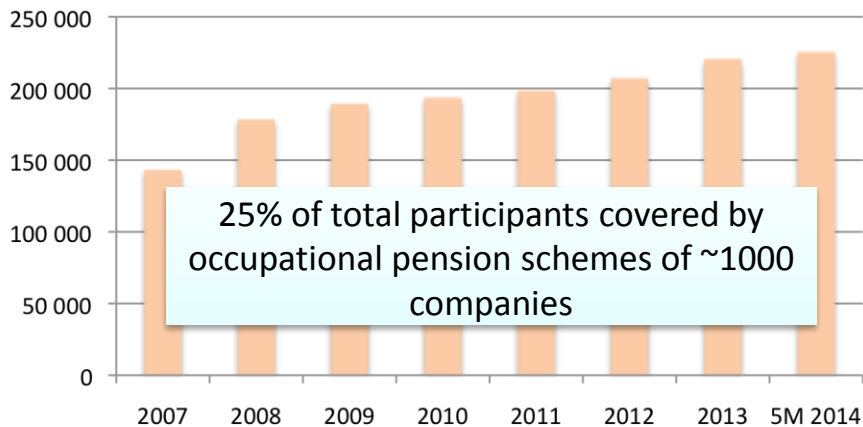
PII participants growth



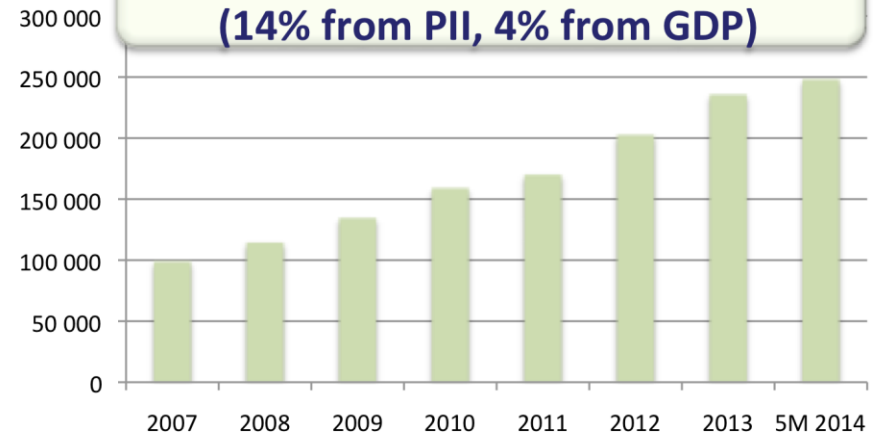
PII assets growth (thousands, EUR)



PII total participants (17% from PII)



PII total assets (thousands, EUR) (14% from PII, 4% from GDP)



Conclusions regarding to PIII

Individual participation developments

- Slow market growth annually 4% (17% from PII participants)
- Awareness, personal responsibility and trust to long term financial instruments, pension system as such
- Low monthly income (**530 EUR gross salary**)
- **Average private pension capital 1600 EUR**/per participant during 10-15 years
- **Beneficiary introduction** additionally to heirs in 2014 would stipulate more savings in private pension funds
- Public education needed and transparency of existing state pension accumulations in Pillar I and Pillar II

Corporate market (occupational pension schemes) development

- Voluntary participation works only for large companies, only **25% from Pillar III participants** covered by occupational pension scheme and only **6% from new participants** comes from companies
- **State institutions** are not allowed to include pension funds as part of remuneration
- Impact of **shadow economy ~ 30%**
- **Mandatory agreement between labor unions and company management** would solve low participation rate of companies similarly like in other European countries – and that would make a protection capital in old age additionally to state pension

Asset Management and Custodian Services of Private Pension Funds

Pillar III

Latvia

Commercial entities eligible to provide asset management services

Commercial banks

Life Insurance companies

Investment brokerage companies

✓ Investment management companies

Commercial entities eligible to provide custodian services

✓ **Commercial banks**

Investment brokerage companies

Investment principles based on EU basics

Internal Market – fundamental freedoms of the EC Treaty

- http://ec.europa.eu/internal_market/capital/

Freedom of capital movements

- ...all **restrictions on the movement of capital** between Member States and between Member States and third countries **shall be prohibited**
- ...all **restrictions on payments** between Member States and between Member States and third countries **shall be prohibited**

Enforcement: Commission as “Guardian of the Treaty”

- Infringement proceedings, jurisprudence of the European Court of Justice

Investment rules

Prudent person rule

To invest in best interest of members, beneficiaries

To ensure security, quality, liquidity, profitability of the portfolio

Predominantly on regulated markets

Derivatives – to reduce risks and facilitate efficient portfolio management

Investment objects

1. LV and other Member states Government and municipality securities (Bonds, T-bills)
2. OECD government investment grade securities
3. Securities of international financial institutions with membership of one or several Member states
4. Equities or other capital securities – on regulated markets
5. Corporate bonds – on regulated markets
6. Term deposits in the banks
7. Investment and alternative funds
8. Real estate
9. Derivatives
10. Risk capital

Main Investment restrictions

1. 30% from assets in securities of one issuer - state, municipality or international financial institution
2. 10% from assets in securities of one issuer – corporate and total exposure to one corporate – 10% from assets
3. 20% from assets in term deposits in one bank, total exposure to one bank – 25% from assets
4. 10% from assets in one investment fund, but no more than 10% from investment fund total assets
5. 10% from assets in one real estate, and total investment in real estate - no more than 15% from assets
6. 5% from assets in financial instruments issued by corporates of one group where pension fund is a part of this group
7. 5% from assets in financial instruments issued by corporate with collective agreement with pension fund
8. 25% from assets in financial instruments issued by one group of corporates
9. No borrowings, no direct credits
10. REPO operations up to 50% from assets
11. 10% from assets of one issuer in risk capital market
12. Open currency position – 10% from assets in one foreign currency, 20% from assets – to all foreign currency

Documents for Investment rules

Pension Plan

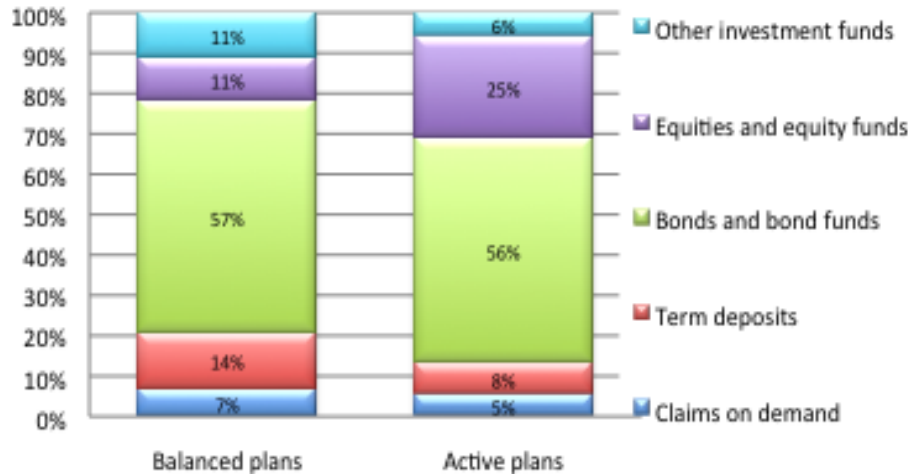
- Investment rules
- Description of investment risks
- Specific investment limits to define pension plan investment strategy (balanced or active)
 - in fixed income and money market instruments,
 - in equities,
 - in real estate and risk capital

Investment policy of pension plan

- Investment strategy the same as in pension plan
- Asset allocation tactics by geography, markets, sectors, partners, currencies
- Investments quantitative restrictions and control
- Policy of using derivatives
- Investment risk control
- Criteria for asset valuation
- Voting policy regarding to investments
- Information about custodian and asset manager and their valuation methods
- Policy of prevention of conflicts of interest

Must be published in pension funds web page

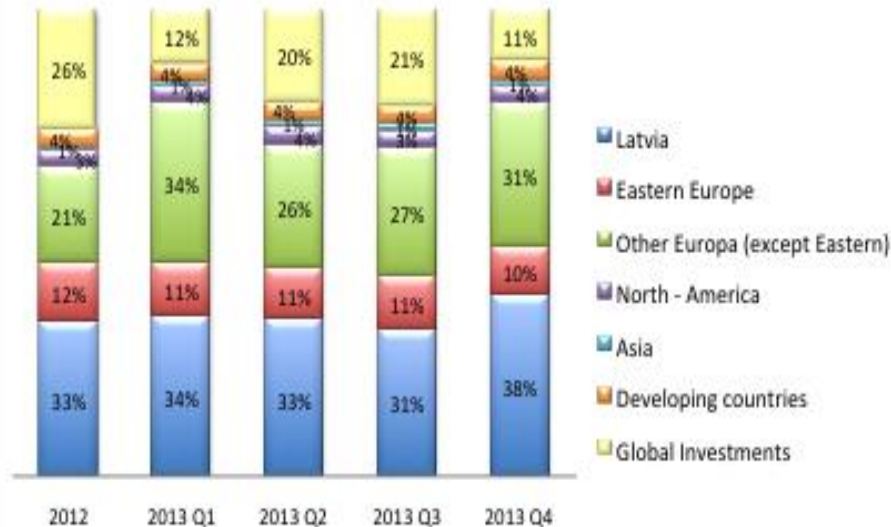
Pillar III Total investments by asset class on 31.12.2013.



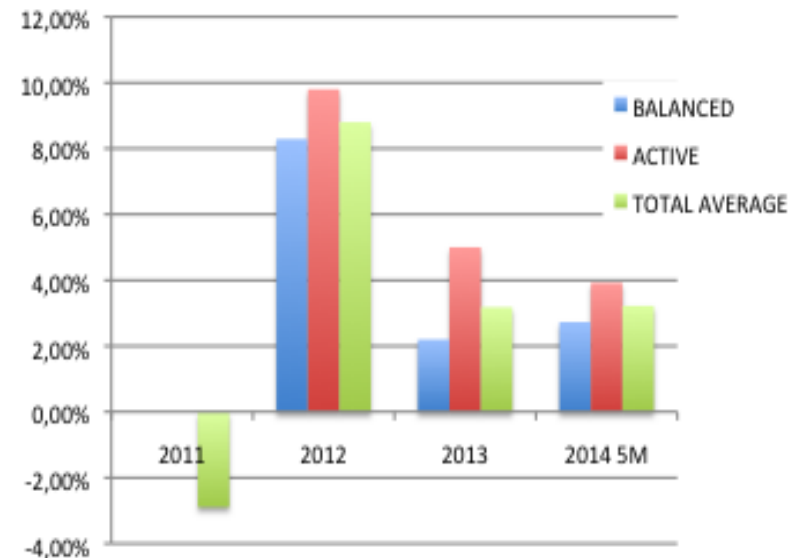
Pillar III Investments by investment currency



Pillar III Total Investments by region



Average profitability of pension plans % p.a.



State Supervision of Private Pension Funds by FCMC

Pillar III

Latvia

“One peak” supervision model



- The Financial and Capital Market Commission (FCMC) is an autonomous public institution, which carries out the integrated supervision of entire financial sector of Latvia supervising **banks**, credit unions, insurance companies and insurance brokerage companies, **participants of financial instruments market**, as well as **private pension funds**, payment institutions and electronic money institutions
- The FCMC was established on 1 July 2001 merging banking supervision (Bank of Latvia), insurance supervision (State Insurance Supervision Inspection under the Ministry of Finance) and securities market supervision (Securities Market Commission under the Ministry of Finance)

Financial and capital market

FCMC = 130
employees



More than 300 financial and
capital market participants

- **Banks (26)**
- Insurance companies (20)
- **Private pensions funds (6) and pension plans (18)**
- **Investment management companies (12), investment funds (34), state pension scheme investment plans (23)**
- Credit unions (35)
- Payment institutions (36) un e-money institutions (14)
- Riga Stock Exchange (1), Latvian Central Depository (1) and participants of financial instruments market
- Other financial market participants

Main tasks of FCMC

Develop regulations

Carry out the supervision

Licensing

Protect the interests of the customers

Improve financial literacy level

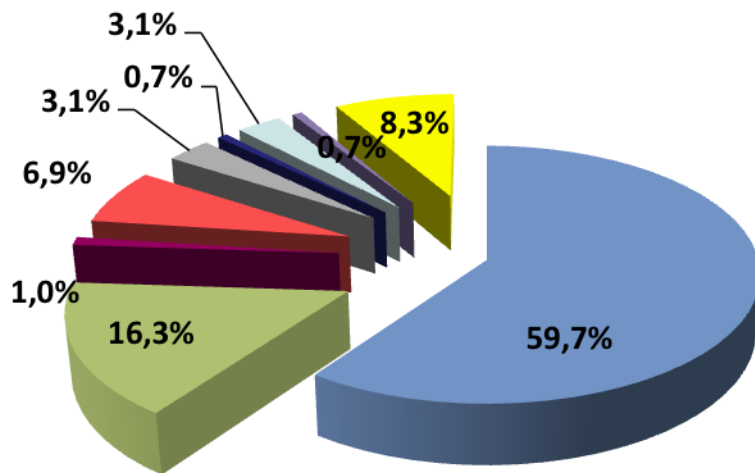
Administer the financial stability fee

International cooperation

Statistics and analyses

Consumer protection issues in FCMC

Complaints received in 2013



- credit institutions (172)
- insurance companies (47)
- insurance intermediaries (3)
- financial instrument market (20)
- credit unions (9)
- state funded pension schemes (2)
- investment management companies (9)
- electronic money institutions (2)
- other complaints (24)

Safeguarding the rights of customers of market participants is a significant supervisory aspect for the FCMC

Supervision of Private Pension Funds

Licensing of pension funds

- Pension plans
- Investment policy of pension plans
- Individual participation agreements and rules of registering
- Agreement with asset manager and custodian
- Methodology of capital pay-out
- Organizational structure, description of management structure, description of accounting policy, IT system protection rules and other relevant documentation

Audits and consumer protection, rules issued by FCMC

- Each 3 years general audit
- Quarterly reporting to FCMC
- Critical situation analysis annually



THANK FOR YOUR ATTENTION!

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Gesellschaft für
Versicherungswissenschaft
und -gestaltung e.V.

