FINANŠU UN
KAPITĀLA
TIRGUS
KOMISIJA

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The Year 2002 in the Financial and Capital Market

Overall, 2002 was a year of dynamic development for the Latvian financial sector. This can be attributed both to Latvia's continued economic development and to its advancement towards the European Union (hereinafter – EU) and NATO. Membership in these two organizations should further add to the country's stability.

Latvia retained a high gross domestic product (GDP) growth rate (6.1%) in 2002, as well as its leading position as the most rapidly growing economy in Eastern and Central Europe. The International Monetary Fund and financial sector experts from the European Union appreciated the development of the Latvian financial sector in 2002. Taking into account these developments and various other measures taken by the Government for strengthening Latvia's market economy, the rating agencies Standards & Poor's and Moody's Investors Service raised Latvia's long-term foreign currency liabilities rating to BBB+ and A2, respectively.

2002 was one of the three most profitable years in the history of Latvian banking. All of the country's banks earned a profit, which exceeded 50 million lats in total. The total assets of the country's banking sector exceeded 4 billion lats, while the credit portfolio surpassed 2 billion lats. In 2002, bank deposits increased by 31.8 % to 3.1 billion lats, which indicates that depositors' confidence in Latvian banks continues to grow. At the end of 2002, 69.9 % of Latvian residents had either a positive or a neutral attitude towards the country's commercial banking system.

The year 2002 was particularly successful for credit unions, whose total asset volume grew by 64% in 2002. The amount of loans issued by credit unions rose at an even higher rate (71%). Five new credit unions launched their operations last year, thus widening the range of financial services available to Latvian rural residents.

Since 1 January 2003, significant changes have occurred in Latvia's deposit guarantee scheme. The deposit guarantee system was extended to cover also deposits of legal persons in banks and credit unions. Although today the guaranteed compensation per person per bank or credit union is set at 3 000 lats, this amount will reach the minimum level prescribed by the European Union (20 000 euros, or 13 000 lats) within the next five years.

[1] Latvia's GDP in 2002 was 5.1947 billion lats, according to data published in the Internet home page of the Central Statistics Board of the Republic of Latvia.
[2] Public poll data of December 2002 of the Public Opinion Research Centre SKDS.

In 2002, Latvia's investor protection scheme also began operating, thus ensuring compensation payments to investors in cases related to the irreversible loss of securities. Particular attention is therefore paid to this subject in the Financial and Capital Market Commission's (hereinafter – the Commission) annual report for 2002. A detailed explanation of the customer protection measures for each financial sector is given.

The Latvian insurance sector experienced more dynamic development in 2002 than previously. The reporting year evidenced by far the largest volume of gross premiums written for life insurance in the last three years – 21% growth as compared to 2001. Insurance premiums written by non-life insurance companies also continued to increase, and grew by 5% as compared to the year before.

In 2002, the development of the Latvian securities market was marked by the stock market capitalisation of the Riga Stock Exchange, which diminished by 4.6% year-on-year and amounted to 418 million lats at the end of 2002. The total turnover of securities at the stock exchange dropped by 42 % to 311 million lats, of which the largest share was in transactions of debt securities. The Dow Jones Riga Stock Exchange index (in US dollars) fell 13.7% and was 148.86 points at the end of 2002.

In 2002, five investment companies obtained a licence from the Commission for the management of the second-tier pension scheme assets. Hopefully, this will promote the further development of Latvia's capital market. At the end of the reporting year, net assets of second-tier pension funds, which until the end of 2002 could only be managed by the State Treasury, reached 12.3 million lats. In 2002, the assets of private pension funds increased by more than 4 million lats to 15.6 million lats. Nevertheless, at the end of 2002, the participation of Latvia's residents in pension plans was very low: of 1.4 million employable persons, only 20 000, or 1.4% had their assets invested in private pension funds.

Overall, the Latvian financial and capital market is ready for integration into the European financial market. This is attested by the comprehensive implementation of the EU *acquis communautaire* in the regulatory enactments governing the Latvian financial and capital market.

In conclusion, I would like to express my special thanks to the staff of the Commission for their dedication and hard work. The setting-up of the Financial and Capital Market Commission was completed in 2002, and I am satisfied that we have succeeded in establishing a professional and consolidated body.

Uldis Cērps
Chairman
Financial and Capital Market Commission

[3] Data of the Riga Stock Exchange.

Report of the Board of the Financial and Capital Market Commission

The Commission operates as an autonomous public institution. The Commission carried out its activities in accordance with its approved strategy – to promote the stability and development of the Latvian financial and capital market, and to ensure the protection of interests of investors, depositors and the insured.

On 26 September 2000, the Chairman and the Deputy Chairman of the Commission were appointed to their posts by the (Parliament) of the Republic of Latvia for a period of six years, whereas the Members of the Board were appointed by the Chairman of the Commission, upon coordination of the relevant candidates with the Minister for Finance and the Governor of the Bank of Latvia. During the year 2002, the composition of the Board of the Commission did not change: Chairman – Uldis Cērps, Deputy Chairman – Jānis Brazovskis, Board Members – Jānis Placis, Gvido Romeiko, and Ludmila Vojevoda.

In 2002, 49 Board meetings took place, during which 25 decisions were taken that were binding on all financial and capital market participants, as well as 275 decisions pertaining to particular financial and capital market participants. Sixty-one decisions were taken regarding the management of the Commission's own activities. In total, 361 decisions were taken.

In 2002, specialists of the Commission participated in the formulation of four draft laws, and either drafted or amended 15 of the Commission's own regulations.

During the reporting year, the Consultative Council of the Financial and Capital Market (hereinafter – the Consultative Council) held 11 meetings. The Consultative Council gave a positive evaluation of the implementation of the Commission's budget for 2002. The Consultative Council believes that the Commission has successfully implemented the functions assigned to it for 2002 and has ensured the stability of Latvia's financial and capital market.

In 2002, while undertaking the supervision of Latvia's financial and capital market participants, the Commission identified and analysed the most substantial material risks incurred through the activities of each particular market participant, i.e. mainly credit risk and operational risk. During the reporting year, 44 examinations were conducted in banks (including five examinations of banks that are supervised on consolidated basis), 22 examinations in insurance companies (including five full-scope and 17 thematic inspections), two examinations in private pension funds, one examination in an investment company, 23 examinations in brokerage firms and banks performing intermediary activities, and nine comprehensive audits of information systems of individual market participants.

In 2002, the Commission's internal control system functioned efficiently. In order to ensure the Commission's continued top-quality performance and maintain the satisfaction of its cooperation partners, the Commission introduced and implemented a new Quality Management System that conforms with the ISO 9001:2000 international quality standard. In preparation for the final audit of the Commission's Quality Management System at the beginning of 2003, and in order to receive certification of this System's compliance to ISO 9001:2000 standards, the Commission underwent a pre-audit conducted

[4] The Consultative Council of the Financial and Capital Market is formed on a parity basis from representatives of the Commission and heads of professional organisations of financial and capital market participants.

by Bureau Veritas Quality International Latvia in December of 2002. In addition, the Commission asked its selected cooperation partners – the Bank of Latvia, the Ministry for Finance, and professional associations of market participants – to evaluate their relationship with the Commission in all major aspects (namely, the conducting of on-site examinations, consultations, the formulation of regulatory enactments and the preparation of information). For the most part, cooperation with the Commission was evaluated as either 'very good' or 'more good than bad.' The cooperation partners' proposals will be reviewed in order to further improve the Commission's performance.

During the reporting year, experts of the Commission improved their knowledge at workshops on International Accounting Standard 39, credit risk assessment, market supervision and prevention of laundering of proceeds derived from criminal activity, which were organised by the Joint Vienna Institute, the International Monetary Fund, the Organisation for Economic Cooperation and Development (OECD), the International Network of Pension Regulators and Supervisors (INPRS), the Financial Stability Institute, the Technical Assistance Information Exchange Office (TAIEX), the Financial Service Volunteer Corps (FSVC), the Association of Latvian Commercial Banks, and the Riga Graduate School of Law. Auditors of the Commission's information systems completed courses offered by the Information Systems Audit and Control Association in order to acquire Certified Information System Auditor (CISA) certificates.

In 2002, the Commission closed seven positions and reduced the number of its staff to 88. In order to increase efficiency and effectiveness in human resources management, Commission staff members attended the Baltic Management Conference. In addition, all managers of the Commission took a lecture course in human resources management offered by the Stockholm School of Economics in Riga.

In order to inform market participants of the latest developments pertaining to applicable regulatory enactments and current statistics, and to enable the general public to receive information on the Commission and market participants, the web page of the Commission on the Internet at www.fktk.lv was constantly upgraded and expanded.

The activities of the Commission in 2002 were financed from three sources – the State budget, the Bank of Latvia, and market participants. State budgetary funding decreased in both 2001 and 2002. Funding by the Bank of Latvia, upon an increase in market participant payments, will gradually decrease according to procedures and amounts specified by Latvian law. By 2007, the activities of the Commission will be financed exclusively from dues paid by financial and capital market participants. During the reporting year, the Commission did not provide any services for pay to the general public and did not receive any donations. The State Audit Office did not perform any audits relating to the activities of the Commission.

In 2002, the Commission approved its budget and action plan for 2003. This plan gives priority to on-site examinations of the operations of market participants, as well as to risk-based off-site monitoring.

Deposit Guarantee Fund

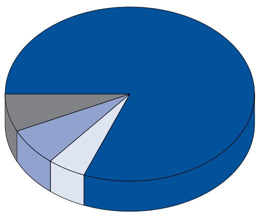
Deposits of natural persons with Latvian credit institutions have been guaranteed since 10 October 1998, in accordance with the Deposit Guarantee Law (formerly the Law on Natural Person Deposit Guarantees).

Since 1 January 2003, under the law's new amendments, assets accumulated by the Deposit Guarantee Fund (hereinafter – the Fund) must guarantee the deposits not only of natural persons, but also of legal persons up to the limit specified by law, which currently is 3 000 lats. This limit will rise to 13 000 lats per person per bank or credit union during the next five years, which equals the minimum amount specified in the European Community directives.

In accordance with Article 8 of Latvia's Deposit Guarantee Law, a deposit taker (a bank, a branch of a foreign bank, or a credit union) shall make quarterly payments into the Deposit Guarantee Fund amounting to 0.05% of the average balance of guaranteed deposits (of natural and legal persons) with the deposit taker during the previous quarter.

The assets of the Fund are accumulated and managed by the Commission. On 31 December 2002, the Fund had accumulated 7.6 million lats (see Figure 1):
1) payments by deposit takers in the amount of 6.3 million lats;
2) a single payment from the State budget in the amount of 0.5 million lats;
3) a single payment by the Bank of Latvia in the amount of 0.5 million lats; and
4) income gained from the management of the Fund's assets in the amount of 0.3 million lats.

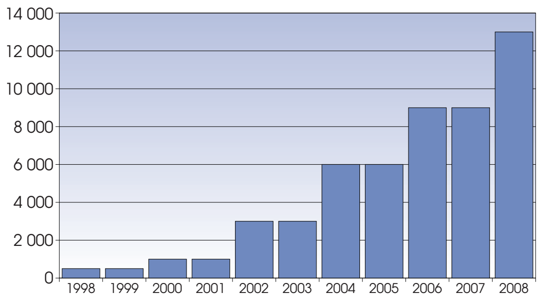
Figure 1
ASSETS ACCUMULATED BY THE DEPOSIT GUARANTEE FUND
(as of 31 December 2003)



The accumulation of the Fund's assets and guaranteed compensation payments are supervised by the Consultative Council of the Commission. If the Fund lacks the resources to make guaranteed compensation payments to depositors, then, in accordance with Latvian law, such payments shall be paid from State budgetary resources.

Until the end of 1999, compensation not exceeding 500 lats per depositor (natural person) per bank or credit union was guaranteed from the Fund's assets. This amount was raised to 1 000 lats in the year 2000 and to 3 000 lats in the year 2002. Since 2003 this amount also applies to legal persons. The Deposit Guarantee Law stipulates a guaranteed compensation of 6 000 lats per depositor in 2004 and 2005, 9 000 lats in 2006 and 2007, and 13 000 lats beginning in 2008 (see Figure 2).

Figure 2
INCREASE IN THE GUARANTEED COMPENSATION PER DEPOSITOR IN 1998-2008
(at end of period; lats)



As the information compiled by the Commission shows, more than 95% of all accounts opened within the Latvian banking system in 2002 had balances that did not exceed 3 000 lats. Thus, 95% of depositors were guaranteed the payment of their entire deposit amount during the reporting year.

In cases when deposits become unavailable to their depositors (according to court adjudication regarding the liquidation of a bank or a credit union or the initiation of bankruptcy proceedings), the Commission exercises the creditors' right to effect claims against banks or credit unions and effects guaranteed compensation payments to depositors no later than three months from the day the case of unavailability of deposits has occurred. To date, the Fund's assets have not been used for guaranteed compensation payments, as no such unavailability of deposits has occurred in the system of Latvian banks and credit unions since the Fund's establishment.

Fund for the Protection of the Insured

In order to protect the interests of the insured in the case of an insurer's bankruptcy, a Fund for the Protection of the Insured (hereinafter – Protection Fund) was set up in 1999. The assets of the Protection Fund are made up of deductions from insurance companies amounting to one per cent of the total of gross insurance premiums received from natural persons for specific classes of insurance as provided by law. The Protection Fund had accumulated 857 500 lats by 31 December 2002.

Both parts of the Protection Fund, i.e., the part comprising payments of life insurance companies and the part comprising payments of non-life insurance companies, were accumulated and managed separately. Indemnity payments could be received only by insurance policy holders who were natural persons:
1) for life insurance – 100% of the insurance indemnity, but not more than 2 000 lats per insurance policy holder;
2) for other classes of insurance provided by law – 50% of the insurance indemnity, but not more than 2 000 lats per insurance policy holder.

On 31 December 2002, the part of the Protection Fund comprising payments of life insurance companies totalled 188 500 lats (see Figure 3):
1) a single payment by the Insurance Supervision Inspectorate in the amount of 75 000 lats;
2) payments by life insurance companies amounting to 99 000 lats;
3) income gained from the management of the Protection Fund's assets amounting to 14 500 lats.

On 31 December 2002, the part of the Protection Fund comprising payments of non-life insurance companies amounted to 669 000 lats (see Figure 4):
1) a single payment by the Insurance Supervision Inspectorate in the amount of 75 000 lats;
2) payments by non-life insurance companies amounting to 547 000 lats;
3) income gained from the management of the Protection Fund's assets amounting to 47 000 lats.

Both the accumulation of assets in the Protection Fund and guaranteed indemnity payments are organised by the Commission. The oversight of the accumulation of assets in the Protection Fund and of guaranteed indemnity payments is carried out by the Consultative Council of the Commission.

A guaranteed insurance indemnity from the Protection Fund is only paid following the initiation of bankruptcy proceedings against an insurance company. The creditors' right to effect claims against insurers is exercised by the Commission. An insured person must submit an insurance indemnity application to the administrator of the insurance company within three months after the insurer has been declared insolvent. Since the start of operation of the Protection Fund, its resources have never been used for guaranteed indemnity payments.

Figure 3

PART OF THE FUND FOR THE PROTECTION OF THE INSURED COMPRISING PAYMENTS BY LIFE INSURANCE COMPANIES

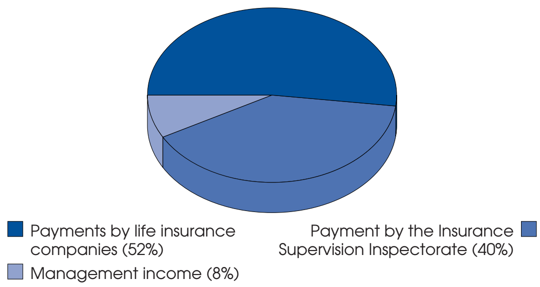
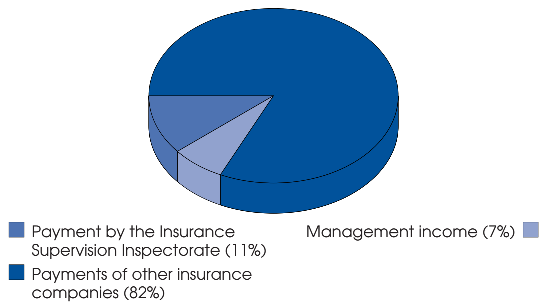


Figure 4

PART OF THE FUND FOR THE PROTECTION OF THE INSURED COMPRISING PAYMENTS BY NON-LIFE INSURANCE COMPANIES



Protection of Securities Market Clients (Investors)

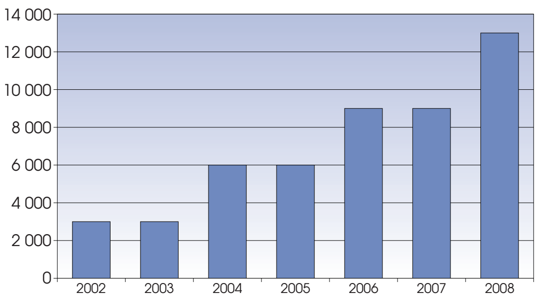
Since 1 January 2002, the Investor Protection Law has been in force in Latvia, ensuring the implementation of an investor protection scheme that complies with EU requirements. In cases where investment service providers (banks and brokerage firms) are not capable of meeting their obligations, investors have the right to receive compensation.

In contrast to the accumulation of assets in the Deposit Guarantee Fund and the Fund for the Protection of the Insured, assets intended for the compensation of investors are not accumulated in a fund. In cases where an investment service provider is unable to meet its obligations, the Commission – based on the quarterly financial reports submitted by investment service providers – calculates the proportionate payments to be made by each market participant (investment service provider) into an account opened in the Bank of Latvia for guaranteeing compensations by the defaulter.

In 2002, each investor (natural person) was guaranteed compensation amounting to 90% of the value of irreversibly lost financial instruments, or losses caused by a non-executed investment service, but no more than 3 000 lats per person in total. In 2004 and 2005, the maximum guaranteed compensation amount will rise to 6 000 lats, increasing further to 9 000 lats in the years 2006 and 2007 and to 13 000 lats in 2008 (see Figure 5).

If required, the Commission organises and supervises compensation payments made by market participants, verifies the validity of applications for compensation, and ensures compensation payments. An application for compensation shall be submitted within one year after the investor has become aware that the investment service provider has not met its obligations, but not later than five years from the date of default on obligations. Compensation shall be paid within a three-month period from the Commission's acknowledgment of an application for compensation as reasonable. To date, the Commission has not received any such applications.

Figure 5
INCREASE IN THE GUARANTEED COMPENSATION AMOUNT PER INVESTOR IN 2002-2008
(at beginning of period; lats)



Licensing

One of the most significant functions of the Commission has been the issue of licences to market participants, as well as the suspension or cancellation thereof.

At the end of the reporting year, there were 22 banks and one branch of a foreign bank in Latvia. In 2002, no credit institution operating licence was issued or cancelled.

At the end of 2002, there were 26 credit unions in Latvia. New credit union operating licences were issued to five cooperative credit unions, whereas one credit union operating licence (that of the cooperative credit union *Savstarpējo ieguldījumu nams*) was cancelled.

At the end of 2002, Latvia's insurance sector comprised 20 insurance companies, which extended the range of services they offered to their customers. In the reporting year, no new licence for insurance operations was issued, whereas all licences issued for insurance operations to one insurance company (JSIC *AK Alianse*) were cancelled.

At the end of 2002, there were 29 insurance brokerage firms in Latvia. New licences were issued to six insurance brokerage firms, whereas the licences of five insurance brokerage firms were cancelled. Interest in insurance brokerage activities was on the rise, as demonstrated by the issue of certificates to 62 persons for insurance brokerage operations. 16 insurance brokerage certificates were cancelled, since their holders discontinued their brokerage activities. At the end of 2002, there were 185 registered insurance brokers in Latvia.

18 new insurance agencies were registered during the reporting year, whereas seven insurance agencies were excluded from the register. The resulting total was 59 registered insurance agencies and 7 969 insurance agents on the insurance market at the end of 2002. During the reporting year, 945 new agents were registered, while 207 agents were struck from the registry.

In 2002, the number of private pension funds remained unchanged at four. At the end of the year these funds offered nine pension plans. At the request of pension funds, six pension plan licences were cancelled and one new pension plan licence was issued.

At the end of 2002, there were six investment companies managing nine investment funds: three closed-end and six open-end investment funds. During the reporting year, two operating licences were issued to investment companies and five new investment funds were registered.

Latvia's three-tiered pension system provides that, as of 2003, private investment companies are also entitled to manage assets of the second-tier, or State-funded pension scheme. In 2002, five investment companies received licences for managing State-funded pension scheme assets. All licensed investment companies have entered into an agreement with the State Social Insurance Agency regarding the management of these assets.

During the reporting year, two investment funds registered abroad obtained a licence for distribution of investment fund certificates in Latvia. In total, three investment funds registered abroad were entitled to distribute fund certificates in Latvia at the end of the year.

At the end of the year, the securities market had 29 licensed intermediary companies – 20 credit institutions and nine brokerage firms. In 2002, the Commission issued a new licence for intermediary activity in the securities market to one credit institution and two brokerage firms. The Commission cancelled the licence of one brokerage firm, the joint stock company (JSC) *Inveks*.

At the end of 2002, the securities market comprised 567 certified professional securities market specialists. Professional securities market specialist certificates were issued to 86 persons. The Commission extended the validity term of 472 specialists' certificates, while 207 professional securities market specialists expressed no intention to extend the validity term of their certificates.

At the end of 2002, there were 89 securities issuers registered with the Commission, including 88 share issuers and two debt securities issuers. There were five new securities issues during the year 2003: two share issues at a face value of 200.6 million lats, one bond issue at a face value of 25.0 million lats, and two mortgage bond issues at a face value of 8.0 million lats.

In 2002, shares of the JSC MS *Kargo*, the JSC *Tipogrāfiju serviss*, the JSC *LMR*, and the JSC *Jēkabpils cukurfabrika* totalling 5 136 900 lats, were withdrawn from public trading.

Supervision

In 2002, the supervision of operations of market participants carried out by the Commission was comprised of on-site examinations and an analysis of the most substantial risks. The purpose of the supervision was to detect any potential problems and to find preventative solutions so as to decrease the risk of a market participant's deficiencies affecting the entire market. One important precondition for Latvia's market development has been customer confidence. Consequently, the Commission also devoted its attention to complaints and client comments in its supervisory practice.

Banks and Credit Unions

Ongoing and all-encompassing banking and credit union supervision was effected by:

1. analysing indicators and banking risk management policies, starting with the processing of documents received for obtaining a licence. Paying constant attention to changes in financial indicators, as well as to compliance with regulatory requirements, on the basis of both individual and consolidated financial statements;
2. analysing policies and procedures regarding the risk management of new financial services;
3. carrying out special purpose on-site examinations of particular financial services.

In 2002, the Commission conducted 44 bank examinations. As in previous years, the main focus was on the asset quality and internal control systems of institutions. The Commission also assessed the compliance of bank procedures for identifying clients and detecting unusual and suspicious financial transactions with the requirements of the Law on the Prevention of Laundering of Proceeds Derived from Criminal Activity.

In 2002, the amount of issued bank loans continued to increase substantially. Therefore, when assessing individual risks during its bank examinations, the Commission paid particular attention to the evaluation of the banks' credit risk management systems in order to identify any shortcomings and potential problems related to loan repayment. The banks' strategies, as well as their policies and procedures regarding the granting of loans were also assessed.

In 2002, the Commission, on the basis of consolidated financial statements, carried out the supervision of five banks forming banking groups. This included the examination of operations by undertakings belonging to these banking groups (mainly leasing companies). The Commission sought to ascertain whether the banking groups had established efficient internal control systems that ensured the preparation of adequate information for supervision needs, as well as risk management systems enabling the banks to continuously control risk transactions within their banking groups.

Insurance Companies

In 2002, the Commission staff conducted 22 examinations of insurance companies, including five full-scope and 17 thematic inspections. During these examinations, attention was focussed on the quality of assets of the insurance companies, the adequacy of their technical reserves, the sufficiency of their technical reserves and compliance of these reserves with Latvian legal requirements, as well as on the assessment of the insurance companies' internal control systems.

The supervision of insurance companies was effected in two stages – the Commission first analysed submitted reports and then conducted on-site company examinations. During these examinations the Commission evaluated the conformity of the companies' operations with Commission regulations and with the requirements of other regulatory enactments. The Commission, on a regular basis, monitored the performance indicators of insurance companies, tendencies towards changes in such indicators and, where necessary, specified measures to be taken to eliminate deficiencies.

Other Financial and Capital Market Participants

In 2002, the Commission conducted two examinations of private pension funds, one examination of an investment company and 23 examinations of brokerage firms and banks performing intermediary activities in the securities market.

When conducting examinations of pension fund and investment company operations, the Commission assessed their compliance with the policies, procedures and restrictions specified by Latvian law. The managing and holding of assets was also assessed to ensure that it conformed to Latvian laws and other regulatory enactments.

In supervising the activities of securities issuers, particular attention was paid to potential misuse of insider information in securities transactions on the stock exchange. The Commission also verified whether shareholders promptly disclosed material events and published annual accounts with a view to protect the rights of minority shareholders, and to provide timely information on recent developments in the activities of public companies. Likewise, the Commission carried out examinations to establish whether persons having acquired more than 50% or 75% of voting shares of public joint stock companies made mandatory share buyout offers to minority shareholders.

In conducting its examinations of intermediary activity while continually analysing exchange and off-exchange securities transactions, the Commission focussed its attention on detecting and preventing any possible misuse of insider information.

Audits of Information Systems Security

As a result of an increase in the role of information systems in the operations of market participants, the risks related to the security of these systems increased correspondingly. The Commission's information systems auditors performed on-site and off-site audits of market participants in all financial and capital market sectors. In total, nine comprehensive security audits of information systems were conducted in 2002. Upon the emergence of new risks and on a regular basis, information systems security specialists of the Commission ascertained and analysed the readiness of market participants to protect their information resources, and provided consultations when necessary.

Formulation of Draft Laws

In 2002, several amendments of importance for the Latvian financial and capital market were adopted and came into effect either during the year 2002 or on 1 January 2003.

Amendments made to the Law on Private Pension Funds provide for equal investment opportunities in Latvia, Lithuania, Estonia, all European Economic Area countries and most Member States of the OECD. Investments of pension plan assets are now allowed in such securities as are admitted to official stock exchange listings, as well as in investment funds, real estate, time deposits with credit institutions, and derivatives.

Amendments to the Law on Investment Companies were formulated for the purpose of widening the type of assets in which investment fund assets may be invested, and for specifying the procedure as to how investment funds registered in Latvia may publicly distribute investment fund certificates.

According to the latest amendments of Latvia's insurance contract law, insurers are obliged to inform their insurance policy holders of the procedures for out-of-court settlements of complaints and disputes, prior to entering into insurance contracts. Insurance contracts also have to specify the term for taking a decision to pay or refuse insurance indemnity, as well as the grounds for any refusal to pay insurance indemnity.

Amendments to the Law on State-funded Pensions regulate the operation of the State-funded pension scheme more specifically. In order to ensure the supervision of managers of State-funded pension scheme assets (i.e. investment companies), the law envisages the formulation of investment plans for investment companies and the registration of their prospectuses with the Commission.

Commission Regulations

In 2002, several new regulations as well as some amendments to former regulations of the Commission were approved, which came into effect either within the year 2002 or on 1 January 2003.

In order to ensure the compliance with EU requirements of procedures by banks and brokerage firms for calculating capital adequacy and for preparing and submitting reports, the Board of the Commission approved, on 11 October 2002, a set of Regulations for Calculating Capital Adequacy of Banks and Brokerage Companies. These Regulations also specify the minimum initial capital of brokerage companies, depending on the type of authorised intermediary transactions.

The Regulations for Obtaining Permits of the Financial and Capital Market Commission Regulating the Operation of Credit Institutions and Credit Unions and for Providing Information were formulated taking into account amendments made to the Latvian Law on Credit Institutions. Pursuant to said regulations, anyone wishing to acquire, increase, decrease, or terminate a qualifying holding in a bank must notify the Commission of his or her intention to do so. In order for the Commission to ascertain the compliance with Latvian legislative requirements of supervisory board members, executive board members, or heads of foreign bank subsidiaries of whom the Commission has no prior information, the person in question must submit notification, an expanded professional biography and a copy of his or her identification documents to the Commission.

If a credit institution has established close links with third persons, the Regulations formulated by the Commission on the Provision of Information regarding Persons with whom a Credit Institution Has Close Links determine the procedures as to how information to the supervisory authority is to be provided.

During the reporting year, in order to ensure a more efficient procedure for the out-of-court settlement of disputes between a credit institution and its customers, the Commission prepared Recommendations for the Formulation of Efficient Procedures for the Out-of-court Settlement of Disputes between a Credit Institution and Its Customers regarding Credit Transfers and Electronic Transactions. These Recommendations set the basic principles for a more efficient dispute settlement process than provided by the general procedures for the court settlement of disputes. The Ombudsman of the Association of Latvian Commercial Banks has been operating since 1 January 2003. His tasks include reviewing the complaints of banks and their customers regarding credit transfers and electronic transactions. Decisions taken by the Ombudsman in the settlement of disputes will be of a recommendable nature, thus the rights of parties involved in a dispute to apply to public authorities or courts pursuant to general procedures will not be restricted.

Taking into account the most recent amendments to International Accounting Standards (hereinafter – IAS), the year 2002 saw the formulation of Regulations on the Preparation of Annual Accounts and Consolidated Annual Accounts for Insurance Joint Stock Companies and Mutual Co-operative Insurance Societies. The Regulations stipulate that insurance companies must evaluate the items listed in their financial statements and prepare annual reports in compliance with IAS.

The Commission's Regulations on the Preparation of Reports on Insurance Operations and of Quarterly Reports for Life Insurance Joint Stock Companies and Mutual Co-operative Life Insurance Societies (approved in 2002) and the Regulations on the Preparation of Reports on Insurance Operations and of

Quarterly Reports for Non-life Insurance Joint Stock Companies and Mutual Co-operative Non-life Insurance Societies determine the amount of information to be provided by insurance companies for supervisory and statistical purposes.

The Regulations on the Licensing of Managers of State-funded Pension Scheme Assets prescribe the procedures as to how investment companies registered in Latvia shall issue, re-register, suspend, and cancel licences for the management of State-funded pension scheme assets. The Board of the Commission also adopted the Regulations on the Placement of Security Deposits of Managers of State-funded Pension Scheme Assets and on the Holding of Own Assets, which, in turn, prescribe the procedures as to how an investment company shall place a security deposit and hold its own assets for additional security.

Amendments introduced to the Regulations on the Preparation of Reports on the Management of State-funded Pension Scheme Assets specify the information to be disclosed in an annual report's financial statement items, management report, statement of responsibility of the asset manager's executive board, and notes to the financial statements. Provisions regarding the valuation of items included in financial statements have been made in accordance with the requirements of IAS 26 and 39.

The Regulations on the Registration of Securities to be Put into Public Circulation, in compliance with the requirements of EU directives, now determine the procedures as to how securities are to be registered with the Commission before they are put into public circulation.

In the reporting year, the Board of the Commission also adopted amendments to its Regulations on the Buyout of Shares, which provide that cash clearing and securities settlement of shares sold in share buyout offers should be effected in conformity with the 'delivery versus payment' principle. Such settlement procedures provide greater assurance that the person who has proposed a share buyout will meet the liabilities he/she has pledged to the shareholders who have accepted his/her buyout offer. Thus, these amendments promote the protection of the rights of minority shareholders in the event of a share buyout.

The Regulations on the Preparation of Investment Fund Reports, which were approved during the reporting year, determine the procedure for preparing and disclosure of information to holders of investment fund certificates and potential investors regarding the operations of an investment fund (i.e. through an annual report and a semi-annual report), as well as the contents of the information required for supervision purposes and the procedure for submitting such information.

The adopted Regulations on the Security of Information Systems of Financial and Capital Market Participants, in turn, are aimed at reducing security risks incurred by market participants. Henceforth, the implementation of solutions for information system security will require compliance with a previously made risk assessment. These Regulations specify the role of the holder of information resources in establishing and maintaining the security of the information systems for which the holder is responsible.

International Cooperation

Cooperation with Institutions of the European Union

Although in 2002 Latvian regulatory enactments governing the country's financial and capital market in all relevant aspects were brought in line with EU requirements, the Commission continued to actively participate in processes affecting Latvia's integration into the EU by submitting proposals for the further harmonisation of Latvian laws with EU directives, and by formulating draft regulatory enactments that would ensure the compliance of Latvia's regulatory requirements with EU legal norms.

Peer Review of Financial Service Supervision in Latvia

From 8 to 12 April 2002, a group of experts from the European Commission composed of the supervisory authorities of financial sectors of EU Member States and representatives of the European Commission paid a visit to Latvia to assess the supervision of financial services in Latvia. The purpose of this visit was to ascertain whether all financial and capital market participants in Latvia are supervised in conformity with international norms and best practice. The Peer Review Report's overall evaluation of the supervision of the Latvian financial sector was positive, which attests to the efficiency of work of the Commission and to the competitiveness of the Latvian financial market. The Peer Review Report states: "The Financial and Capital Market Commission consistently improves supervision practice in conformity with international requirements; these efforts have resulted in good supervision practice." Likewise, the report underlines that the Commission has succeeded in combining the functions of the three former supervisory authorities of the Latvian financial and capital market, which previously had been operating separately. The Commission formulated an action plan to implement the Recommendations of the Peer Review Report and reported on it to the 8th Plenary Meeting of Effective Financial Services Supervision in the Accession Countries, which was held in Brussels on 19 December 2002.

Participation of the Commission in the Work of EU Committees

At the end of the reporting year, representatives of the Commission were invited, as of 2003, to participate as observers in meetings of several committees of the European Commission, namely, the Banking Advisory Committee, the Insurance Committee, the European Securities Committee, the UCITS Contact Committee, the Committee of European Securities Regulators, as well as in the Banking Supervision Committee of the European Central Bank.

Although Latvia will participate in these committees only as an observer until it formally joins the European Union in May 2004, this participation will allow it to follow first-hand the latest developments in regulatory requirements for financial market activities and in supervisory practice.

International Organisations and Foreign Financial Supervisory Authorities

During the reporting year, the Commission was engaged in active cooperation with major international organisations operating in the financial and capital market: the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Organization of Securities Commissions, the International Network of Pensions Regulators and Supervisors, the World Bank, the International Monetary Fund and the International Commercial Crime Bureau. Likewise, active cooperation was effected with the European Committee on Crime Problems and the Council of Europe Select Committee of Experts on the Evaluation of Anti-money

Laundering Measures (MONEYVAL).

The Commission increased its number of cooperation partners among foreign financial supervisory authorities. Agreements (memoranda of understanding) on the mutual exchange of information were signed with the Central Bank of the Russian Federation concerning cooperation in banking supervision, the Danish Financial Supervisory Authority concerning financial and capital market supervision, the German Insurance Supervisory Authority, and the State Insurance Supervisory Authority of the Republic of Lithuania. Negotiations regarding future memoranda of understanding were launched with the Central Bank of Cyprus, the Portuguese Securities Market Commission, and the National Bank of Ukraine. By the end of 2002, the Commission had concluded a total of 16 agreements on the mutual exchange of information with financial supervisory authorities of various countries.

Major Tasks of the Financial and Capital Market Commission for the Year 2003

1. The supervision of the Latvian financial and capital market by analysing financial statements and other information, and by conducting on-site examinations of market participants.

2. Improvements to Latvian legislative enactments and their harmonisation with EU requirements, with the recommendations of international financial supervisory authorities and with the best international practices in this field, so as to continue the preparation of the Latvian financial and capital market for smooth integration into the EU market.

3. Consistent maintenance of the Commission's Quality Management System and certification in conformity with the ISO 9001:2000 international quality standard.

4. E-government project: completion of a new, single electronic database of market participants' financial data, and the exchange of information with market participants in electronic form.

5. Preparation for the countrywide introduction of electronic document circulation.

The Commission's complete Action Plan for 2003 is available on the Commission's Internet home page at www. fktk.lv.

Operations of Market Participants in 2002

Table 1
FINANCIAL AND CAPITAL MARKET PARTICIPANTS
(31.12.2002)

Market participants	Number	Assets (in millions of lats)	Share of assets, %
Banks	23	4 422. 5	96.4
Insurance companies	20	1 24. 1	2.7
Private pension funds	4	15. 6	0.3
Investment funds	9	12.3	0.3
Insurance brokerage firms	29	5.4	0.1
Brokerage firms	8	3.3	0.1
Cooperative credit unions	26	2.7	0.1
Investment companies	6	1.4	0.0
Riga Stock Exchange	1	1.4	0.0
Latvian Central Depository	1	0.6	0.0
Issuers	89	-	-
Insurance brokers	185	-	-
Professional securities market specialists	567	-	-
Total	**968**	**4 589.3**	

Figure 6
ASSET STRUCTURE OF MARKET PARTICIPANTS
(31.12.2002; %)

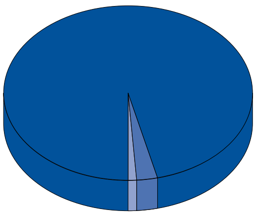
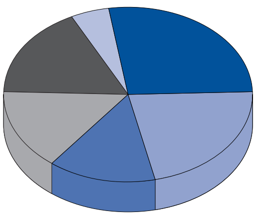
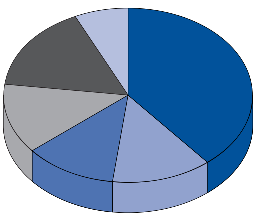


Figure 7
GEOGRAPHICAL BREAKDOWN OF THE SHARE CAPITAL OF LATVIAN BANKS
(%)





At the end of 2002, the share of assets of market participants under the supervision of the Financial and Capital Market Commission (see Table 1) reached 88% of Latvia's GDP (compared to 76% at the end of 2001). This increase testified to the greater confidence of market participants' clients in the Latvian financial and capital market. The share of the banking sector in the volume of assets of market participants (see Figure 6) continued to predominate at 96.4% (compared to 96.0% in 2001).

Banks

During the reporting period, the number of banks in Latvia remained unchanged at 22, along with one foreign bank branch.

The proportion of foreign capital in the paid-up share capital of Latvian banks decreased to 54.4% at the end of 2002, compared to 68% a year earlier (see Figure 7). Foreign shareholders owned more than 50% of the share capital of nine banks, whose market share accounted for 42.8% of the Latvian banking sector's total assets. Six banks were subsidiaries of foreign banks.

During the reporting year, the participation of the State in the banking sector was insignificant. The Latvian Government was still the only shareholder of the JSC *Latvijas Hipotēku un zemes banka*, whose assets made up only 4.0% of the total assets of the Latvian banking sector as of 31 December 2002. The Government-owned share in the JSC *Latvijas Krājbanka* remained unchanged at 32.1%. This bank's assets made up 3.9% of Latvia's total banking assets.

During the reporting year, the market share of Latvia's five largest banks did not substantially change and amounted to 65.3% of total banking assets, 73.7% of loans and 68.4% of deposits at the end of the year (compared to 66.2%, 73.1% and 69.0%, respectively, at the end of 2001).

In 2002, Latvian bank assets grew by 964.0 million lats, or 27.9%, reaching 4 422.5 million lats by the end of the reporting period. The reporting year also saw a rapid growth in borrowing, with loans increasing by 29.9%. Their share of total banking assets rose from 47.3% to 48.1% (see Figure 8).

The ratio of bank loans to residents as compared to Latvia's GDP grew from 29.5% at the end of 2001 to 36.4% by the end of 2002.

The rapid growth of the national economy lead to the increase in loans in all the major national economy sectors: 17.4% in manufacturing, 21.0% in trade, and 23.9% in transport, storage and communications. At the end of the reporting year, 88.9% of total loans had been granted to domestic borrowers.

Mortgage lending developed particularly rapidly and grew by 72.8% during the reporting period. Consequently, the share of mortgage loans in Latvia's bank loan portfolios increased to 19.9% and reached 411.7 million lats at the end of 2002. The ratio of mortgage loans to GDP grew from 5.0% at the end of 2001 to 7.9 % by the end of 2002[5].

In 2002, the term structure of loans changed. The volume of long-term loans rose by 66.4%, and their share in Latvia's bank loan portfolios increased from 29.0% at the beginning of the year to 36.9% by the end of the year.

It is significant that with the increase in the volume of lending, the loan quality did not deteriorate during the reporting year. The share of non-perform-

[5] Latvia's GDP in 2002 was 5.1947 billion lats, according to data published in the Internet home page of the Central Statistics Board of the Republic of Latvia.

ing loans (substandard, doubtful, or lost) in the total of loans granted to non-banks dropped from 2.8% to 2.0%. At the end of 2002, the ratio of specific provisions for non-banks to the total of loans granted to non-banks was 1.5% (see Figure 9). At the end of the reporting year, specific provisions for loans to non-banks covered 78.1% of the amount of non-performing loans.

The amount of deposits in 2002 grew by 740.6 million lats, or 31.8%, and totalled 3 070.3 million lats at the end of the year. Non-resident deposits saw a higher growth rate than resident deposits (38.1%), and amounted to 54.3% of total non-bank deposits at the end of the year. Deposits by residents increased by 25.0% (including deposits of private persons, which grew by 29.5%). During the reporting period, deposits by private persons constituted the largest share of the total deposits made by residents, i.e. 51.5%, while the deposit share by private undertakings constituted 32.5%. Demand deposits still retained the largest share of total deposits – 71.9%.

In 2002, the profit of the banking sector[6] reached 56.3 million lats, i.e. 13.5% more than in 2001, when total profits were 49.6 million lats. This has been the highest profit figure, in absolute figures, in the history of Latvian banks. The return on equity (ROE), in turn, was 16.4% at the end of 2002, a 2.6 percent drop compared to the previous year. During the reporting period, the return on assets (ROA) ranged from 1.3% to 1.5%, and was 1.5% at the end of the year.

In 2002, the main sources of profit in the banking sector were income from interest on loans issued to non-banks (40.4% of total bank income), fee and commission income (24.6%), and interest on debt securities (9.6%).

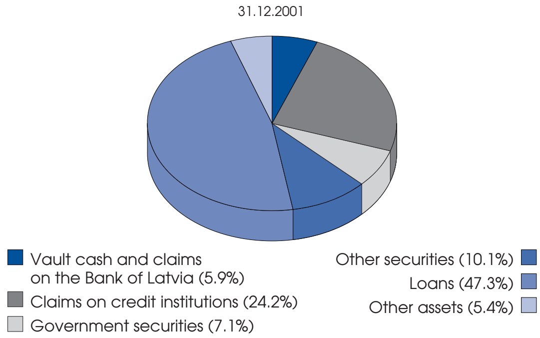
In 2002, the capital adequacy ratio decreased compared to the year before. This testifies to increased efficiency in the use of banking capital. On 31 December 2002, the capital adequacy ratio of the Latvian banking sector was 13.1% (compared to 14.2% a year earlier), which still exceeded the regulatory requirement of 10.0% by more than three percentage points (see Figure 10).

In 2002, Latvia's banks still maintained high liquidity. The liquidity ratio of the banking sector ranged from 61.6% to 66.0% and was 62.1% on 31 December 2002 (the minimum regulatory requirement is 30.0%).

During the reporting year, consolidated bank supervision formed an important aspect of the Commission's supervisory activities. In 2002, six banking groups and one financial holding company group were subject to consolidated supervision. At the end of 2002, these six supervised banking groups had 25 subsidiaries, including seven leasing companies, three investment companies, one bank, one pension fund, two insurance companies, four auxiliary undertakings and seven other financial institutions (securities brokerage firms, etc.). Subsidiaries of these Latvian banking groups were registered mainly in Latvia and Lithuania, as well as in the USA, the United Kingdom and other countries.

At the end of 2002, the average capital adequacy ratio for all Latvian banks was 13.1%. This ratio was calculated on the basis of individual financial bank statements, and was only slightly higher than the ratio calculated on the basis of the consolidated financial statements of banking groups (12.9%).

Figure 8
STRUCTURE OF LATVIAN BANK ASSETS
(%)



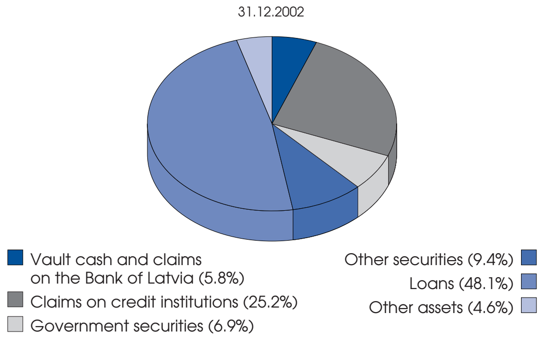


Figure 9
NON-PERFORMING LATVIAN BANK LOANS
(as a percentage of total Latvian bank loans)

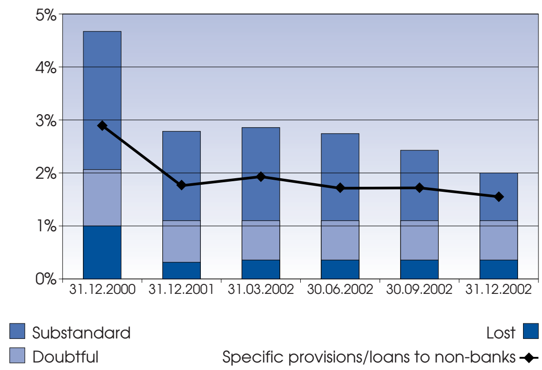
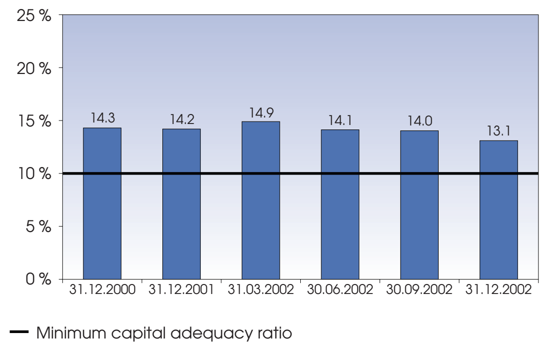


Figure 10
CAPITAL ADEQUACY RATIO OF LATVIAN BANKS



6 Non-audited profit.

Figure 11
LATVIAN CREDIT UNION ASSETS AND DEPOSITS
(at end of period; in thousands of lats)

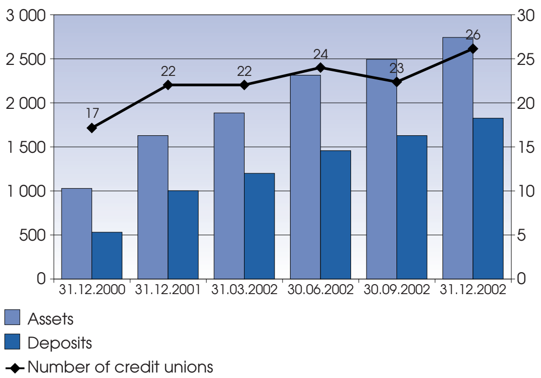


Figure 12
QUALITY OF THE LOAN PORTFOLIO
OF LATVIAN CREDIT UNIONS

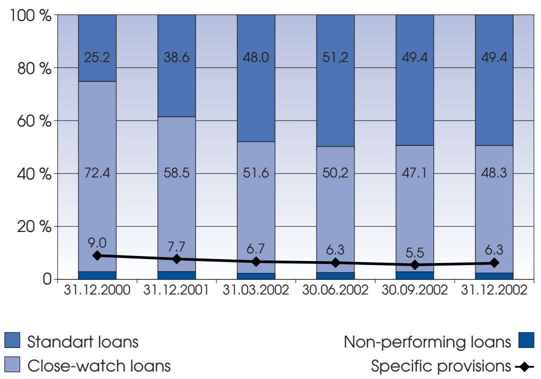
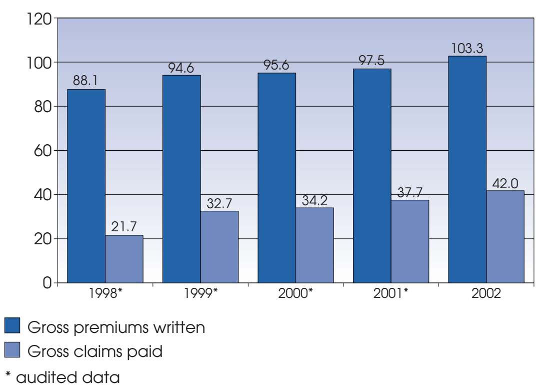


Figure 13
GROSS INSURANCE PREMIUMS WRITTEN AND
GROSS CLAIMS PAID
(at end of period; in millions of lats)



Credit Unions

In 2002, there were 26 cooperative credit unions in Latvia. At the end of the year, the market share of the two largest credit unions comprised 78.8% of credit union assets, 77.0% of loans, and 83.9% of deposits.

In 2002, the total assets of Latvia's credit unions rose by 63.7% and reached 2 707.7 thousand lats (0.06% of all banking sector assets) (see Figure 11). This increase resulted largely from an influx of credit union member deposits, which grew by 76.7% in 2002 to 1 784.6 thousand lats.

The main type of credit union activity was lending to credit union members. In 2002, the amount of such loans increased by 70.7% and totalled 2 096.7 thousand lats on 31 December 2002. These formed the largest share of total credit union assets (77.4%, compared to 74.3% at the end of 2001).

In addition to short-term (up to one year) and medium-term term loans (from 1 to 5 years), credit unions also began issuing long-term loans (more than 5 years) in 2002. The share of these long-term loans in the aggregate loan portfolio of Latvia's credit unions reached 7.8% at the end of the reporting year. At the end of 2001, the share of short-term loans comprised 77.6% of all loans, whereas by 31 December 2002 it had dropped to 64.0%, even though the volume of short-term loans grew by 40.7% within this one-year period.

Latvian credit unions also commenced the issuance of mortgage loans in 2002. At the end of the year, these loans amounted to 201.8 thousand lats, or 9.6% of Latvia's total credit union loan portfolio. Loans for the purchase of consumer goods accounted for the largest share (86.4%) of credit union loan portfolios at the end of the reporting period.

In 2002, the share of non-performing loans in credit union loan portfolios fell from 2.9% at the beginning of the year to 2.4% on 31 December 2002. Specific provisions made up 6.3% of the total loan amount (See Figure 12).

In 2002, five new credit unions launched their operations. The paid-up share capital of Latvia's credit unions rose by 34.3% to 499.3 thousand lats on 31 December 2002, as a result of an increase in the number of credit union members. The aggregate amount of credit union capital and reserves increased by 44.0% to 678.9 thousand lats, or 25.1% of liabilities.

In 2002, credit unions showed a total profit of 59.5 thousand lats[7], which is 2.5 times more than in 2001. During the reporting year, the main source of income for credit unions was interest on loans issued to members. This accounted for 71.3% of all credit union income.

On 31 December 2002, the return on equity (ROE) of credit unions was 10.6% (compared to 5.5% a year earlier), while the return on assets (ROA) was 3.3% (compared to 1.7% in December 2001).

On 31 December 2002, the equity-to-asset ratio of the credit union sector was 24.9% (the minimum requirement specified by law is 10%).

Insurance Companies

At the end of 2002, there were 20 insurance companies operating in Latvia, of which six were involved in life insurance and 14 in non-life insurance operations.

At the end of 2002, the total direct investments made by non-residents in the share capital of Latvian insurance companies amounted to 20.1 million lats, or

7 Non-audited profit.

52.6% of their paid-up share capital. Six insurance companies were operating as subsidiaries of foreign insurers, while the share capital of two Latvian insurance companies was provided by foreign insurance companies. The share capital of two other companies had a substantial foreign participating interest (more than 10%).

In 2002, the gross premiums written by insurance companies in Latvia amounted to 103.3 million lats, or 6% more than in the year 2001, while gross claims paid amounted to 41.96 million lats, or 11% more than in 2001 (See Figure 13).

At the end of 2002, there were 29 insurance brokerage firms in the Latvian market, which intermediated 14.3 million lats worth of insurance services. The share of gross premiums written through these firms constituted 14% of total gross premiums written by insurance companies (the same as in 2001).

At the end of 2002, the insurance penetration ratio remained the same as at the end of 2001 – 2.0%.[8] During the reporting year, the second major indicator characterising the importance of the insurance industry for the national economy – insurance density ratio – rose by 2.6 lats, or 6.3%, to 44 lats.

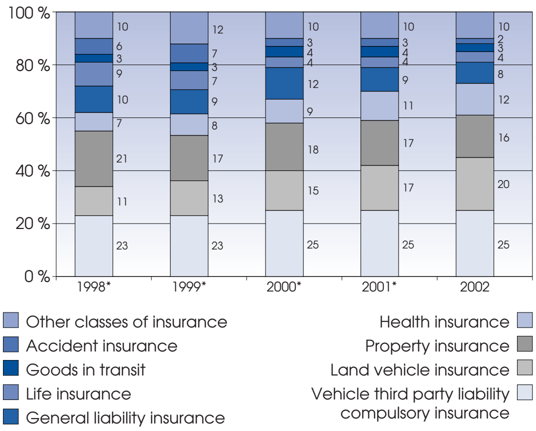
The year 2002 experienced no significant changes in the portfolio of gross premiums written by insurance companies. Various types of risk insurance still prevailed (96%) and the share of gross premiums written for life insurance remained the same as in 2000 – 4% (see Figure 14).

The combined ratio dropped from 100.6% in 2001 to 94.5% in 2002 (see Figure 15). Taking into account the fact that the net return on investments in 2002 was 7.0%, the actual ratio of aggregate insurance operational expenses to proceeds amounted to 87.6%, compared to 92.2% in 2001.

During the year 2002, insurance companies' own funds decreased by 1.4% to 41.7 million lats as compared to the year before. The solvency ratio was 324%, compared to 362% in 2001. The lowest permissible level for this ratio is 100%.

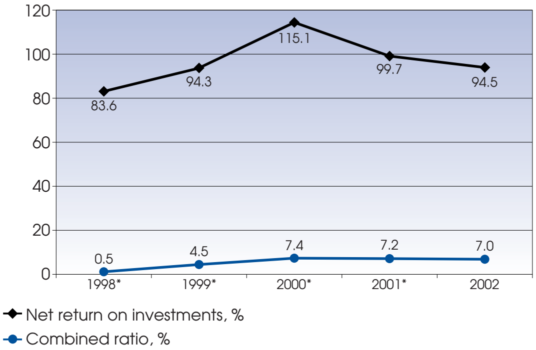
On 31 December 2002, the net technical reserves of Latvian insurance companies totalled 53.3 million lats. These reserves were fully covered by investments as required by law, and 96% of these investments were placed in Latvia. The investment portfolio structure of Latvia's insurance companies was aimed to minimize risks. The bulk of investments consisted of time deposits with credit institutions (39%), as well as securities issued and guaranteed by national or local governments (31%) (see Figure 16).

Figure 14
GROSS INSURANCE PREMIUMS WRITTEN BY CLASS
(at end of period; %)



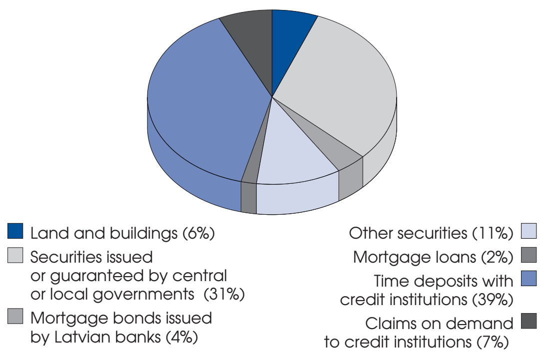
* audited data

Figure 15
NET RETURN ON INSURANCE INVESTMENTS AND COMBINED RATIO OF EXPENSES
(%)



* audited data

Figure 16
STRUCTURE OF INSURANCE INVESTMENTS COVERING NET TECHNICAL RESERVES
(31.12.2002; %)



[8] Latvia's GDP in 2002 was 5.1947 billion lats, according to data published in the Internet home page of the Central Statistics Board of the Republic of Latvia.

Figure 17

SECURITIES PORTFOLIO HELD AND OWNED BY LATVIAN INTERMEDIARY COMPANIES, BROKEN DOWN BY TYPE OF SECURITY

(in millions of lats)

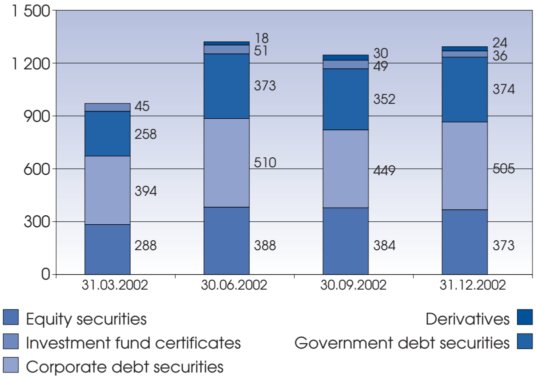
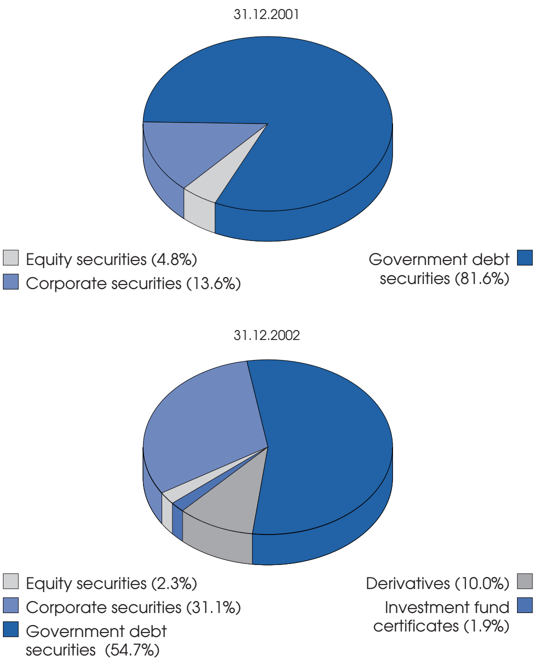


Figure 18

SECURITIES TRANSACTIONS CONDUCTED THROUGH INTERMEDIARY COMPANIES BY TYPE OF SECURITY

(%)



Securities Market

At the end of 2002, the main Latvian securities market operators were the Riga Stock Exchange (hereinafter – the RSE) and the Latvian Central Depository (hereinafter – the LCD). Investment services were also provided by 28 intermediary companies (eight brokerage firms and 20 banks involved in intermediary activities in the securities market) and six investment companies managing nine investment funds (six open-end funds and three closed-end funds).

By the end of the reporting year, four foreign investment funds had obtained permits for public trading of their securities in Latvia.

In 2002, Finland's HEX Group acquired 92.98% of the RSE's shares, thus becoming the principal shareholder of the RSE. The RSE holds 100% of the LCD's shares. During the reporting period, the LCD established correspondent relationships with the European securities depositary Euroclear.

During the reporting year, the total turnover of the RSE amounted to 310.9 million lats, or 41.5% less than in 2001. This was mainly related to a decrease in the turnover of government debt securities and equity securities. In 2002, the stock market's capitalisation shrank by 4.6% to 418.3 million lats, whereas the stock market's liquidity rose from 23.5% to 26.5%[9].

In 2002, the market value of securities held with the LCD continued to increase, reaching 796.4 million lats (in market value) at the end of the year (compared to 717.6 million lats at the end of 2001), including company shares (52.6%), government debt securities (36.8%), corporate debt securities (9.0%), and investment fund certificates (1.5%). During the reporting year, the amount of publicly traded securities at the LCD totalled 743.4 million lats (in market value), or 93% of the amount of securities held by the LCD. The number of holders of securities accounts rose from 97 900 at the end of 2001 to 104 000 in 2002[10].

At the end of 2002, there were 95 issuers, including six investment companies, in the Latvian securities market.

In 2002, five issues of public securities totalling 233.6 million lats were registered, including share issues of two privatised companies at 200.6 million lats, two mortgage bond issues at a face value of 8.0 million lats, and one bond issue at a face value of 25.0 million lats.

During the reporting year, the investment certificate issues of two closed-end investment funds at a face value of 1.1 million lats were registered (investment fund certificates at a face value of 623.6 thousand lats were put into public circulation), along with the investment certificate issues of three open-end investment funds.

During the reporting year, the volume of the securities portfolio held and owned by intermediary companies grew by 30.8% in market value and amounted to 1 311.6 million lats at the end of the year, including corporate debt securities (38.4%), government debt securities (28.5%), equity securities (28.4%), investment fund certificates (2.8%), and derivatives (1.9%) (see Figure 17).
At the end of 2002, securities not traded publicly in Latvia constituted 59.0% of the aggregate securities portfolio. The share of Latvian issuers in the aggregate securities portfolio made up 45.1%.

Although the value of securities transactions effected through intermediary companies in 2002 accounted for only 73.5% of the value effected in 2001, it displayed a growth tendency starting from the second quarter of 2002 and

[9] Data of the Riga Stock Exchange.
[10] Data of the Latvian Central Depository.

reached 2 331.4 million lats at the end of the reporting period. The most significant contributor to the turnover of public securities was government debt securities, which made up 54.7% of the total turnover of public securities at the end of the year (see Figure 18).

In 2002, total assets of Latvian investment funds increased by 62.4% and comprised 12.3 million lats at the end of the year. The securities portfolio of these investment funds reached 8.8 million lats.

During the reporting year, the structure of the securities portfolio of investment funds experienced notable changes. Investments made in government debt securities rose by 112.6% (mainly in bonds of the Republic of Latvia), while the weight of these securities in the aggregate securities portfolio of investment funds grew from 56.7% at the end of 2001 to 73.8% on 31 December 2002.

During the reporting year, the volume of corporate debt securities decreased by 3.3%. Consequently, their weight in the securities portfolio of investment funds dropped from 37.8% at the end of 2001 to 22.4% on 31 December 2002 (see Figure 19).

In 2002, the amount of investments made by Latvian investment funds in Estonia and Lithuania decreased by 81.8%. Investment funds correspondingly increased the amount of their investments in Latvia by more than two times, thus raising the share of investments in Latvia to 91.2% of the aggregate Latvian securities portfolio at the end of the year (see Figure 20).

In 2002, the increase in net assets of investment funds constituted 682 100 lats (compared to 395 300 lats in 2001). The annual profitability of open-end investment funds varied from 4.2% to 16.5%, depending on the investment fund.

Development of the Second- and Third-tier Pension System

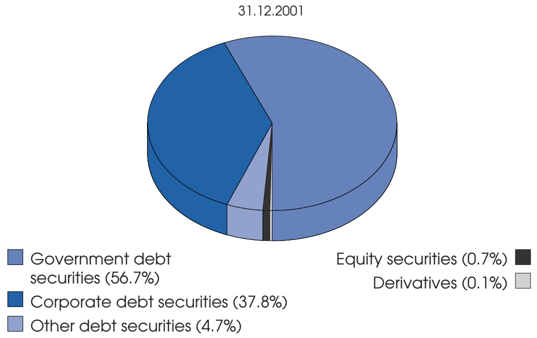
On 31 December 2002, there were four pension funds in Latvia: three open pension funds and one closed pension fund. During the reporting period, the number of licensed private pension funds did not change. Private pension funds offered a total of nine pension plans. During the year 2002, one new pension plan was licensed.

In 2002, the number of private pension plan participants increased by 16% and amounted to 20.1 thousand, or 2.0% of the average number of employed persons in Latvia at the end of the year (compared to 1.7% of employed persons in 2001). Contributions to pension plans were made in the amount of 3.9 million lats (compared to 3.3 million lats in 2001). Of these, 99% were made by employers (the same as in 2001).

Pension plan assets grew by 47% and comprised 14.0 million lats at the end of 2002 (compared to 9.5 million lats at the end of 2001). The investment policy of pension plan assets continued to be conservative. Eighty-eight percent of pension plan assets were invested in Latvia, while the remaining 12% were invested in the other Baltic and OECD countries. (In 2001, 93% were invested in Latvia and 7% in the Baltic and OECD countries). Pension plan assets were invested mainly in debt securities and deposits with credit institutions (See Figure 21 for the asset structure of private pension plans). These investments accounted for 91% of a total of pension plan assets.

In 2002, the amount of paid-out pension capital rose by 50% to 180 000 lats by the end of the year. Ninety-four percent of total payments were paid upon retirement to pension plan participants, while 6% were allocated upon the participants' death.

Figure 19
SECURITIES PORTFOLIO OF INVESTMENT FUNDS, BROKEN DOWN BY TYPE OF SECURITY
(%)



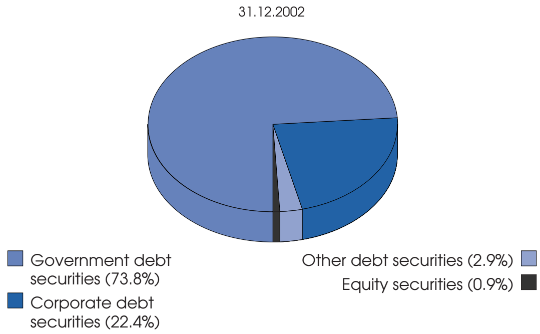
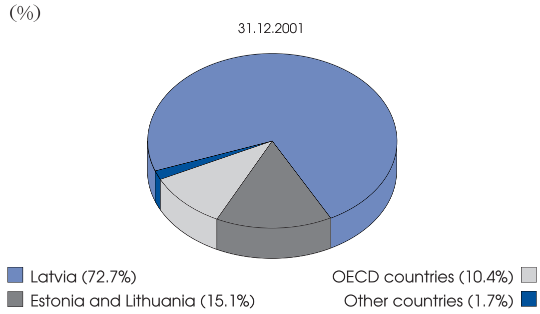


Figure 20
SECURITIES PORTFOLIO OF INVESTMENT FUNDS, BROKEN DOWN BY COUNTRY
(%)



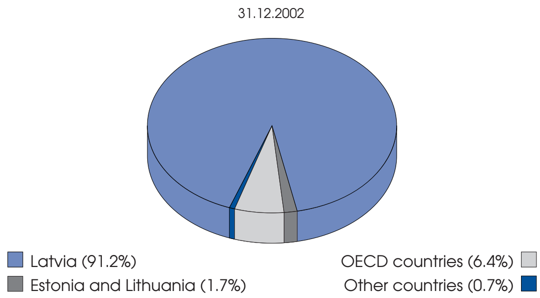
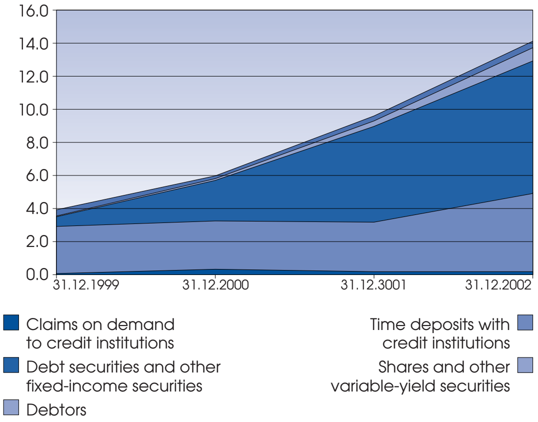


Figure 21
STRUCTURE OF PENSION PLAN ASSETS
(in millions of lats)



Until 2003, assets of the State-funded pension scheme, or the second-tier pension system, were managed by the State Treasury. However, since 1 January 2003, the management of the second-tier pension system has also been open to licensed private asset managers.

During the reporting year, five investment companies obtained licences for managing the second-tier pension system.

At the end of 2002, these investment companies and the State Treasury offered a total of 11 investment plans to second-tier participants.

Before 31 December 2002, 335 000,[11] or 14% of Latvian residents[12] had joined the second-tier of the State pension system. During 2002, 28 094[13] participants, or 8% of the total number of scheme participants, had voluntarily joined the State-funded pension scheme (compared to 26 188[14] residents, or 10% the total number of scheme participants, in 2001).

In 2002, 8.997 million lats were transferred from the State Social Insurance Agency to second-tier participants' accounts. On 31 December 2002, the net assets of the investment plan managed by the State Treasury amounted to 12.3 million lats.

At the end of the reporting period, the value of each investment share was 1.09 lats (compared to 1.02 lats at the end of 2001). Thus the value of each investment share of second-tier pension scheme participants increased by 6.9%.

[11] Data of the State Social Insurance Agency.
[12] Latvia had 2 330 300 inhabitants in December 2002, according to the information published on the Internet home page of the Central Statistics Board of the Republic of Latvia.
[13] Data of the State Social Insurance Agency.
[14] Data of the State Social Insurance Agency.

Financial Statements
of the Financial and Capital Market Commission
for 2002

Management Report on the Budget's Implementation

The Financial and Capital Market Commission (hereinafter – the Commission) has been operating since 1 July 2001 in accordance with the Law on the Financial and Capital Market Commission.

In compliance with Article 7 of the Law on the Financial and Capital Market Commission, the financing for activities of the Commission and the use of these funds were specified by the Commission's Budget for 2002, which was approved by Decision No. 22/3 of the Commission's Board on 7 December 2001. Pursuant to Article 5 of the Transitional Provisions of the Law on the Financial and Capital Market Commission and 14 December 2001 Decision of the Commission's Board No. 23/6 on the Approval of the Regulations on the Amount of Payments by Financial and Capital Market Participants for Financing the Financial and Capital Market Commission and on the Procedures for Submission of Reports for the Year 2002, as of 2002, the financing of activities of the Commission by securities market participants and private pension funds, the financing of which in 2002 could not exceed 50 000 lats, and credit unions was launched.

The Commission conducted accounting in accordance with the Law on Accounting and, as an autonomous public institution possessing State property, complied with the basic principles set out in instructions issued by the State Treasury.

During the reporting year, pursuant to Article 6 of the Law on the Financial and Capital Market Commission, the Commission managed the Deposit Guarantee Fund and the Fund for the Protection of the Insured. For the purposes of a clearer perception, assets of the funds managed by the Commission have been disclosed separately in the balance sheet.

In 2002, the Commission utilised all the funds provided for the establishment of the Commission and commencement of its activities. In 2001, the funds for establishment of the Commission and commencement of its activities were allocated in accordance with the Law on the State Budget for the Year 2001 and 16 November 2000 Decision of the Board of Governors of the Bank of Latvia No. 80/8 on Expenses of the Bank of Latvia for Establishment of the Financial and Capital Market Commission and Commencement of Its Activities. In total, 888 299 lats were used to establish the Commission and to commence its activities.

In 2002, pursuant to Article 13 of the Law on Natural Person Deposit Guarantees (since 1 January 2003 – the Deposit Guarantee Law) and Article 97 of the Law on Insurance Companies and Their Supervision, assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured could only be invested in Latvian Government securities. In 2002, assets of the funds managed by the Commission were invested in compliance with the requirements of the Regulations on the Issue of Latvian Government Securities approved by Instruction No. 87 issued by the Ministry of Finance on 23 January 2002 as well as in compliance with the provisions of the Agreement entered into between the Commission and the State Treasury on Investing Funds of the Deposit Guarantee Fund and the Fund for the Protection of the Insured in Latvian Government Securities.

Since assets of the Commission are State property, on the basis of the Law on the State and Local Government Procurement, State tenders were organised for transactions performed by the Commission.

In 2002, the State Audit Office did not perform any audits relating to activities of the Commission.

On 17 December 2002, following the relevant public sector procurement procedures, the Commission selected Ernst & Young Baltic SIA, represented by Certified Auditor Gundars Ruža, as an auditor of its financial statements for the year 2002.

Total Budget of the Commission

At the end of 2002, assets of the Commission, including managed trust assets, i.e. resources of the Deposit Guarantee Fund and the Fund for the Protection of the Insured, were 9 658 927 lats. In 2002, total revenues were made up of the Commission's financing revenues, which amounted to 1 995 621 lats. The operating expenses of the Commission were 1 857 978 lats. The excess of revenues over expenses for ensuring the Commission's activities was 137 643 lats. The decrease in expenses was achieved by reducing costs as compared to the budget expenses, i.e. mainly expenses related to maintenance, communication, information services and professional services. The expenses on the establishment of the Commission and commencement of its activities totalled 300 358 lats. In addition, in 2002, the funds for commencement of the Commission's activities were utilised in full.

Funds for the Establishment of the Commission and Commencement of Its Activities

In accordance with the cost estimate for the establishment of the Commission and commencement of its activities agreed between the Bank of Latvia, the Insurance Supervision Inspectorate and the Securities Market Commission on 14 November 2000, as well as in accordance with the amendments thereof made on 26 June 2001, the expenditure budget for establishment of the Commission and commencement of its activities was set in the amount of 884 200 lats. Based on 16 November 2000 Decision of the Board of Governors of the Bank of Latvia No. 80/8 on Expenses of the Bank of Latvia for Establishment of the Financial and Capital Market Commission and Commencement of Its Activities, funds in the amount of 694 000 lats were granted, of which the amount whose utilisation was not specified in the estimate (reserves) made up 12 000 lats. Though prepayments of rent in the coordinated cost estimate were planned in the amount of 404 200 lats, as a result of currency exchange fluctuations, the prepayments had to be covered in the amount of 410 499 lats; this difference was covered from the additional funds (reserves) allocated by the Bank of Latvia, of which only 6 299 lats were used. Overall financing for the establishment of the Commission and commencement of its activities was 888 299 lats, which was made up of 688 299 lats granted by the Bank of Latvia and of 200 000 lats allocated by the State budget. On 1 January 2002, the net assets of the budget for establishment of the Commission and commencement of its activities accounted for 739 262 lats and they were reflected in the balance sheet of the Commission in the composition of equity. The use of the rest of funds earmarked for the remainder of these budget monies, which at the beginning of the reporting year amounted to 61 885 lats, was presented in the cash flow statement of establishment of the Commission and commencement of its activities. The funds for the establishment of the Commission and commencement of its activities were utilised in compliance with the estimate provided.

Ensurance of Operations of the Commission in 2002

On the basis of forecasts made for the economic activity of financial and capital market participants in 2002, the Commission planned its revenues precisely. In 2002, the actual revenues of the Commission were 1 995 621 lats, or 0.1% less than the forecasted revenues laid down in the budget approved by the Commission's Board on 7 December 2001 (1 997 898 lats). Expenses of the Commission were 1 857 978 lats, or 95.3% of the planned expenses (1 950 498 lats), of which 83% were used for the staff remuneration and compulsory contributions for the State social insurance. In total, the excess of revenues over expenses for ensuring the Commission's activities in 2002 was 137 643 lats.

Management of the Deposit Guarantee Fund and the Fund for the Protection of the Insured

In the reporting period, revenues of the Deposit Guarantee Fund from credit institution payments comprised 2 340 149 lats while revenues of the Fund for the Protection of the Insured from payments of insurers, 173 940 lats. Revenues from investments of the Deposit Guarantee Fund were 205 140 lats while of the Fund for the Protection of the Insured, 27 359 lats. Total assets of these funds increased by 2 737 245 lats, or 47.5%, that is, assets of the Deposit Guarantee Fund increased by 2 545 289 lats, or 49.9%, while assets of the Fund for the Protection of the Insured, by 191 956 lats, or 28.8%. At the end of 2002, net financial assets of the Deposit Guarantee Fund made up 7 644 979 lats while the net financial assets of the Fund for the Protection of the Insured, 857 578 lats.

In the reporting period, the Commission placed assets of the funds in both short-term and long-term Latvian Government securities. In 2002, the rate of return on assets of the Deposit Guarantee Fund reached 3.22%, while the rate of return on assets of the Fund for the Protection of the Insured, 3.59%, which was determined by dividing the investment revenues (received and accrued) of the relevant fund in 2002 by the average asset value of the relevant fund in 2002.

Uldis Cērps
Chairman of the Financial and
Capital Market Commission

21 March 2003

Balance Sheet as of 31.12.2002 (in lats)

ASSETS	Note	31.12.2002	31.12.2001
ASSETS OF THE FUNDS			
LONG-TERM INVESTMENTS		**1 036 514**	**-**
Investments in securities	4	**1 036 514**	**-**
Securities of the Deposit Guarantee Fund		942 945	-
Securities of the Fund for the Protection of the Insured		93 569	-
CURRENT ASSETS		**7 466 043**	**5 765 312**
Receivables		**686 804**	**525 427**
Due from market participants to the funds	5	686 804	525 427
Investments in securities	4	**6 739 069**	**5 239 855**[1]
Securities of the Deposit Guarantee Fund		6 063 123	4 613 781
Securities of the Fund for the Protection of the Insured		675 946	626 074
Cash		**40 170**	**30**
TOTAL ASSETS OF THE FUNDS		**8 502 557**	**5 765 312**
ASSETS OF THE COMMISSION			
LONG-TERM INVESTMENTS	3	**400 747**	**502 439**
Intangible assets		75 048	83 169
Fixed assets		236 468	331 547
Leasehold improvements		59 662	82 355
Prepayments for long-term investments		29 569	5 368
CURRENT ASSETS		**755 623**	**893 132**
Stock		**370**	**7 419**
Accounts receivable		**156 494**	**148 828**
Due from market participants to the Commission	6	152 951	139 724
Other receivables		2 159	1 000
Due from the personnel		1 384	2 043
Overpaid taxes	7	-	6 061
Prepaid expenses	8	**184 507**	**361 828**
Cash		**414 252**	**375 057**
TOTAL ASSETS OF THE COMMISSION		**1 156 370**	**1 395 571**
TOTAL ASSETS		**9 658 927**	**7 160 883**

The accompanying notes on pages 33 to 40 form an integral part of these financial statements.

[1] Item *Investments in Securities* was increased (by 144 319 lats), including income accrued by the funds, which in the financial statements for 2001 was shown under the balance sheet item *Settlement of Other Payables*.

LIABILITIES AND EQUITY

	Note	31.12.2002	31.12.2001
LIABILITIES AND EQUITY OF THE FUNDS			
EQUITY	9	**8 502 557**	**5 755 969**
Net financial assets (budget result)		**8 502 557**	**5 755 969**
Net financial assets of the Deposit Guarantee Fund		7 644 979	5 099 690
Net financial assets of the Fund for the Protection of the Insured		857 578	656 279
PAYABLES		**-**	**9 343**
Prepayments received in the Deposit Guarantee Fund		-	-
Prepayments received in the Fund for the Protection of the Insured		-	9 343
TOTAL LIABILITIES AND EQUITY OF THE FUNDS		**8 502 557**	**5 765 312**
LIABILITIES AND EQUITY OF THE COMMISSION			
EQUITY	9	**1 139 815**	**1 350 244**
Net assets of the Commission (budget result)		1 139 815	1 350 244
PAYABLES		**16 555**	**45 327**
Accounts payable to suppliers and contractors	10	16 522	29 656
Taxes	7	33	6 485
Deferred income		-	9 186
TOTAL LIABILITIES AND EQUITY OF THE COMMISSION		**1 156 370**	**1 395 571**
TOTAL LIABILITIES		**9 658 927**	**7 160 883**

The accompanying notes on pages 33 to 40 form an integral part of these financial statements.

Chairman of the Financial and Capital Market Commission — Uldis Cērps

Head of the Accounting Division — Rita Vanaga

21 March 2003

Statement of Income and Expenses (in lats)

	Note	Budget of the Commission for 2002	Budget of the Commission for the period 01.07.2001 to 31.12.2001
REVENUES			
State budget		198 962	120 556
Bank of Latvia		1 200 000	600 000
Payments of insurance companies		543 699	248 031
Life insurance companies		26 873	10 820
Other insurance companies		516 826	237 211
Payments of securities market participants and private pension funds		50 000	-
Securities market participants		35 791	-
Private pension funds		14 209	-
Payments of credit unions		2 957	-
Other		3[2]	(9)
Total revenues		**1 995 621**	**968 578**
EXPENSES			
Staff remuneration and other payments		(1 541 487)	(736 274)
Staff remuneration and other payments	11	(1 259 303)	(621 769)
State social insurance compulsory contributions		(282 184)	(114 505)
Staff insurance	12	(69 493)	(9 948)
Improvement of professional skills and business trips	13	(60 114)	(26 073)[3]
Telecommunication and information		(37 832)	(21 145)
Public awareness and external and internal communications		(28 223)	(12 011)[4]
Maintenance expenses		(67 936)	(31 419)[4]
Professional services		(24 353)	(7 811)
Participation in international organisations		(9 489)	(108)[3]
Depreciation/amortisation/ write-off of capital investments	3	(19 051)	(17 825)
Total expenses		**(1 857 978)**	**(862 614)**
Excess of revenues over expenses		**137 643**	**105 964**
Excess of revenues over expenses related to the establishment of the Commission and commencement of its activities	15	**(300 358)**	**539 071**
Excess of revenues over expenses of the Deposit Guarantee Fund and the Fund for the Protection of the Insured	2	**2 746 588**	**1 164 303**
BUDGET RESULT		**2 583 873**	**1 809 338**

The accompanying notes on pages 33 to 40 form an integral part of these financial statements.

Chairman of the Financial and Capital Market Commission — Uldis Cērps

Head of the Accounting Division — Rita Vanaga

21 March 2003

[2] Income from interest on the balance of debit cards of the Commission.

[3] Item *Improvement of Professional Skills and Business Trips* is increased (by 20 645 lats), including expenses related to the staff's business trips, whereas item *Participation in International Organisations* is reduced by this very same amount. In financial statements for 2001, business trip expenses were shown under the expense item *Business Trips and Participation in International Organisations.*

[4] Item *Public Awareness and External and Internal Communications* is increased (by 5 217 lats), including internal communication expenses of the Commission, whereas item *Maintenance Expenses* is reduced by this very same amount. In financial statements for 2001, internal communication expenses of the Commission were shown under the expense item *Maintenance Expenses.*

Cash Flow Statement (in lats)

	Note	Budget of the Commission for 2002	Budget of the Commission for the period 01.07.2001 to 31.12.2001
RECEIPTS			
State budget		198 962	120 556
Bank of Latvia		1 200 000	600 000
Payments of insurance companies		530 097	258 465
Life insurance companies		24 532	9 231
Other insurance companies		505 565	249 234
Payments of securities market participants and private pension funds		42 105	4 194
Securities market participants		33 382	-
Private pension funds		8 723	4 194
Payments of credit unions		2 042	-
Transfer of free cash of the Insurance Supervision Inspectorate from the State Treasury		-	160 628
Total receipts		**1 973 206**	**1 143 843**
PAYMENTS			
Staff remuneration and other payments		(1 542 426)	(731 026)
Staff remuneration and other payments		(1 260 280)	(616 556)
State social insurance compulsory contributions		(282 146)	(114 470)
Staff insurance		(54 585)	(21 167)
Improvement of professional skills and business trips		(64 053)	(15 495)[5]
Telecommunication and information		(42 249)	(21 221)
Public awareness and external and internal communications		(24 674)	(12 250)[6]
Maintenance expenses		(70 445)	(23 966)[6]
Professional services		(25 041)	(4 252)
Participation in international organisations		(9 837)	(1 294)[5]
Total payments		**(1 833 310)**	**(830 671)**
INVESTMENT ACTIVITIES			
Capital expenditure		(38 816)	-
Total investment activities		**(38 816)**	**-**
Net change in cash during the reporting period		**101 080**	**313 172**
Net change in cash from the cash flow of establishment of the Commission and commencement of its activities	14	**(61 885)**	**(133 931)**
Cash balance at the beginning of the reporting period	16	**375 057**	**195 816**
Cash balance at the end of the reporting period	16	**414 252**	**375 057**
Cash balance from the cash flows of the Deposit Guarantee Fund and the Fund for the Protection of the Insured	2	**40 170**	**30**
TOTAL CASH AT THE END OF THE PERIOD		**454 422**	**375 087**

The accompanying notes on pages 33 to 40 form an integral part of these financial statements.

Chairman of the Financial and Capital Market Commission — Uldis Cērps

Head of the Accounting Division — Rita Vanaga

21 March 2003

[5] Item *Improvement of Professional Skills and Business Trips* is increased (by 10 855 lats), including expenses related to the staff's business trips, whereas item *Participation in International Organisations* is reduced by this very same amount. In financial statements for 2001, business trip expenses were shown under the expense item *Business Trips and Participation in International Organisations*

[6] Item *Public Awareness and External and Internal Communications* is increased (by 5 217 lats), including internal communication expenses of the Commission, whereas item *Maintenance Expenses* is reduced by this very same amount. In financial statements for 2001, internal communication expenses of the Commission were shown under the expense item *Maintenance Expenses*.

Statement of Changes in Equity (in lats)

	Note	Result of the budget for establishment of the Commission and commencement of its activities	Result of the budget for financing the Commission	**Net assets of the Commission (result of total budget)**	Result of the Deposit Guarantee Fund	Result of the Fund for the Protection of the Insured	**Net financial assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured (budget result)**
Budget result 01.07.2001		**195 009**	**407 033**[7]	**602 042**	**3 611 615**	**524 614**	**4 136 229**
Changes pertaining to the period before 01.07.2001		5 182	126 547	**131 729**	421 249	34 188	**455 437**
Fixed asset depreciation charged to the budget result	1	-	(28 562)	**(28 562)**	-	-	-
Budget result of 6 months of 2001		539 071	105 964	**645 035**	1 066 826	97 477	**1 164 303**
Budget result 31.12.2001		**739 262**	**610 982**	**1 350 244**	**5 099 690**	**656 279**	**5 755 969**
Fixed asset depreciation/ write-off charged to the budget result	1	-	(47 714)	**(47 714)**	-	-	-
Budget result of the reporting period		(300 358)	137 643	**(162 715)**	2 545 289	201 299	**2 746 588**
Budget result 31.12.2002		**438 904**	**700 911**	**1 139 815**	**7 644 979**	**857 578**	**8 502 557**

The accompanying notes on pages 33 to 40 form an integral part of these financial statements.

Chairman of the Financial and Capital Market Commission — Uldis Cērps

Head of the Accounting Division — Rita Vanaga

21 March 2003

[7] Result of the budget for financing the Commission was made up of the net assets taken over from the Bank of Latvia – in the amount of 43 894 lats; from the Insurance Supervision Inspectorate – in the amount of 299 616 lats; from the Securities Market Commission – in the amount of 55 710 lats; from the Deposit Guarantee Fund – in the amount of 7 813 lats.

Notes to the Financial Statements

The Financial and Capital Market Commission (hereinafter – the Commission) was established and operates in accordance with the Law on the Financial and Capital Market Commission.
The objective of activities of the Commission is to promote the protection of interests of investors, depositors and the insured as well as the development and stability of the financial and capital market.

1. Accounting Policies of the Commission

Basis for Preparation of the Financial Statements
The financial statements were prepared on the basis of the principles set out in Instruction No. 3 issued by the State Treasury on the Preparation of Semi-annual Reports, Nine-month Reports, Annual Reports for State Budget Institutions and Annual Reports for Local Government Budget Institutions.
The accounting principles applied were consistently used when preparing the financial statements for the years 2001 and 2002.
In relation to changes in the classification of expense items in 2002, relevant indicators of the previous year presented in these statements were attributed to those items for which expenses were accounted for in 2002.
The Commission presented all assets and liabilities, including those of the Deposit Guarantee Fund and the Fund for the Protection of the Insured, in a single balance sheet. The Commission reflected all revenues and expenses related to its financing as well as revenues and expenses of the Deposit Guarantee Fund and the Fund for the Protection of the Insured in a single statement of income and expenses.
Also, the cash flow statement and the statement of income and expenses of the Deposit Guarantee Fund and the Fund for the Protection of the Insured were prepared as separate notes to the financial statements.
The cash flow statement and the statement of income and expenses for the assets constituting the financing for establishment of the Commission and commencement of its activities were also prepared as separate notes to these financial statements. The acquired assets will henceforth be utilised for ensuring activities of the Commission, consequently, these assets were included in the single balance sheet of the Commission.

Accounting Principles Applied
The financial statements were prepared in compliance with the following accounting principles:

- Accounting is performed on an accrual basis providing for recognition of revenues and expenses in the financial statements at the date of occurrence, irrespective of the related cash flows. Revenues are derived on the basis of payments of the Bank of Latvia and the State budget specified by law as well as on the basis of business operations performed by financial and capital market participants, which are reported in the submitted financial statements and from which payments to be made are calculated. Expenses are recognised at the date of occurrence, with the exception of vacation reserves, which are not included in salary payments. Taking into account the procedure prescribed by the By-law of the Commission regarding the calculation of bonus and material assistance payments and funds provided for such purposes, vacation reserves are not calculated; thus the management of the Commission does not consider that the setting up of such reserves is efficient.
- Assets are recognised at historic cost. Assets are booked on the date of acquisition at the amount of paid cash or cash equivalents, or at fair value of other consideration provided plus any other costs related directly to acquisition.

- Transactions and other events are reflected by taking into account the principle of substance over form stating that transactions and events should be recognised and disclosed according to their contents and economic substance and not only according to their legal form.
- The financial statements have been prepared on a going concern basis.

Fixed Assets

Long-term investments are recognised in accordance with the basic principles set out in the Instructions of the Ministry of Finance for the Accounting of State (Local Government) Budget Institutions and Local Government Budgets. Depreciation rates for long-term investments are applied in accordance with Regulation No. 96 issued by the Cabinet of the Republic of Latvia on 6 March 2001, On Fixed Asset Depreciation Rates for Budget Institutions, which stipulates the following annual depreciation rates:

- computers and equipment 35%;
- other fixed assets 20%.

The Commission applied such depreciation rates to those fixed assets which were acquired after 31 December 2000 as well as to those fixed assets whose residual useful life on 1 July 2001 was more than half of the useful life determined for a similar new asset. The depreciation calculated for these fixed assets was included in the Statement of Income and Expenses of the Commission.

An annual 50% depreciation rate was applied to those fixed assets taken over from budget institutions (the Insurance Supervision Inspectorate, the Securities Market Commission and the Deposit Guarantee Fund Administration) on 1 July 2001, the residual useful life of which was less than half of the useful life determined for a similar new asset.

The amount of depreciation for fixed assets, which were taken over from budget institutions at the moment of establishing the Commission on 1 July 2001 and acquired prior to 31 December 2000, was not charged to the Commission's Statement of Income and Expenses, instead the value of fixed assets and the budget result was decreased by this amount. In the respective institutions, fixed assets were expensed in their full value at the date of acquisition in the Statement of Income and Expenses and a corresponding fixed asset fund for this amount was added to the equity.

The following annual depreciation rates were applied to leasehold improvements:

- security systems 33%;
- fixings 20%.

Depreciation of leasehold improvements was charged to the Statement of Income and Expenses.

Securities

Securities in the possession of the Commission are being held to maturity. Valuation of securities was performed using the straight-line discount amortisation method.

Accounts Receivable

The Commission as a State institution steadily follows that settlements are made in due time (balance sheet item *Accounts receivable* (due from market participants to the Commission)). In case of a doubtful debtor, the debtor will be excluded from the balance sheet item *Accounts receivable* by decreasing revenues of the Commission in that reporting period for which the debtor has been excluded.

2. Actual Result of Revenues and Expenses and Cash Flows of the Deposit Guarantee Fund and the Fund for the Protection of the Insured (in lats)

	Actual result of revenues and expenses in 2002	Actual result of revenues and expenses 01.07.-31.12.2001
REVENUES		
Payments to the Deposit Guarantee Fund	2 340 149	934 577
Payments to the Fund for the Protection of the Insured	173 940	77 000
Payments of life insurance companies to the Fund for the Protection of the Insured	25 273	11 801
Payments of other insurance companies to the Fund for the Protection of the Insured	148 667	65 199
Income from investments	232 499	152 726
In the Deposit Guarantee Fund	205 140	132 248
In the Fund for the Protection of the Insured	27 359	20 478
RESULT	**2 746 588**	**1 164 303**

	Cash flow in 2002	Cash flow 01.07.-31.12.2001
RECEIPTS		
Payments to the Deposit Guarantee Fund	2 187 194	869 943
Payments to the Fund for the Protection of the Insured	156 175	72 593
Payments of life insurance companies to the Fund for the Protection of the Insured	24 399	9 060
Payments of other insurance companies to the Fund for the Protection of the Insured	131 776	63 533
Income from investments	192 702	8 407
In the Deposit Guarantee Fund	171 075	2 529
In the Fund for the Protection of the Insured	21 627	5 878
Transfer of free cash of the funds from the State Treasury	-	3 937 657
Other payments	-	9 343
Total receipts	**2 536 071**	**4 897 943**
INVESTMENT ACTIVITIES		
Investments in securities	**(7 601 540)**	**(5 266 024)**
Investments of the Deposit Guarantee Fund	(6 851 449)	(4 647 933)
Investments of the Fund for the Protection of the Insured	(750 091)	(618 091)
Investments of the Fund for the Protection of the Life Insured	(174 654)	(145 494)
Investments of the Fund for the Protection of the Other Insured	(575 437)	(472 597)
Repayment of securities	**5 105 609**	**368 111**
Repayment of investments of the Deposit Guarantee Fund	4 493 227	163 871
Repayment of investments of the Fund for the Protection of the Insured	612 382	204 240
Repayment of investments of the Fund for the Protection of the Life Insured	145 581	79 989
Repayment of investments of the Fund for the Protection of the Other Insured	466 801	124 251
Result of investment activities	**(2 495 931)**	**(4 897 913)**
RESULT	**40 140**	**30**
Cash balance at the beginning of the reporting period	**30**	**-**
Cash balance at the end of the reporting period	**40 170**	**30**

3. Long-term Investments

	Intangible assets	Fixed assets				Prepayments for	
	Licences and software	Computers and office equipment	Transport vehicles	Other fixed assets	Leasehold impro-vements	long-term invest-ments	Total
Book value							
31.12.2001	**83 169**	**168 858**	**26 848**	**135 841**	**82 355**	**5 368**	**502 439**
Additions	28 478	25 235	-	6 378	-	29 569	89 660
Write-offs and disposals	-	(11 490)	-	-	-	(5 368)	(16 858)
On 31.12.2002	**111 647**	**182 619**	**26 848**	**142 219**	**82 355**	**29 569**	**575 241**
Depreciation/Amortisation							
Charge	36 599	77 436	5 906	42 425	22 693	-	185 059
Reversal due to disposals	-	(10 565)	-	-	-	-	(10 565)
On 31.12.2002	**36 599**	**66 871**	**5 906**	**42 425**	**22 693**	**-**	**174 494**
Book value							
31.12.2002	**75 048**	**115 732**	**20 942**	**99 794**	**59 662**	**29 569**	**400 747**

In 2002, prepayments for long-term investments were made in the amount of 29 569 lats, i.e. for the development of the statistical information system in electronic format, which was provided for the compilation, storage and processing of statistical information of financial and capital market participants – in the amount of 17 387 lats, for the software for the exchange of ciphered data with financial and capital market participants – in the amount of 9 527 lats, for the software ensuring the work of the Commission – in the amount of 2 065 lats, and for the improvement of the accounting software of the Commission – in the amount of 590 lats.

In the reporting period, the depreciation/amortisation calculated for long-term investments of the Commission amounted to 185 059 lats. The calculated depreciation/amortisation in the amount of 136 838 lats was included in the Statements of Income and Expenses, and in the amount of 48 221 lats was charged against the result of the Commission's budget, as shown in the Statement of Changes in Equity. The depreciation/amortisation calculated for investments in fixed assets and leasehold improvements from the budget for establishment of the Commission and commencement of its activities in the amount of 118 226 lats was included in the Statement of Income and Expenses pertaining to the budget for establishment of the Commission and commencement of its activities, as shown in Note 16. The depreciation/amortisation of the fixed assets taken over from the Bank of Latvia in the amount of 18 612 lats was included in the Statement of Income and Expenses of the Commission.

At the end of 2002, the net book value of the assets taken over, which in the next periods will be attributed to the result of the Commission's budget, was 59 063 lats. The number of these fixed assets – 446 units.

4. Investments in Securities

This item contains purchased Latvian Government securities. The value of the securities was disclosed in the balance sheet as the amount of historic cost and accrued income of the securities.

Securities of the funds were placed in the following issues of the Latvian Government securities:

2002

Issue No.	Purchase date	Maturity date	Annual rate of return (%)	Nominal value (in lats)	Book value (in lats)
LV0000570034	07.06.2002	08.05.2007	5.50	1 028 000	1 036 514
LV0000531986	09.08.2002	07.02.2003	3.68	928 500	924 749
LV0000540698	19.04.2002	17.04.2003	4.61	5 252 800	5 180 720
LV0000540714	06.12.2002	05.12.2003	3.33	653 500	633 600
				7 862 800	7 775 583

2001

Issue No.	Purchase date	Maturity date	Annual rate of return (%)	Nominal value (in lats)	Book value (in lats)
LV0000531945	06.07.2001	04.01.2002	6.56	4 071 200	4 068 372
LV0000531960	05.10.2001	05.04.2002	5.74	212 100	209 023
LV0000531978	09.11.2001	10.05.2002	7.17	687 000	673 358
LV0000540664	20.07.2001	19.07.2002	5.74	299 100	289 102
				5 269 400	5 239 855

At the end of the reporting period, the breakdown of the accrued income included in the book value of securities was as follows:

	31.12.2002	31.12.2001
Accrued income of the Deposit Guarantee Fund	163 784	129 719
Accrued income of the Fund for the Protection of the Insured	20 332	14 600
	184 116	144 319

5. Due from Market Participants to the Funds

This item contains amounts due from financial and capital market participants to the Deposit Guarantee Fund and the Fund for the Protection of the Insured for the fourth quarter ended 31 December 2002 and the fourth quarter ended 31 December 2001, respectively, with the exception of the amounts overdue, as indicated hereinafter. At the end of 2002, there was an overdue payment in the amount of 109 lats from one market participant for the third quarter ended 30 September 2002.

	31.12.2002	31.12.2001
Due from market participants to the Deposit Guarantee Fund	638 838	485 883
Due from market participants to the Fund for the Protection of the Insured	47 966	39 544
Due from the Fund for the Protection of the Life Insured	7 907	7 033
Due from the Fund for the Protection of the Other Insured	40 059	32 511
	686 804	525 427

6. Due from Market Participants to the Commission

This item contains amounts due from financial and capital market participants to the Commission on the date indicated in the Statement for the fourth quarter ended 31 December 2002 and the fourth quarter ended 31 December 2001, respectively, with the exception of the amounts overdue, as indicated hereinafter. At the end of 2002, there was an overdue payment in the amount of 4 244 lats from one market participant for the second and third quarter ended 30 September 2002 and 30 June 2002, respectively.

7. Taxes

Type of tax	Balance on 31.12.2001	Calculated in the reporting period	Decreased SSICC result	Paid in the reporting period	Balance on 31.12.2002
State social insurance compulsory contributions (SSICC) liabilities/(overpayment)	(6 061)	385 142	(4 176)	(374 905)	-
Resident income tax liabilities/(overpayment)	6 485	284 106	-	(290 558)	33
	424	669 248	(4 176)	(665 463)	33

Including:	31.12.2001	31.12.2002
Tax liabilities/(overpayment)	(6 061)	-
Tax liabilities/(overpayment)	6 485	33

8. Prepaid Expenses

	31.12.2002	31.12.2001
Prepayment for rent of premises until 9 January 2004	173 971	343 833
Services of news agencies	2 642	-
Periodic literature	2 557	-
Membership dues	1 535	1 186
Commission's property insurance	1 370	1 339
Staff health and accident insurance	-	14 997
Other prepaid expenses	2 432	473
	184 507	361 828

9. Equity

This item contains net assets of the Commission (result of total budget) and the net financial assets of the funds managed by the Commission (budget result). Changes thereof are disclosed in the Statement of Changes in Equity and Notes thereto.

10. Accounts Payable to Suppliers and Contractors

This item contains payables for the materials and services supplied to the Commission in the previous month on the date indicated in the Statement.

11. Staff Remuneration and Other Payments

Contains remuneration to the staff of the Commission, including remuneration to the Board in the amount of 208 803 lats, or 16.6% of total remuneration expenses. At the beginning of 2002, 95 employees were employed by the Commission. Within the reporting year, as a result of improvements to the work organisation process, seven positions were eliminated, and there were 88 positions at the Commission at the end of the year.

12. Staff Insurance

The actual expenses related to the Commission' s staff insurance are as follows:

	01.01.-31.12.2002	01.07.-31.12.2001
Endowment life insurance	47 940	-
Health insurance	11 770	5 719
Accident insurance	9 783	4 229
	69 493	9 948

In 2002, in accordance with the Procedure approved by the Board of the Commission for Health Insurance, Accident Insurance and Endowment Life Insurance for the Staff of the Commission, the Commission effected insurance for its staff, namely, endowment life insurance for those employees who had been employed by financial and capital market supervisory authorities for at least five years, as well as endowment life insurance for the Board members of the Commission. In 2002, for the endowment life insurance contract, the Commission paid the insurer for each insured person the insurance premium in the amount of the respective person's monthly salary.

13. Improvement of Professional Skills and Business Trips

In 2002, the staff's business trip expenses comprised 29 660 lats. In the period from 1 July to 31 December 2001, they totalled 20 645 lats and were disclosed in the Statement of Income and Expenses and the Cash Flow Statement for 2001 under the item *Business Trips and Participation in International Organisations.*

14. Cash Flow of the Budget for Establishment of the Commission and Commencement of Its Activities

In 2002, the Commission utilised all the funds provided for its establishment and commencement of its activities. In 2002, the cash flow of the budget for establishment of the Commission and commencement of its activities (in lats) was as follows:

	Cash flow in 2002	**Cash flow 01.07.-31.12.2001**
RECEIPTS		
Bank of Latvia	-	688 299
Other	-	(280)
Total receipts	**-**	**688 019**
PAYMENTS		
Staff remuneration and other payments	5 181	(16 880)
Staff remuneration and other payments	(915)	(14 268)
State social insurance compulsory contributions	6 096	(2 612)
Improvement of professional skills and business trips	-	(236)
Telecommunication and information	-	(2 345)
Public awareness and external and internal communications	(3 540)	(310)
Maintenance expenses	(1 144)	(436 890)
incl. rent	-	(410 499)
Professional services	(1 198)	-
Participation in international organisations	-	(94)
Total payments	**(701)**	**(456 755)**
INVESTMENT ACTIVITIES		
Capital expenditure		
Software	(38 179)	(52 940)
Computers and data processing equipment	(18 571)	(98 999)
Furniture and fixings	(1 970)	(99 085)
Other fixed assets	(2 464)	(27 304)
Substantial repairs	-	(86 867)
Total investment activities	**(61 184)**	**(365 195)**
Net change in cash during the reporting year	**(61 885)**	**(133 931)**
Cash balance at the beginning of the reporting period	**61 885**	**195 816**
Cash balance at the end of the reporting period	**-**	**61 885**

15. Income and Expenses of the Budget for Establishment of the Commission and Commencement of Its Activities

In 2002, the actual result of the revenues and expenses of the budget for establishment of the Commission and commencement of its activities (in lats) was as follows:

	Revenues and expenses in 2002	Revenues and expenses 01.07.-31.12.2001
REVENUES		
Bank of Latvia	-	688 299
Total revenues	**-**	**688 299**
EXPENSES		
Staff remuneration and other payments	-	(16 469)
Telecommunication and information	-	(1 269)
Public awareness and external and internal communications	(3 540)	(310)
Maintenance expenses	(177 257)	(87 113)
incl. rent	(169 862)	(66 666)
Professional services	(1 198)	-
Depreciation/amortisation/write-off of capital investments (See Note 3)	(118 363)	(44 067)
Total expenses	**(300 358)**	**(149 228)**
Excess of revenues over expenses	**(300 358)**	**539 071**

16. Cash Balance

Contains balance of the budget for establishment of the Commission and commencement of its activities and cash of the Commission's budget. On 1 July 2001, cash balance was made up of the cash balance of the budget for establishment of the Commission and commencement of its activities. On 31 December 2002, cash balance was made up of the cash balance of the Commission's budget only. The cash was held with the Bank of Latvia.

17. Significant Agreements

On 5 December 2000, a contract between the Bank of Latvia and *SIA Drave* was concluded for the rent of premises at 1 Kungu Street, Riga, for 10 years, which was renewed between the Commission and *SIA Drave* on 2 August 2001. The Commission has no intention to terminate the contract.

18. Court Proceedings and Claims

The Commission, when performing the functions specified by the Law on the Financial and Capital Market Commission, may become involved in court proceedings related to supervision activities.

At the moment of signing the financial statements, the Commission as a defendant is being involved in a court proceeding of financial nature. The management of the Commission is of the opinion that the amount of this claim totalling 225 990 lats is unfounded and should be rejected in substance. The application filed by the plaintiff on 28 February 2003 in the Riga Regional Court requesting the court to dismiss the claim raised by the plaintiff, is at the disposal of the Commission. By the moment of signing the financial statements, the court has not taken a decision on the said request made by the plaintiff. It will be adjudicated in accordance with the procedure prescribed by the Civil Procedure Law.

ERNST & YOUNG

AUDITORS' REPORT

To the Parliament
of the Republic of Latvia

We have audited the accompanying financial statements of the Financial and Capital Market Commission (hereinafter – the Commission) for the year ended 31 December 2002, set out on pages 28 through 40, which comprise the balance sheet, the statements of income and expense, cash flows and changes in equity and the related notes. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above give a true and fair view of the financial position of the Financial and Capital Market Commission as of 31 December 2002, and of the results of its operations and its cash flows for the year then ended in accordance with the accounting policies of the State Treasury instructions of the Republic of Latvia as adopted by the Financial and Capital Market Commission.

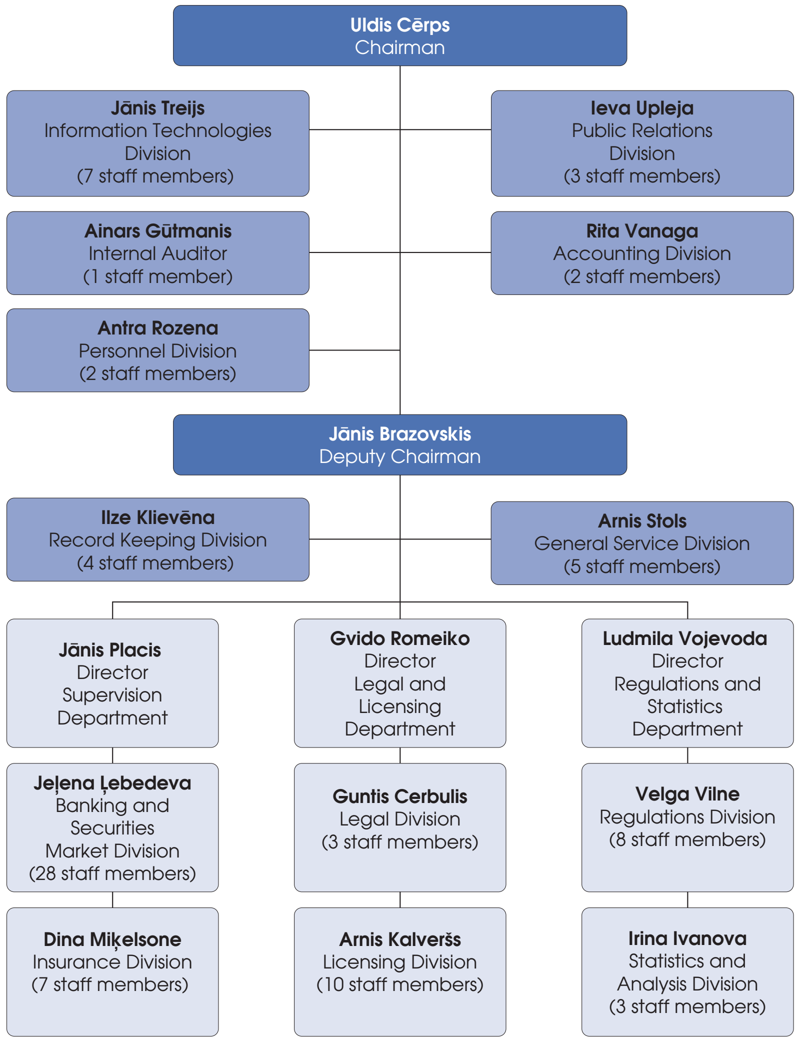
Ernst & Young Baltic SIA
License No. 17

Neil Jennings
Personal ID code: 240165-14652
Member of the Board

Gundars Ruža
Personal ID code: 310375-10517
Latvian Sworn Auditor
Certificate No. 137

Riga,
21 March 2003

STRUCTURE OF THE FINANCIAL AND CAPITAL MARKET COMMISSION



Contacts:
Financial and Capital Market Commission
Kungu iela 1, Riga, LV-1050
Tel.: (+371) 777-4800
Fax: (+371) 722-5755
http://www.fktk.lv

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A complete list of financial and capital market participants is available on the Internet home page of the Commission.