State-funded pension scheme, or Tier 2 (3/44/17)

This article completes what we wrote on this topic last week.

Accounting for a participant's Tier 2 pension

Once you become a Tier 2 participant, a personal Tier 2 account will be opened for you to enter all contributions paid for you. Unlike a bank account, the participant's pension account doesn't directly hold money – it's constantly invested for the purpose of making a profit, so the participant receives a higher pension in their old age.

Once contributions are entered in the participant's account, the amount of money is transferred within five working days into a custodian bank account for the asset manager's investment plan chosen by the participant, and the number of investment plan units matching the participant's pension capital will be entered in their pension account. So choosing an investment plan means you will exchange your Tier 2 pension capital for units of that investment plan.

When more contributions are paid into your account, they will be automatically converted into units of your chosen investment plan. The value of a unit varies according to how the plan performs. Based on the information about the unit value on a particular day, we can calculate how much Tier 2 pension capital each person has accrued to date.

So your pension account stores units of your chosen investment plan, and if you want to know how much pension you have accrued, the number of your units should be multiplied by the unit value. The daily unit value is calculated and posted by the asset managers daily on www.manapensija.lv in the section *Tier 2 Pension / Current Data.*

The single central and local government services portal www.latvija.lv makes the following e-services of the National Social Insurance Agency (NSIA) available to Tier 2 participants:

- Information about the state-funded pension scheme participant's registration and choice of investment plan – here we can find out when our Tier 2 participation began and see the history of our asset-manager and investment-plan changes;
- Information about the change of state-funded pension scheme asset manager and investment plan – here we can get information about our last change of asset manager and investment plan;
- The state-funded pension scheme participant's account statement – here we can get details of our Tier 2 pension capital accrued in the last year and any other past period.

To prevent the funds invested in Tier 2 from exposure to risk, they are held separately from the custodian's assets. This ensures that the money invested will not be lost in the event the custodian bank becomes insolvent or the asset manager has his licence cancelled or goes bankrupt. The safety of pension capital is also monitored by the Financial and Capital Market Commission and the Latvian Central Depositary. The asset manager is required to regularly file reports to the NSIA, who passes the information about the asset manager's activities and the investment plan's performance to the Tier 2 participant. This allows you to monitor the safety of your capital.

How can I use my Tier 2 pension capital?

A person that has reached the retirement age has two options.

One option is to add the amount to what is accrued in Tier 1 and then receive a single state pension.

The other option is to purchase a life pension policy from an insurance company that offers such policies. In this case it is possible to designate a beneficiary – this might be your spouse and children, or any other person. The benefit period is limited to 20 years. In this case the funds accrued in Tier 2 will no longer be automatically transferred to the government budget, but rather paid out as inheritance.

The pensioner can change the beneficiary during the agreement and –

- select up to three pension payment stages during which a different amount of pension will be set;
- choose the frequency of receiving pension – monthly, quarterly, half-yearly, or annually;
- defer the start of pension payments for up to ten years.

Voluntary Tier 2 participants reached the full retirement age in 2013.

How do I apply for a life pension?

To receive a life pension in retirement you should –

- file an application to the NSIA indicating your desire to receive life pension insurance;
- study life pension insurance offers and choose a suitable life insurer; and
- enter into a life pension insurance agreement with the chosen insurer.

It is important to remember that you can cancel your agreement or change its terms within 15 days after signing it. In that case your Tier 2 pension capital will be added to your Tier 1 pension capital. Your agreement will take effect from the 16th day and can no longer be cancelled.

Insurance services

Life pension policies are currently available from three insurers:

- SEB Dzīvības Apdrošināšanas Sabiedrība AAS;
- ERGO Life Insurance SE Latvian branch; and
- Compensa Life Vienna Insurance Group SE Latvian branch.

The insurers have set a minimum amount of accrued capital that is required for entering into a life pension insurance agreement. The minimum capital requirement varies from insurer to insurer.

If a person dies before reaching the retirement age, their pension capital will be transferred to the social insurance budget and taken into account when it comes to calculating a loss-of-provider pension for the pension scheme participant's dependants (children etc).

Each person is responsible for their accrued Tier 2 pension capital. The amount of money accrued in the account depends on –

- the level of salary;
- the amount of Tier 2 contributions;
- the length of Tier 2 participation; and
- profits depending on the state-funded pension scheme asset manager and the investment plan chosen by the participant.

Latvia has 11 active plans, 4 balanced plans, and 8 conservative plans. Two new active plans have been registered this year.

As Parliament is debating proposals for amending the State Funded Pensions Act, there is a lobby to have rules adopted for inheritance of Tier 2 pension capital where the participant dies before reaching the retirement age.