



THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

J U D G E M E N T

On Behalf of the Republic of Latvia

Riga, 1 December 2010

Case No. 2010-21-01

The Constitutional Court of the Republic of Latvia, composed of the Chairman of the Court hearing Gunārs Kūtris, Justices Kaspars Balodis, Aija Branta, Kristīne Krūma, Vineta Muižniece and Viktors Skudra,

having regard to a constitutional complaint of Eduards Ikvilds,

according to Article 85 of the Satversme (Constitution) of the Republic of Latvia, Article 16 1st indent, Article 17 (1), 11th indent, and Article 19.² and Article 28.¹ of the Constitutional Court Law,

on 2 November 2010, in writing examined the case

„On Compliance Section 4 (2) of the Law on State Funded Pensions and Para 2, Para 3 (4) and (5) of Transitional Provisions thereof with Article 1, Article 105 and Article 109 of the Satversme of the Republic of Latvia”.

The Facts

1. On 17 February 2000, the Saeima [Parliament] of the Republic of Latvia (hereinafter – Saeima) adopted the Law on State Funded Pensions (hereinafter – the Funded Pension Law) that came into effect on 1 July 2001. The Law on Funded pensions establishes general principles of establishment and functioning of schemes of State funded pensions (hereinafter – funded pension scheme), procedure of payment of financial resources, administration, management and provisions of depositing and disbursement, as well as ensures State supervision over the above mentioned activities.

Section 4 (2) of the Funded Pension Law initially provided:

“The contribution rate in the funded pension scheme shall be ten per cent of the contribution object specified in the Law on State Social Insurance.”

Para 2 of Transitional Provisions of the Funded Pension Law (hereinafter – Transitional Provisions) established:

“The rate determined in Section 4, Paragraph two of this Law shall come into force on 1 January 2010.”

On 29 April 2009, the Saeima adopted the Law “Amendments to the Law on State Funded Pensions” that came into force on 1 May 2009. The above mentioned Law provided the following wording of Section 4 (2) of the Funded Pension Law:

“The contribution rate in the funded pension scheme shall be six per cent of the contribution object specified in the Law on State Social Insurance”.

Para 2 of Transitional Provisions of the Law acquired the following wording:

“The rate determined in Section 4, Paragraph two of this Law shall come into force on 1 January 2012.”

Para 3 (4) of Transitional Provisions now have the following wording:

“as of 1 May 2009 2 per cent of the contribution object determined in law. The rate shall be applied to contributions which are registered from 1 May 2009 in the account of a participant of a funded pension scheme, except adjusted contributions for the time period until 31 December 2008”

Moreover, Para 3 of Transitional Provisions was supplemented by indent 5 with the following wording:

“as of 1 January 2011 not less than 4 per cent of the contribution object determined in law.”

2. The person who submitted the constitutional complaint **Eduards Ikvilds** (hereinafter – the Applicant) asks the Constitutional Court to recognize Section 4 (2) and Para 2 and Para 3 (4) and (5) of the Funded Pension Law (hereinafter – the Contested Norms) as non-compliant with Article 1, Article 105 and Article 109 of the Satversme of the Republic of Latvia (hereinafter – the Satversme).

The Applicant indicates that the Funded Pension law has been elaborated and adopted with a view to form a financially independent, stable and economically substantiated pension system.

The amount of pension depends on participation of a person in accumulating pension capital. The Applicant has been a voluntary member to the funded pension scheme since 1 December 2003. By becoming a member to the funded pension scheme, it was possible to accumulate additional pension capital because the Applicant could contribute into it after having selecting deposit plan, which would thus ensure a higher income level when in retirement.

The Applicant indicates that, pursuant to case-law of the Constitutional Court, the right to disbursement of pension irrespective the source of the funding thereof pertains to the content of Article 105 of the Satversme. The right to social security, however, have been infringed by the fact that the State has amended, without any legitimate aim, the legal regulatory framework that concretizes the fundamental rights established in Article 109 of the Satversme; the legislator has also breached principles of a law-governed State

– the principle of legitimate expectations, the principle of proportionality, and that of a socially responsible State.

Section 4 (2) of the Funded Pension law has remained unchanged since 1 July 2001; consequently, there is no doubt that trust of a person in such legal regulatory framework in the field of funded pensions, provided that the person has made payments into the funded pension scheme, has been lawful, reasonable and grounded. When adopting amendments to the Funded Pension Law, the legislator has failed to establish any transitional period for persons to be able to adapt to the new regulatory framework; neither has it established any compensation mechanism. Consequently, according to the Applicant, the Saeima, when adopting the Contested Norms, has breached the principle of legitimate expectations.

Pension is one of social security measures implemented by the State with the purpose to ensure observance of the principle of a socially responsible State. Pensions not only perform an economical function, i.e. to compensate loss of incomes for a person, but also a social one, i.e. to ensure a person the possibility to preserve a status of a full-fledged member of the society. As the rate of contributions into the funded pension scheme is reduced from eight to two percent, profitability of the funded pension scheme has reduced irrespective of the investment plan selected by a person.

According to the Applicant, Para 3 (4) of Transitional Provisions has a retroactive force because the contribution rate at the amount of two percent of the contribution object is also applied to those contributions that a person has made into the funded pension scheme before 1 May 2009.

The Applicant holds that the ill-considered procedure of adoption of the Contested Norms shows that the aim of these norms is covering of the State budget deficit rather than balancing of incomes and expenses of the State social insurance special budget (hereinafter – social budget). Consequently, the Contested Norms do not have any legitimate objective. The aim put forth by the legislator, which is balancing of social budget, cannot be reached by means of the Contested Norms.

The Applicant agrees that the present economical situation of the State has made the legislator to look for the ways of reducing State budget expenses, including those of social budget. However, when adopting the Contested Norms, the Saeima has failed to

make an exhaustive assessment of financial benefit for social budget and consequences caused by the Contested Norms to persons who would use their right to retire. When adopting the Contested Norms, the legislator has not analysed and considered measures to be applied in order to ensure sustainability of social budget. Absence of such measures and unwillingness to elaborate and implement them proves that existence of social budget is endangered. Measures selected by the legislator cannot be regarded as proportional because social impact of the Contested Norms has not been assessed when adopting them.

The Applicant assumes that, in the future, the legislator could reallocate initially established contribution rate equally between the first level of pension system and the funded pension scheme. However, the material loss, i.e. the unearned profit cannot be compensated because profitability of issued financial tools cannot be as high in the future as it was in 2009 and 2010.

In the explanatory report submitted by the Applicant to the Constitutional Court after having got acquainted with the case materials, it has been indicated that a person who accedes has agreed to its provisions that were effective before adoption of the Contested Norms. Therefore it is not correct to compare persons who have the possibility to voluntarily join the funded pension scheme with those who are subject to obligatory participation therein because the legislator has failed to provide a possibility to refuse participating in the funded pension scheme even in case if its provisions are substantially changed. In the case under review, there is no dispute on the fact that, due to high inflation and financial crisis, profitability of contributions made into the funded pension scheme has reduced, in the result of which the participants to the scheme incurred losses. These losses would be of importance only if in 2009 they had to make payments using the resources accumulated in the funded pension scheme.

The Applicant is confident that such procedure of introducing amendments into legal regulatory framework, namely, by failing to observe principles of a law-governed State and apply an adequate legislation procedure, does not ensure trust of the society into work of the legislator. This might produce far-reaching consequences, notably, the society could lose trust into the funded pension scheme and even avoid social contributions.

3. Institution that adopted the Contested Norms, **the Saeima** does not share the opinion of the Applicant and asks the Constitutional Court to recognize the Contested Norms as compliant with Article 1, Article 105 and Article 109 of the Satversme.

In order to implement requirements of Article 109 of the Satversme regarding social security in old age, the legislator has established such pensions system in Latvia that operates at three levels. The amount of pensions depends on contributions. A person who makes greater contributions or postpones his retirement for later gains more incomes at the retirement age. At all three levels, these contributions are being accumulated by means of pension capital and interest thereof. The funded pension scheme is based on payment individual social insurance contributions. This means that, in the frameworks of this scheme, a particular part of social insurance contributions of a person meant for old age pension is invested into the financial capital market so that the money invested would earn interest. Consequently, not only accumulation is generated, but also State economy is facilitated.

According to the Saeima, the conclusion made by the Applicant that greater contributions into the second level of pension system would ensure additional pension capital and higher standard of living in the old age is ungrounded because, in total, profitability of the first level of pension system in the period from 2001 to 2009 has increased more rapidly than that of the second level of pension system. Consequently, it cannot be unequivocally established that the Contested Norms would infringe property right of a person because a person has the right to disbursement of pension irrespective the level of pension system, wherein a person has made contributions.

The Saeima indicates that, in 2009, the State economical situation has deteriorated, unemployment rate has increased, and incomes of the inhabitants and those of the social budget have reduced. Under such circumstances, it was necessary to take immediate measures to solve the situation because the financial reserve accumulated in the social budget as on 1 January 2009 was 951.1 million lats, whilst it was prognosticated that the reserve would reduce to 383.1 million lats by the end of 2010. By reducing contribution rate into the funded pension scheme, it was prognosticated that incomes into the social budget would increase. The Saeima holds that the shift of the

contribution rate from ten to six percent constitutes an optimal distribution between the first and the second pension system level and ensures that pensions system could operate in a long term.

The aim of the Contested Norms is to optimize provision of social insurance services by ensuring the ability of the social budget to operate in a long term provided that it is necessary to balance incomes and expenses of the social budget. Consequently, the Contested Norms have a legitimate aim, namely, to ensure sustainable operation of the State social insurance system by reaching the aim enshrined in Article 116 of the Satversme, i.e. welfare of the society.

According to the Saeima, the Contested Norms are the most lenient solution available because, by reducing contribution rate into the second level of pension system and thus increasing contribution rate into the first level of the system, the amount of first level pension is, in fact, increased. Thus the hypothetical restriction established by the Contested Norms is lesser than the benefit gained by the society from balancing of incomes and expenses of the social budget.

The Saeima indicates that Article 105 and 109 of the Satversme does not commit the State to dividing pension system into the first and the second level; neither has it obligated establishing such division in the framework of the pension system.

When analysing legislative procedure, in the frameworks of which the Contested Norms were adopted, the Saeima refers to conclusions made by the Constitutional Case in the judgment of 26 November 2009 in the case No. 2009-08-01, namely, that acknowledging of a draft law as urgent and establishing of a particular term for submitting suggestions, provided that members of the parliament who want to present suggestions have the possibility to prepare them in accordance with requirements of law, as such cannot be regarded violation of the Rules of Procedure.

4. The summoned person, **the Cabinet of Ministers** informs that in the Memorandum of Understanding signed on 18 December 2008 and addressed to the International Monetary Fund (hereinafter – the IMF), readiness to implement short-term and long-term measures in order to receive international loan and thus to stabilize the national economy has been expressed. The Memorandum of Understanding also included

determination to restrict budget expenses up to the amount of 40 percent of the Gross Domestic Product (GDP). However, on July 2009, the GDP continued reducing; therefore it was evident that the established fiscal deficit would not be achieved. Consequently, receipt of the loan was threatened. The Cabinet of Ministers emphasizes that the IMF will grant another loan only if determinations expressed in the Memorandum of Understanding are implemented. In order to prevent failure by the State to fulfil liabilities, the Memorandum of Understanding dated with 27 July 2009 was prepared and the Latvia's Economic Stabilization and Growth Revival Programme was also supplemented. The above mentioned Memorandum of Understanding included a determination to elaborate, before 1 July 2010, pension reform in order to ensure sustainability of the three levels of the pension system. International creditors have not stipulated reducing contribution rate of the State funded pension scheme. The Cabinet of Ministers emphasizes that, when discussing terms of the international loan and considering the plan for reducing budget deficit, no substantial cut of funding for the social field has been planned.

The Cabinet of Ministers indicates that the basic principle for administration of resources in the pension scheme is administration of the resources in the long term. Such long-term administration of resources could prevent reduction of value of deposit plan due to losses incurred by financial instruments.

5. The summoned person, **the Ministry of Welfare** holds that, by transferring a part of social insurance contributions into the funded pension scheme, the first level of pension scheme might have enough resources to disburse pensions for present pensioners. Such basic role has been taken into account when elaborating the Funded Pension Law.

According to the Ministry of Welfare, pension system, wherein the principle of solidarity of generations is combined with individual investments of a person to secure his or her old age serves as an optimal model for social protection of persons that also balances demographical and economical rhythms.

Before 2009, re-allocation of social contribution rate between pension levels has been financially successful. State social insurance operates based on the principle of

solidarity. Therefore, as social budget expenses increased rapidly, it was necessary to review allocation of social insurance contribution rate. Re-allocation of contribution rate between the first and the second pension level has not been executed with a view to react on fluctuations in financial markets because functioning of the funded pension scheme is based on profitability of long-term investments.

When responding to questions set by the Constitutional Court, the Ministry of Welfare informed that Para 3 (4) of Transitional Provisions is applied to those social insurance contributions that were calculated and made for the period from January to April 2009. The reference of the Annotation to the Funded Pension Law to possible contradictions with the Satversme should be perceived as a request to pay attention to possible risk related with Para 3 (4) of Transitional Provisions that envisages applying the new regulatory framework to social insurance contributions already made. The above mentioned annotation is of informative rather than of factological character because it neither contains any particular facts, nor provides any arguments that would prove violations of articles of the Satversme.

To offer alternative solutions, the Ministry of Welfare suggests increasing of social insurance contribution rate and optimizing social services. However, according to the Ministry of Welfare, such measures would have negative socio-economic consequences.

6. The summoned person, the **State Social Insurance Agency** [*Valsts sociālās apdrošināšanas aģentūra – VSAA*] (hereinafter – VSAA) informs that mandatory and voluntary participants of the funded pension scheme have equal rights and duties. Identical terms apply to all these participants; therefore the type of participation has no influence on further participation of a person in the funded pension scheme.

7. The summoned person – **the Ministry of Finance** informs that in 2009 the situation of the social budget has considerably deteriorated, namely, incomes did not cover expenses; therefore it was necessary to introduce amendments into the Funded Pension Law. As economic crisis proceeded, the reserve accumulated in the social budget continued to reduce. Under the above mentioned circumstances, it was necessary to

implement urgent measures to solve the situation. By reducing the contribution rate into the funded pension scheme in 2009 up to two percent, it was planned that social budget incomes in the first pension level would increase and reach the amount of 106.3 million lats (actual accomplishment – 166 million lats). However, by establishing the contribution rate at the amount of two percent to be paid to the funded pension scheme in 2010, contribution rate of 4 percent in 2011, and that of 6 percent starting with 2012, it is prognosticated that social budget incomes into the first pension level would increase up to the following amounts: in 2010 – 181 million lats, in 2011 – 160 million lats, and 2012 – 112 million lats.

8. The summoned person, **the Financial and Capital Market Commission** [*Finanšu un kapitāla tirgus komisija*] (hereinafter – the Commission) indicates that it has submitted its opinion to the Saeima regarding the amendments into the Funded Pension Law. Questions regarding reduction or increasing of contribution rate into the funded pension scheme does not pertain to the field of competence of the Commission. It neither impacts performance of supervision functions delegated to the Commission. However, according to the Commission, introduction of such amendments could have a substantial impact on the pension system in general.

The Latvian pension system has a stable and predictable character. The decision to introduce amendments into the legal regulatory framework with the purpose to change proportions of current pension levels might have several negative consequences. First, voluntary participants of the funded pension scheme that have counted on the legal regulatory framework have transferred contributions into the funded pension scheme. The Law does not establish any possibility for voluntary participants of the funded pension scheme to refuse participation to the funded pension scheme and to make contributions only into the first pension level in case of provisions of the funded pension scheme are amended. According to the Commission, the principle of legitimate expectations might have been breached in relation to these persons. Under such circumstances, it is possible to admit that persons would not trust into sustainability of pensions system and thus lose motivation to participate in accumulation of pension capital. Second, by deviating from principles established in the funded pension scheme, Latvia lost its reputation as a state with a stable and sustainable pension system aimed not

only at reaching of short-term aims but also at ensuring stability and development in the long term. Third, it should also be taken into account that aging of the society and demographical trends are an indicative of reduced number of employees in the future. As contributions into the social budget reduce, whilst budget expenses increase, the level of income substitution for pensioners in the future might reduce and become insufficient for meeting everyday needs. Consequently, the present benefit ensured by additional resources in the social budget might be non-commensurable with the detriment caused to future pensioners.

9. The summoned person, **the State Treasury** informs that, by reducing contribution rate into the funded pension scheme, social budget incomes have increased, whilst its deficit has been reduced. Taken into account the difficult economic situation, the necessity to increase incomes of the social budget and reduce deficit thereof makes the legislator adopt many unpopular decisions. However, when adopting such decisions, it is important to ensure stability of pension system in the long term and facilitate trust of participants of the funded pension scheme into receipt of incomes in the future.

10. The summoned person, **the Bank of Latvia** indicates that the rapid recession of national economy and deterioration of macro-economic indices in 2009 manifested itself in considerable fall of employment and labour wage, which resulted in reduction of social insurance contributions and increase of social budget expenses. This clearly evidenced that rapid increase of social insurance contribution incomes had a short-term character and that the amount of expenses of the social budget would for deficit in the long term.

Based on prognosis of the Bank of Latvia, if no consolidation of social budget is executed, this might lead to deficit at the amount of 1.5 billion lats. Taking into account the aging tendency of the society and prospective development of demographic indices, it is possible to conclude that the social budget would have no resources to finance this deficit. According to the Bank of Latvia, it is necessary to ensure that social budget is formed with a surplus in the middle term in order to maintain sustainable social budget.

The Bank of Latvia emphasizes that increasing of State social insurance contribution rates would cause detriment to the national economy.

11. The summoned person, **the Ombudsman of the Republic of Latvia** (hereinafter – the Ombudsman) indicates that the State has established a three-level pension system in order to implement the right to social security in the old age guaranteed in Article 109 of the Satversme. The legislator, when reducing contribution rate into the funded pension scheme and thus changing the previous procedure, has restricted the fundamental rights established in Article 109 of the Satversme.

The Ombudsman is of the opinion that the right of the Applicant to social security in the old age has not been directly infringed because the respective risk that enables a person to claim social security in old age has not yet set in for a person. It cannot be prognosticated whether such infringement could occur in reality after a person reaches retirement age because it depends on both, individual circumstances, like contributions made by the person, functioning of the selected investment plan, and external factors, like possibilities of the existent pension system and economic situation of the state. However, the duty of the State to establish social security system, to observe and protect it from ungrounded interference follows from Article 109 of the Satversme and international documents binding on Latvia. Consequently, a person has the right to protect his or her interests against measures taken by the State that, according to a particular person, could influence the rights guaranteed for him or her in the future.

The Ombudsman emphasizes that the legislator has neither amended retirement provisions, nor the procedure for pension calculation. Consequently, it can be concluded that the right to pension based on contributions made is preserved for the following generations. The legislator has changed allocation of contributions between the first and the second pension level. The State enjoys a broad freedom of action in relation to creation of pension system; therefore the Ombudsman holds that such decision is of a political character.

The Ombudsman indicates that, as the amount of available resources reduces, the State shall have the right to change allocation of state social insurance contributions between the first and the second pension level with the purpose to ensure stability and

sustainable functioning of pension system. Consequently, it is reasonable to hold that the Contested Norms have been adopted based on reasonable considerations and the necessity to balance interests of the society and those of individual persons.

The Ombudsman is also of the opinion that pension system should be able to timely react on changing circumstances. Consequently, persons are not protected against reasonable and grounded amendments in operation of pension system. Moreover, a person is the one who is responsible for one's provision in the old age, and this he or she can implement by participating in the third pension level.

12. The summoned person, *Mg. mpa. Maija Poršnova* indicates that pension system is constituted by three levels. Changes introduced at any of these levels influence the entire system. Levels of pension system are constitutive parts of a common system; however, they function based on different principles.

Funded pension scheme operates in accordance with the principle of individual social insurance contributions; therefore, pursuant to the Funded Pension Law, a person has legitimate expectations in stable provision at his or her retirement age established by the State.

When creating the pension system, the legislator has indicated the ways of allocating resources in the frameworks of the first pension level. Moreover, for the sake of ensuring disbursement of the following generations, it has provided that a part of these resources would be invested into the second pension level. The summoned person holds that the main advantage of such pension system is the possibility to timely prevent negative impact on the social budget caused by different risk factors. Both pension levels are subject to fluctuations; therefore, simultaneous participation in both pension levels permits accumulating a greater pension capital if compared with a situation if a person participates only at one of the levels. Stability of the pension system is guaranteed by means of proportional investments into both levels.

When adopting the decision to reduce contribution rate into the funded pension scheme, the possibility of a person to influence one's social situation in the old age is reduced. As a result, this has made them doubt whether proper administration of resources would be ensured at the first pension level. According to the summoned

person, the decision to reduce contribution rate into the funded pension scheme has been adopted with the view to improve social budget indices rather than to solve problems that have led to deficit of the social budget.

The summoned person draws attention to the fact that social protection system is based on the principle of solidarity, namely, the society associates itself with a view to reach short-term and long-term aims. This means that persons who make social insurance contributions ensure disbursement of pensions to current pensions, as well as the fact that the elder generation associates itself with the young one by accepting measures that would guarantee social security of the following generations in the old age.

The Constitutional Court has established:

13. The Applicant asks the Constitutional Court to assess compliance of the Contested Norms with the principle of legitimate expectations that follows from Article 1 of the Satversme. Likewise, the Applicant asks to assess compliance of the Contested Norms with the principle of a socially responsible State that follows from the body of social rights guaranteed in the Satversme, as well as compliance with the property right enshrined in Article 105 of the Satversme and the right to social security established in Article 109 of the Satversme.

The duty of the State to observe in its activities a range of fundamental principles of a law-governed State, including that of legitimate expectations, follows from the notion of a democratic republic included in Article 1 of the Satversme. Public institutions must be consistent in their activities in relation to adopted normative acts, as well as they should observe legitimate expectations conferred to persons by a particular legal norm (*see: Judgment of 10 June 1998 by the Constitutional Court in the case No. 04-03(98), concluding part, and Judgment of 24 March 2000 in the case No. 04-07(99), Para 3 of the concluding part*).

The Latvian constitutional legislator has determined several social rights in the Satversme. Thus the legislator has determined that Latvia is a socially responsible State,

namely, such a State, which is trying to potentially extensively realize social justice in legislature, administration and court adjudgment (*see: Judgment of 2 November 2006 by the Constitutional Court in the case No. 2006-07-01, Para 18*).

The Constitutional Court has already concluded that The content of a socially responsible state is broader if compared to the content of any particular social right; however, the right to social security is one of the most characteristic elements of this principle (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 14*).

It has already been established in the case-law of the Constitutional Court that, when assessing compliance of legal norms with those principles that follow from fundamental constitutional values of the State established in Article 1 of the Satversme, it should be taken into account that manifestation of these principles in different fields of lay may differ (*see, e.g.: Judgment of 8 November 2006 by the Constitutional Court in the case No. 2006-04-01, Para 15.2 and Para 15.3, and judgment of 21 December 2009 in the case No. 2009-43-01, Para 21*). In cases when compliance of a norm on social law with principles that follow from Article 1 of the Satversme and those that follow from Article 109 of the Satversme is contested, usually compliance of the norms with Article 1 of the Satversme is assessed in conjunction with Article 109 of the Satversme.

Consequently, compliance of the Contested Norms with the principle of legitimate expectations and that of a socially responsible State must be assessed in conjunction with Article 109 of the Satversme.

13.1. The Applicant holds that the Funded Pension Law establishes a direct link between contributions made by a person and pension capital accumulated; therefore the Contested Norms must be assessed in conjunction with the property right enshrined in Article 105 of the Satversme.

However, it can be concluded from the reply of the Saeima that the Contested Norms apply to the field of social rights, and the present case deals with the freedom of action of the legislator to establish the amount of the right to social security established in the Satversme.

The Constitutional Court has already indicated that the right to pensions irrespectively the date of granting a pension or source of funding pertain to the content of

the notion “property” included in the first sentence of Section 105 of the Satversme (*see: Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 20*).

The Constitutional Court has also concluded that Article 105 of the Constitution guarantees to persons legal protection of a lesser extent than Article 109 of the Constitution. It has also been established in the case-law of the Constitutional Court that it is not necessary to separately assess compliance of a legal norm of social law with Article 105 of the Satversme if it has already been established that the norm does comply with Article 109 of the Satversme (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 20, and Judgment of 29 October 2010 in the case No. 2010-17-01, Para 6.3*).

Consequently, if any legal norm of social law pertains to the scope of Article 105 and Article 109 of the Satversme, the Court shall assess compliance thereof with Article 109 of the Satversme only.

13.2. The Applicant has indicated that he questions compliance of reduction of contribution rate into the funded pension scheme with the Satversme.

The amount of social insurance contribution and its percentage in the framework of the social budget are usually established based on calculations of social expenses and prognosis of growth of GDP, demographic situation in the State, and socio-economical policy implemented by the State in the long term, as well as policy of the legislator regarding mandatory and voluntary social insurance (*see: Walton J. Pension Schemes: Social Insurance and Social protection, International Monetary Fund, London, 2003, pp. 1 – 5, <http://www.imf.org/external/np/sta/ueps/2003/070103.pdf>, consulted on 10 November 2010*).

Usually the political dimension of the decisions of the state and especially that of its legislator in realization of social rights is important, namely, decisions in this sector are usually adopted more on the basis of political and not legal reasons (*see: Judgment of 25 February 2002 by the Constitutional Court in the case No. 2001-11-0106, Para 1 of the concluding part, and judgment of 8 November 2006 in the case No. 2006-04-01, Para 16*).

However, political decisions, too, are restricted by the Satversme; therefore the limits of action of the legislator, when adopting decisions in the field of social rights, must comply with norms and principles of the Satversme.

In the field of social law, the boundary between legal argumentation and political considerations cannot always be precisely established. The Constitutional Court has recognized that it is possible to assess to a certain extent the contents of the Satversme norms also from the legal viewpoint by first establishing the content of legal norms and principles (see: Judgment of 16 December 2005 by the Constitutional Court in the case No. 2005-12-0103, *Para 17*).

The special character of social rights also determines the limits of control executed by the judicial power in this field. Criteria that should be applied when assessing compliance of a legal norm with the right to social security may differ depending on the fact whether the particular norm restricts the rights conferred to the person or obligates the State to implement its positive duty (*see: Judgment of 2 November 2006 by the Constitutional Court in the case No. 2006-07-01, Para 13 and Para 14, and Judgment of 21 April 2009 in the case No. 2009-86-01, Para 9*).

13.3. The Applicant holds that Para 3 (4) of Transitional Provisions has a retroactive force because social insurance contributions made before adoption of the Contested Norms are registered in the funded pension scheme already at the amount established by the Contested Norms.

Section 9 of the Law “On the Procedure of Proclaiming, Publishing, Coming into Effect and Validity of the Laws and Other Acts Adopted by the Saeima, the State President and the Cabinet of Ministers” provides: “Normative acts shall not have retroactive force, unless otherwise established by law.”

A law cannot be conferred a retroactive force in all cases because it is necessary to observe the general legal principles that protect legitimate expectations of persons against unexpected amendments into legal regulatory framework.

Consequently, compliance of Para 3 (4) of Transitional Provisions with norms of a higher legal force should be assessed along with compliance of the Contested Norms with the principle of legitimate expectations.

13.4. It has been established in the case-law of the Constitutional Court that the legislator shall have the right to amend legal regulation in the field of social rights provided that the principle of legitimate expectations is observed (*see: Judgment of 29 October 2010 by the Constitutional Court in the case No. 2010-17-01, Para 12*).

When adopting the Funded Pension Law, the legislator established a minimum contribution rate into the funded pension scheme, as well as the procedure for gradual increase of the contribution rate up to the date when the scheme established by the law would start functioning at full extent. Consequently, the legislator, when elaborating the funded pension scheme, has also established a transitional period by establishing gradual introduction of this scheme.

When adopting the Contested Norms, the legislator has not only changed the contribution rate to be paid into the funded pension scheme, but also extended the term of introduction of the funded pension scheme. Consequently, the Contested Norms form a common, mutually related and inseparable regulatory framework. The Contested Norms taken as a common regulatory framework has an impact on the scope and content of each norm because, if taken together, they regulate development of the funded pension scheme.

Consequently, the Constitutional Court, when assessing compliance of the Contested Norms with a legal norm of a higher legal force, shall assess them as a single regulatory framework.

14. It follows from Article 19.² (1) of the Constitutional Court Law that, when adjudicating a case having regard to a constitutional complaint, the Constitutional Court shall have the duty to establish infringement of fundamental rights of a person.

The Ombudsman has indicated that the Contested Norms do not yet infringe the rights or legal interests of the Applicant that follow from Article 109 of the Satversme.

In the assessment of the restrictions to a person's rights, both the risk that this restriction would inevitably affect a particular person and the possible infringement of the person's lawful rights must be taken into consideration (*see: Judgement of 18 February*

2010 by the Constitutional Court in Case No. 2009-74-01, Para 12.1, and judgment of 22 June 2010 in the case No. 2009-111-01, Para 10).

The Constitutional Court has already indicated that, due to their specific nature, only by examining a case on its merits it is possible to establish whether in a particular case fundamental rights of a person have been infringed (*see: Judgment of 7 April 2009 by the Constitutional Court in the case No. 2008-35-01, Para 11.3*).

The right of a person to social security after having reached a particular age, are closely related with effective functioning of social protection system; therefore the Constitutional Court holds that the issue regarding possible infringement of the fundamental rights of the Applicant shall be assessed by first establishing whether the Contested Norms pertain to the content of the fundamental rights established in Article 109 of the Satversme.

15. Article 109 of the Satversme provides: „Everyone has the right to social security in old age, for work disability, for unemployment and in other cases as provided by law.”

The Constitutional Court has indicated that Article 109 of the Satversme guarantees the inhabitants the right to a stable and predictable, as well as effective, fair and sustainable system of social protection that ensures a proportional social security (*see, e.g.: Judgment of 15 April 2010 by the Constitutional Court in the case No. 2009-88-01, Para 8*).

The funded pension scheme is a part of the pension system existing in Latvia, which gives a person the possibility to accumulate extra pension capital without increasing the total contribution amount for old-age pensions and by making a part of contributions into finance instruments.

Pursuant to Section 3 (1) and (2) of the Funded Pension Law, all persons who are subject to the State pension insurance and who have not reached the age of 50 years on the day of coming into force of the funded pension scheme shall be registered as participants of a funded pension scheme. The legislator has established that participants of the funded pension scheme who have reached the age that gives them the right to

receive pension or later has the right to choose whether to add the accumulated capital of funded pension to the unfunded pension capital or to recalculate old-age pension, or to purchase a life insurance policy using the accumulated capital of funded pension.

Since the right to social security pertains to social rights, the State shall enjoy freedom of action to select measures and mechanisms for implementation of these rights (*see: Judgment of 13 March 2001 by the Constitutional Court in the case No. 2000-08-0109, first paragraph of the establishing part*).

The Constitutional Court has already concluded that Article 109 of the Satversme does not guarantee the right to certain kinds of pensions, including the long-service pension that is calculated based on certain criteria or provided at a certain amount (*see: Judgment of 31 March 2010 by the Constitutional Court in the case No. 2009-76-01, Para 6.1*). Consequently, when assessing economic possibilities of the State and other circumstances, the legislator shall have the right to use freedom of action and form a social security system by establishing general principles of its functioning, procedure for making contributions, administration, management and disbursement of funds.

However, the Constitutional Court has already indicated the following in its case-law: “If the legislator, making use of its authority in creation and realization of the social policy as well as in determination of the amount of social rights, has incorporated social rights into the Satversme and has specified the contents of these rights in laws, then they have turned into the rights of an individual. A person may request realization of these rights from the State as well as protect his/her rights at the court.” (*see: Judgment of 19 March 2002 by the Constitutional Court in the case No. 2001-12-01, Para 2 of the concluding part*).

Consequently, the Contested Norms do pertain to the content of the right to social security guaranteed in Article 109 of the Satversme.

16. The term "social guarantees in old age" used in Article 109 of the Satversme includes disbursement the person receives in compliance with schemes of social insurance (*see: Judgment of 26 June 2001 by the Constitutional Court in the case No. 2001-02-0106, Para 3 of the concluding part*).

When adopting the Contested Norms, the legislator has not restricted the right of a person to social security in old age because the right of participants of the funded pension scheme to disbursement of a pension are preserved irrespective of the pension level, where to a person has made contributions. By means of the Contested Norms, allocation of social insurance contributions is changed between the first and the second pension level.

If the legislator has decided to establish such pension system, wherein amount of pension depends on participation of a person in accumulation of pension capital, then Article 109 of the Satversme requires that all further activities of the State regarding such pension system would comply with the principles of a law-governed State.

When assessing whether the State has fulfilled the duty that follows from social rights, the Constitutional Court will investigate the following: 1) whether the legislator has taken measures to ensure persons with the possibility to exercise their social rights; 2) whether these measures have been taken timely, namely, whether persons are ensured with the possibility to exercise their social rights at least at the minimum level; 3) whether the principle of legitimate expectations and that of socially responsible State have been observed.

17. Before 1 January 1996, the Latvian pension system was based on the principle of re-allocation, namely, there was no relation between the amount of social contributions and amount of pension. This did not facilitate making of social contributions and interest of employees in securing their old age (*see: Judgment of 19 March 2002 by the Constitutional Court in the case No. 2001-12-01, Para 1 of the concluding part and pp 4 of the Pension Reform Concept, case materials, pp.3, vol. 70*).

In 1994 – 1995, pension system reform was launched. In the result of long political discussions and consultations, it was decided to form such pension system, wherein material provision risk at the old age would be divided between the State (tax payers) and resources accumulated by a person in the obligatory or voluntary pension scheme.

In 1995, the Saeima accepted the Pension Reform Concept and planned to introduce pension system of three levels that would include an adolescent solidarity

pension scheme, a funded pension scheme, and private pension funds. The legislator was planning to elaborate such pension system that could preserve stability irrespective of economic changes (*see: pp. 10 of Pension Reform Concept, case materials, Vol.3, pp. 76*). Fundamental principles of pension system, circle of insured persons and the procedure for accumulating resources were established in the Law “On State Pensions”. By adopting this Law, principles of State mandatory pension insurance system based on insurance contributions were introduced in Latvia.

The legislator also elaborated regulatory framework that gave possibility to persons to accumulate resources in private pension funds by making contributions in their own favour and thus ensuring additional pension capital (*see: Law “On Private Pension Funds” // Latvijas Vēstnesis, 20 June 1997, No. 150/151*).

Taking into account demographic prognosis, the legislator decided to accumulate a part of social insurance contributions meant for pensions outside the framework of an adolescent solidarity scheme. According to the legislator, formation of the funded pension scheme would facilitate accumulation of funds and would also serve as extra support for the social security system (*see: case materials, Vol. 2, Para 143*).

When adopting the Funded Pension Law, the pension system reform was terminated. Its aim was to establish financially stable system that would be able to adapt to demographic situation and facilitate interest of person into paying taxes, staying in the labour market as long as possible, and facilitating development of the State in general.

Pension reform that introduced the system of accumulating pension capital at several levels was regarded as one of the most advantageous structural reforms in Latvia (*see, e.g.: Par Latvijas pensiju sistēmas starptautisko novērtējumu // Latvijas Vēstnesis, 10 April 2001, No. 57; Kad Latvijas pensiju sistēmu uzskata par paraugu Eiropai // Latvijas Vēstnesis, 19 February 2002, No. 27*).

When analyzing the Latvian pension system, the Constitutional Court has indicated that this system not only allows hoping that a person could receive material support that depends on the circumstances at the moment of granting a pensions, but it also establishes rights to count on the fact that the amount of a pension shall be defined in accordance with the scheme of pension calculation provided for in the normative acts. The pension system should ensure availability of pension in proportion to the amount of

person's participation in this system, whereas inconsiderate or hasty decisions may considerably endanger the sustainability and well-balanced continuation of the system (see: *Judgment of 8 June 2007 by the Constitutional Court in the case No. 2007-01-01, Para 20, and judgment of 21 December 2009 in the case No. 2009-43-01, Para 23*).

Consequently, when reforming the pension system, especially by creating the funded pension scheme, the legislator has taken measures to ensure persons, as much as possible, the possibility to exercise the right to social security established in Article 109 of the Satversme when having reached a particular age.

18. Article 109 of the Satversme commits the State to form and maintain the social security system in general (see: *Judgment of 29 October 2010 by the Constitutional Court in the case No. 2010-17-01, Para 10.2*).

The Constitutional Court has already indicated that the main challenge of the pension system is to ensure its sustainability. The sustainability of pension system is based on three principles: adequacy, financial sustainability and capability to adapt itself to changes (see: *Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 27.2*).

The funded pension scheme was launched rather recently; therefore participants of pension plans have not yet managed to accumulate such extra pension capital that could be regarded as a considerable replacement of wage. However, by continuing making contributions into pension plans in an extended period of time, it planned that this art would constantly become greater (see: *Concept on the social security system long-term stability, informative part, pp. 16 – 17, [Konceptijas par sociālās apdrošināšanas sistēmas ilgtermiņa stabilitāti informatīvā daļa], <http://polsis.mk.gov.lv/view.do?id=3518>, consulted on 23 November 2010; the Concept was approved by Order of 17 November 2010 by the Cabinet of Ministers No.. 647 //Latvijas Vēstnesis, 23 November 2010, No. 185*).

Profitability of the funded pension scheme is conditioned by trends of contribution fund market. Fluctuations local and global stock markets have a direct impact on the future amount of pensions. Risks related with contributions into pension plans are

undertaken by participants of a particular pension plan when selecting manager of the pension scheme.

Consequently, persons are rather uncertain about receiving pension that would be sufficient for them and proportional with their contributions made during employment period (*see: Voļskis E. Pensiju sistēmas pilnveidošanas problēmas Latvijā. Promocijas darbs. Rīga: Latvijas Universitāte, 2008, pp. 25*).

The three levels of the pension system are elements of a single system that supplement and impact each other. The system ensures adequate incomes that do not burden future generations and ensures justice and solidarity as a possibility to react to changing needs of persons and the society (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 24*).

The legislator has left unchanged provisions regarding retirement and the procedure of pension recalculation.

Consequently, in the particular case, the right to social security at least at the minimum extent are not infringed.

19. The Applicant holds that the Contested Norms do not comply with the principle of legitimate expectations.

The Constitutional Court has already indicated that the principle of legitimate expectations does not exclude the right of the State to amend existent regulatory framework. An opposite approach would lead to inability of the State to react to changing living circumstances. The principle of legitimate expectations requires that the State, when amending normative regulatory framework, would observe a reasonable balance between trust of a person and those interests, in favour of which regulatory framework is being amended.

Consequently, in order to assess whether the legal act that provided for deviation from the rights conferred to a person comply with the principle of legitimate trust, the following should be investigated: 1) whether a person has been conferred legal security to safeguarding or implementation of any particular rights; and 2) whether a reasonable balance between protection of legal security of a person and ensuring of interests of the

society has been observed (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 23*).

20. In order to establish whether the Applicant was given any legitimate expectations to preservation or exercise of particular rights, it is necessary to assess whether his trust into the Contested Norms was legitimate, well-grounded and reasonable, and whether the legal regulation in its substance is definite and constant enough so that one can trust in it (*see: Judgment of 19 March 2002 by the Constitutional Court in the case No. 2001-12-01, Para 3.2 of the concluding part, judgment of 25 October 2004 in the case No. 2004-03-01, Para 7, and judgment of 8 November 2006 in the case No. 2006-04-01, Para 21*).

20.1. The funded pension scheme was elaborated based on Order No. 184 of 20 June 1997 by the Cabinet of Ministers “On Elaboration of State Funded Pension Scheme Concept” (hereinafter – the funded pension scheme concept). The draft law on introduction of the funded pension scheme was submitted to the Saeima already on 30 November 1998 (*see: register of draft laws of the 7th Saeima, http://helios-web.saeima.lv/saeima7/reg_gk, consulted on 15 November 2010*).

In order to reach the aim of creation of the funded pension scheme, which is to ensure accumulation of pension capital, the legislator has initially established that the contribution rate cannot be less than two percent of social insurance contributions (*see: Section 4 of the draft law “State Funded Pension Law”, wording of 3 December 1998, and register of draft laws of the 7th Saeima, http://helios-web.saeima.lv/saeima7/reg_gk, consulted on 15 November 2010*).

On 17 February 2000, when adopting the Funded Pension Law, the legislator established that the contribution rate into the funded pension scheme shall be ten percent of the social insurance contributions. Para 2 of Transitional Provisions also established that the contribution rate established in Section 4 (2) of the Funded Pension Law shall come into force on 1 January 2010. Para 3 of Transitional Provisions establishes gradual increase of the contribution rate from two percent up to the date of coming into force of the contribution rate established in Section 4 (2) of the Funded Pension Law.

When elaborating such regulatory framework, the legislator has decided to gradually increase amount of accumulated resources. First, it was established that the Funded Pension Law would come into force on 1 July 2001. The legislator has also established that from 1 July 2001 to 2008, two percent of social insurance contributions shall be transferred to the funded pension scheme.

Consequently, normative regulatory framework of the funded pension scheme shall be regarded as definite enough. Provisions and principles that establish the possibility to accumulate pension capital were elaborated into the law; therefore a person could trust into functioning of the funded pension scheme.

Establishment of the funded pension scheme and fundamental principles on operation of it established in the law gave grounds to persons to trust into the fact that funded pension scheme would be implemented in such a way to facilitate accumulation of pension capital.

20.2. In the basis of the funded pension scheme, there lies long-term prognosis of demographical and economical indices. When elaborating the concept for the funded pension scheme, it was assumed that it would be necessary to correct economical and demographic prognosis during its operation, meanwhile also changing terms of functioning of the scheme, this relating to, for instance, contribution rates. Initially, contribution rate into the funded pension scheme was planned at the amount of three to seven percent of the social insurance contributions (*see: Funded pension scheme concept, case materials, Vol.2, pp.144 – 146*).

When elaborating the Funded Pension Law, the legislator prognosticated such social budget deficit that would reach the greatest amount of this budget by 2004; however, it would then gradually reduce. Therefore, the budget would run short of resources for disbursement of pensions. Therefore such provisions that ensure stable formation of pension capital and would not influence disbursement of pensions were supported (*see: Transcript of the Saeima meeting of 17 October 2000, <http://www.saeima.lv/steno/2000/st1702.html>, consulted on 17 November 2000*).

It follows from the aforesaid that allocation of contribution rates between the first and the second pension level must be established by the legislator after having assessed sufficiency of financial resources of the pension system. When performing such

assessment, it is necessary to take into account financial situation of the social budget and prognosis of economic development of the State, as well as prognosis regarding long-term stability of the pension system and demographic indices.

Financial and economic crisis has amplified impact of trends of demographic aging on successful operation of the pension system [see: *European Commission Green Paper – towards adequate, sustainable and safe European pension systems, SEC(2010)830, Brussels, 7 July, 2010 pp. 3*].

It is permitted to reduce financing of the funded pension scheme only in exceptional cases established by law, and such reduction should be of a short-term character. However, even under particularly grave economic circumstances the amount of social insurance contribution rate into the funded pension scheme can be reduced only insofar as for this scheme be to able to ensure accumulation of pension capital.

Consequently, character and principles of the funded pension scheme show to a possibility to change contributions into the scheme by preserving the aim of formation of the scheme, which is to facilitate accumulation of pension capital.

20.3. The stipulated contribution rate into the funded pension scheme has not yet been reached because the transitional period established by law has been extended several times.

On 25 September 2008, the Saeima adopted the Law “Amendments to the State Funded Pension Law” by thus extending the transitional period and establishing that the contribution rate established in Section 4 (2) of the Funded Pension Law shall come into force on 1 January 2011.

It has been indicated in the annotation to the draft law that “the normative act will have a positive impact on development of the society because, by transferring resources to ensuring of disbursements from the first pension level, material provisions of pensioners with considerable length of insurance period and small pensions” [*annotation to the draft law “Amendments to the State Funded Pension Law” (No. 778/Lp9), <http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/85989A3F967A6202C22574C10036F977?OpenDocument>, consulted on 16 November 2010*].

At the Saeima meeting of 18 September 2008, when the above mentioned draft law was considered at the first reading, a member of the Saeima Kārlis Leiškalns reported that such amendments are necessary “in relation to those additional payments that have already been allocated to pensioners and disabled persons, especially those pensioners who retired before 1 January 1996. I am talking about the previously mentioned 70 santimes. Consequently, we have already adopted the law, and this draft law enables us to find money”. The member of the Saeima also emphasized that persons who participate in the second and the third pension level trust in the effective law (*see: transcript of the Saeima meeting of 18 September 2008, <http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/02FC88AA21FE604DC22574D3002CCC53?OpenDocument>, consulted on 16 November 2010*).

Social protection system cannot be used as an instrument for reaching of short-term aims. The legislator must consider impact of each decision on sustainability of the pension system and take timely measures to prevent economical and demographic risks. By failing to timely prevent all risks, the pension system can be weakened so much that restoration of its normal functioning would require even more time and greater amounts of resources.

The legislator not only elaborates legal regulatory framework for funded pensions, but also decides on circumstances, under which amendments into the pension system shall be made. The legislator has the right to amend provisions of the funded pension scheme if this has a legitimate aim, objective reasons, and proper justification.

Consequently, extension of the transitional period for complete introduction of the funded pension scheme is permissible if this is justified by social considerations.

20.4. When adopting the Contested Norms, the legislator has reduced the contribution rate established in Section 4 (2) of the Funded Pension Law from ten to six percent. Meanwhile it has extended the transitional period up to 1 January 2012.

Contested Norms assed in the frameworks of the present case do not establish a general change of the State policy regarding functioning of the funded pension scheme; however, it reduced the amount of resources to be deposited for a certain period of time.

The Applicant reasonably draws attention to the fact that a participant of the funded pension scheme has agreed to become a party to such scheme under the provisions that were effective at the time when he or she made the decision. The legislator has not given voluntary participants of the funded pension scheme the possibility to terminate their participation in the scheme.

The Constitutional Court has already established that a legal norm that has not yet been applied may constitute a protected legal security if it provides for planned rights. Namely, if rights are envisaged in the particular normative act but not all preconditions for the exercise of the rights are yet present. Such legal security is conferred particularly in case if a legal norm applies to legal relations already initiated (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 25*).

The same conditions can be established in relation to participation in the funded pension scheme, namely, a person had already made the choice in favour of participation in the funded pension scheme, legal regulation of which gave a possibility to accumulate pension capital. Consequently, the fact that a person has not yet reached the retirement age impacts the protection level of his or her legitimate expectations rather than the fact that such legitimate expectations could not even be given.

Consequently, the Applicant had legitimate, well-grounded and reasonable trust into the fact that the funded pension scheme would be implemented in a way that would envisage the possibility to accumulate extra pension capital.

21. When assessing whether a reasonable balance between the necessity to protect legitimate expectations of persons and that to ensure interests of the society has been observed, it is necessary to investigate whether a lenient transition to the new regulatory framework has been established.

The Constitutional Court has already concluded in its case-law that a lenient transition to a new regulation is characterized by establishment of a reasonable term or a due compensation (*see: Judgment of 25 March 2005 by the Constitutional Court in the case No. 2002-12-01, Para 2 of the concluding part*). However, the aforesaid does not exclude that it is possible to establish such lenient transition by means of other mechanisms. In certain cases, when balancing the amount of the restriction of legal

security and the necessity and urgency of amendments to legal regulation, deviation from the rights guaranteed to a person is permissible without providing a transitional period. Moreover, in separate cases such lenient transition is not the only criterion that determines whether a reasonable balance has been observed (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 25*).

21.1. Pursuant to Para 3 (4) of Transitional Provisions, the reduced rate shall be applied to contributions which are registered from 1 May 2009 in the account of a participant of a funded pension scheme.

Para 46.2 of 27 May 2003 Cabinet of Ministers Regulation No. 272 “Regulations on Operation of the State Funded Pension Scheme” provides that compulsory contributions of an employee to the account of a scheme participant shall be registered no earlier than on the first business day of the fourth month following the reporting month and no later than on the tenth business day. Therefore, social insurance contributions made since January 2009 into the funded pension scheme had to be registered from 1 May 2009. It follows from the case materials that after 1 May 2009 the VSAA registered contributions in accounts of participants of the funded pension scheme by applying the contribution rate of two percent (*see: case materials, Vol. 1, pp. 20*).

Consequently, contributions from those social insurance payments that were made before adoption of the Contested Norms, i.e. 1 May 2009, were transferred to the funded pension scheme.

The legislator has not changed provisions of functioning of the funded pension scheme in relation to registration of the contribution rate. Participants of the funded pension scheme are aware of the registration procedure. However, as to social insurance payments already made, a person had the right to count on the fact that these payments would be registered at the amount established by the law effective before adoption of the Contested Norms.

The Saeima has indicated that the aim of the Contested Norms is to ensure functioning and sustainability of the pensions system to at the time when it is necessary to balance incomes and expenses of the social budget.

The Ministry of Finance has furnished information that in 2009, as the contribution rate into the funded pension scheme reduced to the amount of two percent,

incomes of the social budget into the first pension level have increased by 166 million lats.

The Constitutional Court has already concluded that the situation of the social budget is linked with the general economic situation of the State, which, since the beginning of 2009, was characterised by reduction of economic activities, cut of salaries, and increase of unemployment rate. The above mentioned circumstances determined reduction of the amount of social insurance contributions (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 27.1, and judgment of 15 March 2010 in the case No. 2009-44-01, Para 20*).

The Constitutional Court has no reason to question that the Contested Norms reduce threat to the pension system constituted by economic crisis.

In a law-governed State, cases when a law is conferred a retroactive effect are regarded as exceptional. However, in certain cases, the legislator does have the right to confer such retroactive effect to a law with the purpose to protect constitutional values.

Consequently, when assessing whether a fair balance has been observed, it is necessary to compare protection of legitimate expectations of a person with the necessity to amend a particular regulation in the interests of the entire society.

21.2. The Constitutional Court has already indicated in its case-law that under the circumstances of rapid economical fall or in any other extraordinary situation the principle of legal security requires balancing of legitimate expectations of persons and interests of the society. The decisive role is plaid by the fact whether the principle of proportionality has been observed (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 25*).

Balancing of the special budget of social insurance shall be regarded as the grounds for guaranteeing sustainability of the budget and confidence into the fact that the right of the following generations to social security would be realized (*see: Judgment of 26 November 2009 by the Constitutional Court in the case No. 2009-08-01, Para 18.2*).

Consequently, the Contested Norms do have a legitimate aim, which is ensuring of sustainability of the social insurance budget by balancing incomes and expenses of it, and, consequently, protection of welfare of the society.

21.3. Measures, chosen by the legislator may be regarded as proportionate for reaching the legitimate aim only if they are in compliance with the principle of the socially responsible state (*see: Judgment of 2 November 2006 by the Constitutional Court in the case No. 2006-07-01, Para 18*).

The duty of the State to form a sustainable and balanced policy to ensure welfare of the society follows from the principle of a socially responsible state. The State has to coordinate not only the rights of a person in the social field but also the necessity to ensure welfare of the entire society with its economical possibility, as well as to elaborate such regulatory framework that would be aimed at sustainable development of the State.

At the Saeima discussions, when considering the Contested Norms at the second reading, it was indicated, among the rest, that such amendments could undermine trust of persons into the pensions system in general and reduce interest of persons to pay taxes (*see: Transcript of Saeima meeting of 23 April 2009, <http://titania.saeima.lv/LIVS/SaeimaLIVS.nsf/0/847FC04251AB35AFC22575A6002BD647?OpenDocument>, consulted on 24 November 2010*).

The Strategic Analysis Commission of the State President has indicated that the majority of the society is ready to cease fulfilling their obligations in front of the State and paying taxes with a view to ameliorate financial situation of them (*see: Para 6 of the report of the Strategic Analysis Commission of the State President on mood of the society in 2009, [Valsts prezidenta Stratēģiskās analīzes komisijas pārskata ziņojuma par sabiedrības noskaņojumu 2009. gadā] <http://polsis.mk.gov.lv/view.do?id=3168>, consulted on 24 November 2010*).

Consequently, the legislator, when introducing amendments into the funded pension scheme, has to elaborate such legal regulatory framework that would be aimed at sustainable development of the funded pension scheme.

21.4. The Contested Norms constitute a single regulatory framework. When adopting the Contested Norms, the legislator established that two percent out of social insurance contributions shall be transferred to the funded pension scheme.

The Contested Norms preserve the aim of establishment of the funded pension scheme, namely, such amount of contributions is being transferred to the funded pension

scheme that the legislator has initially established as the minimum amount for accumulation of capital.

When Adopting Para 3 (5) of Transitional Provisions, the legislator has established that, as from 1 January 2011, contribution rate into the funded pension scheme shall be no less than four percent. Consequently, the legislator has established procedure, according to which operation of the funded pension scheme would be facilitated. Namely, in Transitional Provisions, the le legislator has established a mechanism for balancing of contributions between the first and the second pension level for persons to be able to accumulate pension capital.

Consequently, reduction of contribution rate into the funded pension scheme is possible if the meaning and aim of creating this scheme is not threatened, and the gradual increase of contribution rate in accordance with economic possibilities of the State, as established in Transitional Provisions, is observed.

When comparing significance of interests of the Applicant and those of the entire society, it can be concluded that, in the case under review, the Contested Norms compensates the fact that the rights of person, implementation of which could be counted upon, were restricted.

Consequently, the Contested Norms do not infringe the principle of legitimate expectations, and therefore they comply with Article 1 and Article 109 of the Satversme.

The Constitutional Court

Based on articles 30 – 32 of the Constitutional Court Law,

h o l d s :

Section 4 (2) of the Law on State Funded Pensions and Para 2 (3), (4) and (5) of Transitional Provisions thereof taken as a single regulatory framework does

comply with Article 1, Article 105 and Article 109 of the Satversme of the Republic of Latvia.

The Judgment shall be final and not subject to appeal.

The Judgment shall come into force on the date of publishing it.

Presiding Judge

G. Kūtris

Translated by Egija Labanovska, translator of the Constitutional Court