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ANNUAL REPORT OF THE FINANCIAL AND CAPITAL MARKET
COMMISSION OF THE REPUBLIC OF LATVIA FOR 2004

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Report of the Board of the Financial and Capital Market Commission

During the year 2004, the Latvian Financial and Capital Market Commission (hereinafter - Commission) continued to carry out its mandate of supervising the activities of banks, credit unions, insurance companies and insurance brokers, as well as financial instrument market participants in accordance with the Law on the Financial and Capital Market Commission. These supervisory activities took place in accordance with the Commission's strategy, which was drawn up to ensure the stability and promote the development of Latvia's financial and capital market, as well as to protect the interests of investors, depositors and the insured.

The Commission continued to work during the reporting year as an entirely autonomous state institution that is governed by its Board. The membership of the Commission's Board has remained unchanged since the Board's inception and is as follows: Chairman – Uldis Cērps, Deputy Chairman – Jānis Brazovskis, Board members – Ludmila Vojevoda, Jānis Placis and Gvido Romeiko. The Board's Chairman and his deputy were appointed to a six-year term of office by the Latvian parliament on 26 September 2000, while the other Board members were appointed by the Chairman in 2001 with the approval of the Minister of Finance and the Chairman of the Bank of Latvia.

The activities of the Commission were financed in 2004 by payments from Latvia's financial and capital market participants, as well as by payments from the national state budget and from the Bank of Latvia. The Commission did not provide any paid services and did not receive any donations. During the reporting year the Commission was not subject to audits by the State Audit Office. An inspection of the Commission's accounting procedures by the State Revenue Service did not establish any irregularities.

During the year 2004, the Board of the Commission held 50 meetings and adopted 312 decisions, of which 46 were binding on all of Latvia's financial and capital market participants. Two hundred and twenty-six (226) decisions pertained to individual market participants, of which 51 were unfavourable and applied to 61 parties, while 175 were favourable and applied to 227 parties. Forty (40) decisions concerned the management of the Commission's own activities.

The Consultative Council of the Financial and Capital Market (hereinafter – Consultative Council) met 18 times during the reporting year. The Consultative Council is formed on a parity basis of representatives of the Commission, together with the heads of professional associations of participants of the Latvian financial and capital market. The Consultative Council assessed two draft laws (the Law on Financial Conglomerates and the Law on Insurance and Re-Insurance Intermediaries), five legislative amendments (concerning the Law on Insurance Companies and Supervision Thereof, the Credit Institution Law, the Law on Private Pension Funds, the Law on the Financial Instrument Market and the Law on State Funded Pensions), as well as 39 draft ordinances and recommendations by the Commission. The Consultative Council was also regularly informed about the management of assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured. In addition, the Consultative Council assessed various recommendations by market participants. The Consultative Council positively evaluated the implementation of the Commission's budget for the year 2004 and approved its draft budget for 2005. The Consultative Council believes that the Commission successfully carried out the functions assigned to it for the year 2004 and that the Commission has ensured the stability and development of Latvia's financial and capital market.

In 2004, Commission specialists participated in the drafting of several new European Union (EU) directives, and in the harmonization of Latvian legislation with existing EU directives. Previous amendments to Latvia's Credit Institution Law, the Law on Insurance Companies and Supervision Thereof and Law on Investment Companies came into effect. The Commission drafted three new draft regulations and laws (the Cabinet of Ministers' Regulations Concerning the Activity of Insurance and Reinsurance Brokers, the Law on Conglomerates and the Financial Collateral Law, as well as six amendments to other laws. The Commission continued to broaden its regulatory activities in 2004, approving 16 new regulations and nine regulatory amendments.

Last year, the Commission conducted 39 bank examinations, during which it evaluated the banks' assets and internal control systems. In 35 of these inspections the Commission also assessed the banks' compliance with the requirements of the Law on the Prevention of Laundering of Proceeds Derived from Criminal Activity. During the reporting year, the Commission conducted 13 insurance company inspections, including seven full-scope inspections and six thematic inspections. It also carried out one private pension fund examination, which also included examinations of the pension fund's custodian bank and asset manager. The Commission inspected one private investment management company in charge of managing the assets of a state-funded pension scheme. The commission conducted two investment broker company examinations and one examination of a bank offering investment services. It also inspected the organizer of the regulated market, the Riga Stock Exchange. In supervising financial instrument market transactions, activities of the Commission were aimed at minimizing the risk of occurrence of manipulative transactions or transactions using insider information. During the reporting year the Commission initiated two administrative procedures and continued three investigations in which it sought to establish whether certain persons had not indirectly obtained at least 50 percent of the listed companies' voting capital and whether they were thus not avoiding their legal obligation to express mandatory takeover bids. The administrative proceedings regarding these investigations are continuing.

The Commission's internal control system worked successfully during the reporting year and the Commission continued to maintain and enhance its Quality Management System, which was certified on 7 May 2003. Several audit inspections, including both internal Commission inspections and inspections conducted by Bureau Veritas Quality International, attested that the Commission's Quality Management System conforms to ISO 9001:2000 standards. In 2004, the Commission conducted its annual client survey, which it sent to the management of the Bank of Latvia, professional associations and market participants. Respondents were asked to evaluate the Commission's work in its most significant spheres of activity – inspections, consultations, the drafting of regulations and dissemination of information. The survey's results showed that the Commission's work predominantly was evaluated as being either "good" or "very good". Suggestions and recommendations by the survey's respondents were then assessed at a quality ma-nagement review meeting and used to improve the Commission's operations still further. The Commission also conducted a job-satisfaction survey of its own employees and used these results to improve its work environment. Ninety-five percent (95%) of the survey's respondents claimed to be satisfied with their work conditions at the Commission.

During the reporting year, Commission specialists attended seminars concerning the implementation of the new Basel Capital Accord II, the assessment of credit risks, the prevention of money laundering and the prevention of financing of terrorist activities.

In 2004, the Commission approved its budget and work plan for 2005. One of the priorities for this year is the supervision of market participants through on-site risk-based inspections. The other priority involves activities aimed at the prevention of money laundering and financing of terrorism.

International Co-operation

The European Union

Following Latvia's accession to the European Union (EU) on May 1st, 2004, the Commission continued the work that it had already begun in harmonizing Latvia's legislation with EU directives. It also participated in the drafting of new EU directives. The Commission has prepared Latvia's national position and drafted instructions in order to present a strong Latvian position and submit recommendations concerning various draft EU normative acts affecting the financial and capital market, which were reviewed last year at the European Council's ECOFIN and the Permanent Representatives Committee (COREPER) meetings. Within the sphere of its competence, the Commission also reviewed draft positions and instructions prepared by other Latvian institutions.

International Organizations

During the reporting year, the Commission continued to cooperate with such international organizations as the Group of Banking Supervisors from Central and Eastern Europe, the International Association of Insurance Supervisors, the International Organization of Pensions Supervisors, the World Bank and the International Monetary Fund. Commission experts took part in meetings of the Selected Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL). The Commission also cooperated with foreign financial supervisory authorities.

The Commission participated in a self-evaluation programme organized by the International Association of Insurance Supervisors (IAIS) to assess how well the Commission is conforming to 28 internationally recognized basic principles concerning the supervision of insurance companies.

Following Latvia's accession to the EU, the Commission became a party of several European agreements. It signed the Memorandum of Understanding on Co-operation Between Payment Systems Overseers and Banking Supervisors in Stage Three of Economic and Monetary Union, the Memorandum of Understanding on High-level Principles of Co-operation Between the Banking Supervisors and Central Banks of the European Union in Crisis Management Situations, as well as the Committee of European Securities Regulators' Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities.

Foreign Financial Supervisory Authorities

The Commission expanded its sphere of co-operation with foreign financial market supervisory institutions and signed an information exchange agreement with the Swiss Federal Banking Commission. This is the 18th information exchange agreement that the Commission has signed with other financial market supervisory authorities.

Preparation of Normative Acts

In order to ensure the conformity of Latvia's normative acts with the directives of the EU, as well as a better supervisory process, seven legislative amendments were drawn up and brought into effect in 2004, along with 16 regulations and nine regulatory amendments issued by the Commission.

At the request of the European Commission, the Latvian Financial and Capital Market Commission drew up Transposition Tables which provide a comparison between Latvian normative acts and EU directives – including Directive 2001/17/EC on the reorganization and winding up of insurance undertakings, Directives 2002/12/EC and 2002/13/EC regarding the solvency margin requirements for life and non-life assurance undertakings, and Directive 98/78/EC on the supplementary supervision of insurance undertakings in an insurance group – so that EU experts might better evaluate the conformity of Latvia's normative acts with the EU *acquis communautaire*.

Draft Legislation

During the reporting year, the Commission took part in the drafting of three new laws and six legislative amendments, which were still going through the approval process in 2004.

In 2004, the following legislative amendments came into effect:
Amendments to the **Credit Institution Law**, according to which:

- The minimum capital requirement was reduced from 10% to 8%;
- The law was supplemented with a new form of credit institution – the electronic money institution. The law provides an exception for electronic money institutions that do not plan to emit more than five million euros in electronic money. These institutions do not need to obtain a license from the Financial and Capital Market Commission;
- In order to protect the rights of creditors and third parties in all of the EU member states, the law was supplemented with norms that regulate the reorganization, bankruptcy and liquidation of credit institutions;
- The law was supplemented with norms that specify the overall principles for supervising EU credit institutions on the basis of consolidated financial reports. It also specifies the co-operation and information exchange rights of supervisory authorities;
- The law specifies the requirements that credit institutions must meet in receiving outsourcing services from third parties in such areas as accounting, internal audit, management or development of information technologies and the provision of financial services.

Amendments to the **Law on Insurance Companies and Supervision Thereof**:

- The law now specifies requirements regarding the supplementary supervision of insurance undertakings in connection with their parent companies, or in connection with enterprises in which the insurance undertakings have obtained at least 20% participation;
- The law states that the branches of insurance companies from non-member states (i.e. countries that are not members of the EU or the European Economic Area - EEA) must place a security deposit in a credit institution that is registered in the Republic of Latvia;
- The law was supplemented with norms that list additional requirements for covering the technical provisions of insurance and non-member insurance company branches;
- The law now specifies the requirements regarding the transfer of insurance contracts;
- The law was supplemented with norms that define the co-operation and information exchange rights of involved supervisory authorities;
- The law was supplemented with requirements that insurance companies and insurance company branches of non-member countries must meet in receiving outsourcing services from third parties in such areas as accounting, internal audit, management or development of information technologies, taking of insurance risks, calculation of insurance indemnity and investment management.

Amendments to the **Law on Investment Companies**:

- The law prescribes the replacement of the term "investment company" with the term "investment management company", which unambiguously defines those services (i.e. the management of collective and individual investments) that the above-mentioned commercial companies are entitled to offer;
- The law has expanded the list of services that investment management companies are entitled to offer. They may now manage individual portfolios and provide consultations concerning investments in financial instruments;
- The law establishes a unified license principle in the operations of investment management companies.

Commission's Regulations

In 2004, the Board of the Commission approved several regulations in order to ensure that Latvia's regulatory framework conforms to the requirements of EU directives, as well as to the recommendations of international supervisory institutions, to the approved Commission's strategy and to the best international practices.

Recommendations for the Establishment of Internal Control Systems Designed to Prevent Laundering of Proceeds Derived from Criminal Activity and Financing of Terrorist Activities were drawn up, taking into account both Latvia's Law on the Prevention of Laundering of Proceeds Derived from Criminal Activity and 40 recommendations approved by the Financial Action Task Force (FATF) on 20 June 2003. The recommendations present significant changes in such fields as the definition of beneficial owners, shell banks and politically exposed persons, as well as in client identification requirements. The recommendations also broaden the criteria for "high risk" customers.

Amendments to the **Regulations on Capital Adequacy Calculation**:

- In view of the fact that the list of Zone A countries was expanded following the accession of ten new member states to the EU, the requirements concerning degrees of notional risk weighting were reduced for these countries' national governments and central banks (from 50% to 0%), as well as for local governments of the Republic of Latvia (from 50% to 20%);
- In view of the pegging of the lat to the euro starting from 1 January 2005, the euro's open position is excluded from open position calculations of foreign currencies, but the capital claim on concurrent position between the euro and the lat will be set at 1%.

The Regulations Concerning Restrictions on Investments by Electronic Money Institutions were drawn up to set additional restrictions on investments that licensed electronic money institutions must follow. Henceforth the volume of placed assets must correspond with the volume of emitted electronic money. **The Regulations on the Preparation of Reports and the Calculation of Prudential Ratios for the Operations of Electronic Money Institutions** define the framework for making the said ratios, as well as for the content of the reports and the procedure for their submission.

The **Regulations on the Preparation of Reports on Risk Management and Interest Rate Risk Term Structures** add more detail to the general requirements cited in the Recommendations for the Establishment of Internal Control Systems pertaining to risk management in accordance with the specifics of interest rate risks. The regulations also define the procedures for preparing and submitting interest rate risk term structure reports. Once these regulations come into effect, all of the basic principles of the Basel Committee on Banking Supervision will have been implemented in Latvia.

The **Regulations Concerning the Preparation and Submission of Information on the Structure of Bank Credit Portfolios** were drawn up in order to ensure better monitoring of bank-assumed credit risks. The regulations also foresee the provision of additional information by banks for evaluating the quality of the banks' credit portfolios. This will permit the Commission to heighten the effectiveness of its supervisory activities, particularly in the preparation and execution of bank supervisory inspections.

Amendments to the Regulations on the Preparation of Annual Reports and Consolidated Annual Reports for Insurance Joint Stock Companies and Mutual Insurance Co-operative Societies stipulate that henceforth the insurance company branches of the EU nonmember countries must also prepare their annual reports in accordance with the requirements of these regulations.

The **Regulations on the Preparation of Reports for Non-life Insurance Companies and the Regulations on the Preparation of Reports for Life Insurance Companies** will henceforth apply not only to insurance companies established in Latvia, but also to the insurance company branches of member and non-member countries.

The **Regulations on the Calculation of Solvency Margin and Own Capital for Life Insurance Companies and the Regulations on the Calculation of Solvency Margin and Own Capital for Non-Life Insurance Companies** institute changes in the calculation of solvency rates to ensure conformity with EU directives 73/239/EEC, 2002/13/EC and 2002/83/EC. The calculation of insurance companies' own funds remains unchanged, but now applies to non-member state insurance company branches as well.

The **Regulations on the Preparation of Annual Reports for Investment Management Companies** and the **Regulations on the Preparation of Annual Reports for Investment Brokerage Companies** are binding to these companies' internal accounting practices and in preparation of annual reports. The evaluation of financial reports must be conducted in accordance with both International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation Committee's interpretation standards.

The **Regulations on the Preparation of Quarterly Reports for Investment Management Companies** concern the content, form and terms of submission of these reports. The regulations shall apply not only to investment management companies licensed in Latvia, but also to the Latvian branches of investment management companies licensed in other EU member states, as well as to investment management companies licensed in the EU member states that deliver management services in Latvia without opening a branch there.

Licensing

At the end of the reporting year, there were 22 banks and one branch of a foreign bank operating in Latvia. No licences were either granted or annulled in 2004 for the operation of credit institutions.

By the end of the year, 52 notifications had been received from financial sector supervisory agencies in European Economic Area countries, indicating the desire of banks from these countries to provide financial services without opening a branch. During the reporting year, one Latvian bank submitted a notification to the relevant EU supervisory agency, in which it expressed the intention to provide cross-border services by using the freedom to provide services in Sweden and Germany.

At the end of 2004, 32 cooperative credit unions were operating in Latvia. Four of these were new institutions licensed to operate as credit unions. No licences for credit unions were annulled.

In the insurance sector there were 17 insurance companies operating at the close of 2004. During the reporting year, operating licences for one insurance company were annulled at the company's own request. Two other companies were allowed to merge in the course of their reorganization.

By the close of the reporting year, the Commission had received 109 notifications from insurance sector supervisory agencies in 20 European Economic Area countries notifying of the intent of these insurance companies to make use of the principle of the freedom to provides services in Latvia, as well as one notification by a Lithuanian insurance company requesting to open a branch office. Three notifications from Latvian insurers declaring their desire to take advantage of the principle of the free provision of services were sent to insurance supervisory agencies in other EU member states.

There were 31 insurance brokerage companies operating in Latvia at the end of 2004. Licences were issued to five and annulled for three brokerage companies. Licences were refused to two companies because the shareholders could not provide sufficient evidence of that they possess enough own funds to make these investments.

There was considerable interest concerning insurance brokerage operations, as evidenced by the granting of insurance brokerage licences to 66 persons. Twenty-one insurance brokerage certificates were annulled to persons who had ceased to act as brokers. At the end of 2004, there were 238 physical persons registered as insurance brokers in Latvia.

At the end of 2004, there were five private pension funds operating in Latvia and 12 pension plans. Upon the request of one fund, the licence for one plan was annulled.

At the end of 2004, there were nine investment management companies operating in Latvia, of which eight were also licensed to manage funds for state-funded pension scheme. During the reporting year, two investment management companies were licensed; while one licence was denied because the firm's shareholders could not provide sufficient evidence of that they possess enough own funds to make these investments. Two investment management companies received licences for the management of investments in state funded pension scheme. In 2004, two new investment plans for state-funded pension scheme were registered, and 10 amendments to existing plans for state-funded pensions were approved. In accordance with amendments to the Law on Investment Management Companies, the licences of eight investment management companies were reregistered.

At the end of the reporting year, investment management companies managed 12 open-end investment funds and four close-end investment funds. In the course of 2004, two new open-end funds were registered and one close-end fund was liquidated. In 2004, three new foreign investment funds applied for permission to offer their fund units in Latvia, raising the number of funds registered in foreign countries with the right to offer their fund units in Latvia to seven.

In the financial instrument market, 27 providers of financial services were operating in Latvia at the end of 2004, including 21 credit institutions and six brokerage companies.

By the end of the reporting year, 73 notifications were submitted by supervisory authorities of the financial sector in European Economic Area countries regarding the intent of these countries' investment brokerage companies to operate in Latvia without opening a branch there.

In 2004, the Commission permitted five joint stock corporations to issue a public offering of their securities. Public offerings of debt securities totalled 31 million lats, while the public offering of stock totalled 0.4 million lats: public offerings of promissory notes by *Nordea Bank Finland PLC* were made in the amount of 10 million lats; the *Akciju komercbanka "Baltikums"* issued 5 million euros worth of bonds, the state joint stock company *Latvijas Hipotēku un zemes banka* issued mortgage bonds worth 25 million US dollars, and the *Baltic Trust Bank* joint stock company issued mortgage bonds amounting to 3 million lats and 3 million US dollars; there was also a public offering of shares by *SAF Tehnika* in the amount of 0.5 million lats. After the initial public offering, the aforementioned debt securities in the amount of 28 million US dollars, 3.9 million euros and 4 million lats, and stock with a value of 0.5 million lats were included and listed on the Official List of the Riga Stock Exchange.

In the reporting year, the Commission registered the prospectuses of seven joint stock corporations on listing of 14 076 074 shares in the regulated market, of which 10 694 149 shares with a nominal value of 1 lats per share were included in the Free List of the Riga Stock Exchange.

In accordance with the first section of Section 66, Part I of the Financial Instrument Market Law, takeover bids were made to the minority shareholders of nine joint stock corporations in 2004.

In accordance with the Law on the Financial Instrument Market, the shares of 12 joint stock corporations were withdrawn from public circulation in 2004.

Supervision

The Supervision Department is the largest department in the Commission. It has 27 employees in the Banking and Securities Market Division and seven employees in the Insurance Division. In banking, supervision is conducted in accordance with the Basel Committee Core Principles for Effective Banking Supervision. In insurance, supervision is conducted in accordance with the Core Principles of the International Association of Insurance Supervisors (IAIS), and in securities, in accordance with the Principles of Securities Regulation set down by IOSCO. These principles have also been incorporated in Latvia's regulatory enactments.

The Commission cooperates with the Bank of Latvia in the preparation of bi-annual financial stability reviews, focusing on macro prudential issues.

Core Principles of Supervision

Risk-based supervision of the financial sector has been conducted in Latvia. In 2004, the supervision of market participants was carried out both through on-site inspections and on the basis of submitted reports, combined with an analysis of the key risks incurred by market participants. In accordance with EU principles for supervision, the Commission began to develop a manual for the constant and systematic monitoring of individual market participants in 2003. This work continued in 2004.

To ensure that its adopted decisions are accurate and fair, the Commission conducts hearings with the market participants before taking any administrative actions.

The analysis of financial reports allows for an evaluation of the financial stability of market participants, operational risks and their trends, and the conformity of participants' operations with the requirements set forth by law. The results of these analyses were regularly submitted to the Board of the Commission, where the priorities of supervision were discussed. The analyses of financial reports are also used to plan on-site inspections. The primary purpose of such inspections is to evaluate the financial stability of the institution under supervision, assess its capital adequacy and examine the internal controls of the institution to ensure that risks are adequately monitored and managed. By revealing the causes of arising problems timely and finding solutions to them, the possibility of an individual market participant not fulfilling its obligations is reduced, as is the possible influence of such problems on the financial market as a whole.

In order to ensure the efficient and fair supervision of all market participants, the Commission has developed a Supervision Handbook, which delineates the procedures for supervision. In 2004, following further consultations with financial supervision specialists, the handbook was amended to update guidelines on the inspection of internal control systems designed to prevent money laundering and the financing of terrorism.

Review of Client Complaints

In 2004, the protection of the interests of clients of financial market participants was enhanced through the continued monitoring by the Commission of whether market participants provide clear and accurate information regarding the legal requirements for the provision of financial services, and whether they provide assistance in the understanding conflict resolution procedures, as well as in the understanding of the rights and obligations of clients.

The specialists of the Commission examined client complaints regarding the participants of Latvia's financial and capital markets (in total in 2004, the Commission received 180 submissions, of which 101 concerned banks, 67 concerned insurers, and 12 concerned companies in the financial instrument market). The majority of complaints against credit institutions concerned the electronic (non-cash) transfer of funds and credits. Complaints against insurance companies mainly related to the payment of indemnity, but complaints in the financial instrument market concerned the failure to express takeover bids. Client complaints were an important source of information regarding possible problems in the operations of market participants. Although in the majority of cases the Commission did not have the legal right to resolve civil disputes between market participants and their clients (as such cases are to be mediated in courts of law), the Commission's specialists were able to familiarize themselves with the complaints and to demand additional information from the market participants involved. This helped the Commission to determine whether the market participant had not violated any laws or regulations falling within the competence of the Commission.

Supervision of Banks and Credit Unions

In 2004, banks accounted for 96% of the total assets of Latvia's financial system, while credit unions accounted for 0.1%.

During the reporting year, employees of the Commission conducted 39 bank inspections. As in previous years, the banks' asset quality was assessed and their internal control systems were analysed. The Commission also assessed whether the banks' procedures for identifying unusual and suspicious financial operations were in accordance with the requirements of the Law on the Prevention of the Laundering of Proceeds Derived from Criminal Activity.

On the basis of consolidated financial reports, the Commission examined eight banks, which were a part of banking groups. These examinations included the evaluation of the operations of the groups' member companies, including leasing companies. The examinations sought to ascertain whether effective internal control and risk management systems had been established.

Credit Risk

During the reporting year, the volume of issued credits grew significantly in Latvia. For this reason, special attention was paid to evaluating banks' credit risk management systems (identification, assessment, management and control of credit risk) in order to identify weaknesses and possible problems. The policies, procedures, and strategies for granting credit were evaluated, and employees of the Commission examined the quality of the credit portfolios at 11 banks in 2004.

In view of the rapid increase in credit volumes in Latvia, Latvian bank credit portfolios had a significant proportion of newly issued loans during the reporting year (61% of the banks' total credit portfolio at the end of 2004). For this reason, greater attention was paid to each bank's ability to evaluate the creditworthiness of potential clients. This was particularly important with regard to consumer loans and mortgage loans extended to individuals.

In 2004, the Commission also devoted greater attention to the banks' policies of providing information to potential borrowers, drawing the banks' attention to their obligation to objectively inform clients – before granting them credit – of the potential risks in borrowing at variable rates or in a currency which is different from the one in which a client gets his/her principal income. The banks must familiarize their clients with various examples of how the clients' regular payments might be affected by interest rate rises and/or changes in the exchange rate of a foreign currency to the national currency (lats).

Liquidity Risk

The previous year's examinations of banks (in 2003) already attested to the fact that the banking sector is well capitalized and liquid. In 2004 as well, banks in Latvia showed consistently high liquidity indicators. In conducting bank examinations, the principal goal of the Commission was to establish whether the banks had ensured the day-to-day management and control of their liquidity, observed their own internal limits and whether they had not exposed their operations to increased liquidity risk in the future.

Market Risks

Latvian banks did not have any significant market risks because their investments in financial instruments were not large. Nonetheless, in examining banks with investment portfolios, attention was paid to the management and risk-assessment procedures in place.

Reputational Risk

In 2004, the Commission continued its work in the legislative sphere by assisting the drafting of new laws, as well as in practical supervision to ensure that the internal control systems of market participants are able to assure the timely identification of unusual and suspicious transactions. Market participants must be able to refrain from execution of such transactions and inform the Office for the Prevention of the Legalization of Proceeds Derived from Criminal Activity about all such instances.

In 2004, the Commission conducted 35 thematic inspections at 19 banks to evaluate their compliance with the Law on the Prevention of the Laundering of Proceeds Derived from Criminal Activity and to evaluate the quality and effectiveness of the banks' internal control systems. These inspections revealed the following weaknesses:
– incomplete policies and/or procedures at 13 banks;
– failure to observe the requirements set by law regarding client identification at 5 banks;
– failure to observe the legal requirements for implementing purposeful measures to identify third parties (beneficial owners) at 13 banks;
– failure to notify the Office for the Prevention of the Legalization of Proceeds Derived from Criminal Activity about certain unusual or suspicious operations at 13 banks.

In cases when the Commission, in the course of a bank inspection, determines that a certain transaction appears suspicious or unusual and that the bank has not fulfilled its obligations with regard to this particular transaction, the Commission informs the Office for the Prevention of the Legalization of Proceeds Derived from Criminal Activity. In 2004, the Commission informed the Office about 103 such instances.

The primary weaknesses discovered centred around an inadequate knowledge and a lack of documentation concerning clients' business activities, as well as insufficient documentary evidence on the source of funds.

In view of the nature of these transgressions, the Commission issued nine administrative penalties in 2004:
– one bank was fined;
– five banks were subject to intensified supervision which in effect allows the Commission for providing binding instructions and/or imposing penalties on a bank (two of these banks were warned of the potential dismissal of the board member responsible for preventing money laundering);
– two banks were warned of the potential dismissal of their boards;
– one bank was warned of the possible annulment of its license to provide financial services.

Each of the banks with respect of whom the Commission has taken regulatory action was given a time limit for effecting retroactive procedures, determining the beneficial owners of accounts, for documenting the economic and personal activities of their clients, ensuring the collection of the necessary documentation in the bank's document and accounting registers, and closing all the accounts where the bank was unable to complete client identification requirements or whose personal and economic activity was unknown to the bank.

The fulfilment of the Commission's requirements in 2004 resulted in the closing the banks' accounts of those clients who were unwilling to provide all of the necessary information about their business activities or beneficial owners or whose transactions were considered as suspicious. Taking into account the improvement of the internal control systems, increased supervision was terminated at three banks.

In order to promote continued improvements in banks' internal control systems, the Commission:
– informed banks about the typology of unusual and suspicious transactions that were most frequently detected during inspections by the Commission, thus helping them to make sure that their internal control systems were capable of ensuring timely identification of suspicious transactions. Such informative summaries were also sent to the banks previously;
– advised the banks to conduct an ongoing analysis of the Internet advertisements having reference to the banks, in order to prevent the publication of misleading information that might have a negative effect on the banks' reputation.

New Financial Services

In 2004, the Commission examined 20 applications by credit institutions to provide new financial services or requesting changes to procedures for the provision of existing financial services. The Commission examined the applications to determine whether the submitted policies and procedures ensured sufficient risk management and complied with laws and regulations. In two instances the Commission objected to the introduction of the proposed new services.

Supervision of Insurance Companies

At the end of 2004, insurance companies accounted for 1.9% of the assets in Latvia's financial system.

Employees of the Commission conducted 13 examinations of insurance companies in 2004, including seven full-scope inspections and six thematic inspections. Special attention was paid to the quality of the assets of the insurance companies, as well as to the adequacy of their technical provisions, reinsurance contracts, reinsurance operations, the conformity of technical provisions with the Law on Insurance Companies and Supervision Thereof, and to the internal control systems in place at the insurance companies – including their compliance with the Law on the Prevention of the Laundering of Proceeds Derived from Criminal Activity. The Commission issued specific instructions on remedying problems that it had discovered in the course of each of these inspections. Inspections were focused on the internal controls at the insurance companies to ensure that the insurers were constantly monitoring and controlling possible risks. Risk assessments were prepared for each of the insurers following the inspections and these assessments were examined by the Commission's Board. The risks assessed included underwriting, the development of technical provisions, reinsurance operations, investment operations, as well as management, operational and reputational risks.

The supervision of insurance companies is conducted in two phases. Employees of the Commission first analyze the reports submitted by the insurance companies and subsequently conduct on-site company inspections. During these inspections the compliance of the companies' operations with Latvian legislation, with Commission regulations and with other relevant legislation is assessed. The employees of the Commission regularly monitor the insurers' prudential ratios, the Commission issues directives for the correction of deficiencies if necessary.

The following drawbacks were discovered at insurance company inspections conducted in 2004:
– assets were not valued in compliance with the regulations of the Commission;
– in calculating certain expense items, the Commission's requirements concerning the preparation of reports were not observed;
– deficiencies were detected in the financial calculations and implementation of procedures for technical provisions. As a result, technical provisions were insufficient for obligations assumed by the insurer;
– an effective internal control system had not been established and implemented.

In 2004, the Commission continued to focus on efforts to prevent the money laundering.

During the reporting year, the Commission issued fines of 10 000 lats each to two insurance companies for their failure to observe the Law on Insurance Companies and Supervision Thereof and other legal requirements. The fined companies were required to submit plans for the improvement of their financial situation and ensuring that their technical provisions were in accordance with the requirements set by law.

Supervision of Private and State-funded Pension Funds

At the end of 2004, pension funds accounted for 0.01% of the assets in Latvia's financial system.

One full examination of a private pension fund was conducted in 2004, including an examination of its custodian bank and an examination of the investment brokerage firm that manages the fund. The examinations sought to assess the financial situation of the pension fund, the operations of its management, the composition and valuation of the pension plan's assets, the structure of its income and expenses, as well as the compliance of the pension fund, its custodian bank, and the fund's brokerage firm with the regulations and instructions of the Commission and other legal requirements.

Also in 2004, one investment management corporation responsible for managing funds of second-tier pension scheme was examined to assess the compliance of its operations with the relevant laws and regulations.

Supervision of the Financial Instrument Market

Operation of Issuers

The year 2004 was significant regarding the supervision of issuers, because according to the new Law on the Financial Instrument Market – which took effect on 1 January 2004 – financial instruments must be listed on a regulated market to be considered as being in public circulation. A transition period was granted to allow issuers of financial instruments to restructure in accordance with the requirements of the new law. The law allowed those stock corporations that had issued publicly tradable shares prior to 1 January 2004, and which were not listed on a regulated market, to decide on the listing of their shares on the regulated market at the stockholders' meetings held to affirm the corporations' annual reports for the year 2003. If the stockholders made the decision not to list their corporation's shares on a regulated market, then those stockholders voting against listing for the rest of shares were required to make an obligatory takeover bids.

The new regulations for the transition period in the Law on the Financial Instrument Market applied to 29 issuers, all of whom were required to consider whether or not to list their shares on a regulated market at their stockholders' meetings. Sixteen corporations made the decision to list their shares on the regulated market in 2004. In accordance with the Law on the Financial Instrument Market, the listing of shares on the regulated market requires each of these corporations to register a prospectus with the Commission. Of the aforementioned 16 corporations, seven registered a prospectus for the inclusion of their shares in the regulated market in 2004. The shareholders of ten corporations voting against the inclusion of their companies' shares in the regulated market made the required takeover bids for the rest of the shares to other shareholders. Of these, four shareholders were authorized by the Commission to make a final takeover bid. In two other cases, the Commission began administrative proceedings against shareholders who had voted against the inclusion of their corporation's shares in the regulated market, but had failed to make the mandatory takeover bids of shares in accordance with the procedures and terms set forth in the Law on the Financial Instrument Market. The shareholders of three other corporations did not adopt a decision on whether to list their shares on the regulated market. The Commission has drafted amendments to the Law on the Financial Instrument Market, setting 31 December 2005 as the final date for the adoption of a decision by corporations on whether to include their shares in the regulated market and foreseeing penalties for the failure to observe this legal requirement.

In two cases, the Commission implemented administrative procedures against persons who had not notified the Commission of their acquisition of a qualifying holding of voting capital in a listed company or had not reported disposal of shares in the amounts as set by the law.

In supervising operations with financial instruments in the regulated market, the Commission constantly monitored the market to ascertain that no market manipulations were taking place.

In one instance, the Commission provided information to the police in an effort to determine whether the transactions of certain persons were not made by issuing of inside information and in violation of Section 85 of the Law on the Financial Instrument Market. In addition, Part 1 of Section 193 in Latvia's Criminal Law stipulates that the insider trading of financial instruments is a criminal offence.

In 2004, the Commission initiated two administrative procedures and continued three other administrative procedures initiated in 2003, in which it sought to determine whether persons had indirectly acquired at least 50% of the issuer's voting capital and thus intentionally avoided making the mandatory takeover bids. In such cases the length of the administrative procedure is affected by the necessity of obtaining information from foreign supervisory institutions and participants in foreign markets.

Investment Brokerage Firms and Investment Management Corporations

Investment brokerage firms accounted for 0.07% of the assets in Latvia's financial system at the end of 2004, while investment management corporations accounted for 0.02%.

In 2004, the Commission conducted two examinations of investment brokerage firms and one of a bank providing investment services. In these examinations, the assets of the brokerage firms were examined, their internal control systems were analyzed, and the procedures of the services they provided were reviewed to establish the procedures' compliance with the requirements of the law, the regulations of the Commission and the rules of the regulated market's organizers. In addition, the Commission assessed whether the firms' procedures for identifying unusual and suspicious transactions conformed to the requirements of the Law on Prevention of the Laundering of Proceeds Derived from Criminal Activity.

Organizers of the Regulated Market

The organizer of the regulated market – the Riga Stock Exchange – was a subject of one examination in 2004. The examination sought to assess the functioning of the organizer's protective measures against market manipulators operations and against the misuse of inside information, as well as to assess the organizer's internal control system.

Supervision of Information Systems

In view of the considerable dependence of services provided by participants in the financial and capital market on information technologies, the Commission continued to monitor IT security risks in the management of information systems in 2004. In the reporting year, the Commission conducted 10 on-site IT security inspections. The focus of these inspections was primarily on the electronic services provided to remote clients by participants in the financial and capital markets.

Since there is a growing tendency of external threats to information systems, one of the Commission's objectives in monitoring information systems is to ensure that market participants develop adequate security for the information systems they use in providing services to their clients.

Operation of Guarantee Funds

Deposit Guarantee Fund

The deposits of natural persons in Latvian credit institutions have been guaranteed since 1 October 1998, when the Law on Natural Person Deposit Guarantees, came into force. Under the Law on Deposit Guarantees which came into effect on 1 January 2003, the assets collected in the Deposit Guarantee Fund (hereinafter – Fund) must guarantee not only the deposits of natural persons, but also the deposits of legal entities, to the extent stipulated by law. In 2004, the guaranteed compensation in every credit institution for both individuals and legal entities, was 6 000 lats. Following an incremental growth in this figure, the maximum guaranteed amount of deposits will reach 13 000 lats for depositors (both natural persons and legal entities) in each bank or credit union by the year 2008 (see Figure 1).

Information compiled by the Commission indicates that 97% of the sums in depositors' accounts did not exceed 6 000 lats. Thus, it can be said that in 2004, the state already guaranteed full compensation to 97% of depositors in Latvia.

The collection and management of the Fund's assets is conducted by the Commission. At the end of the reporting year, the Fund had assets of 23.2 million lats.

The collection of assets in the Fund, as well as the payment of compensation, is monitored by the Consultative Council of the Commission. In the case that the Fund would lack sufficient assets to compensate depositors in the amount guaranteed, then the law provides for the remaining sum to be remitted from the state budget, with the Commission acting as the intermediary. There have been no instances of inaccessible deposits in the Latvian banking and credit union system since 1998, the date of the creation of deposit guarantee system.

Fund for the Protection of the Insured

In order to protect the interests of insured persons in the case of an insurance company's bankruptcy, a Fund for the Protection of the Insured was created in 1999 (henceforth the Protection Fund).

The assets of the Protection Fund consist of deductions in the amount of 1% of the gross sum of insurance premiums received from physical persons for the classes of insurance specified by law. At the close of 2004, the Protection Fund amounted to 1.4 million lats.

The part of the Protection Fund funded by payments from providers of life insurance was 0.3 million lats at the end of 2004. The part of the Protection Fund funded by payments from providers of other classes of insurance was 1.1 million lats at the close of the reporting year (see Figure 2).

Indemnity payment can be claimed only by insured natural persons, as follows:
1) For life insurance policies – 100% of the insurance

Figure 1
INCREASE IN THE GUARANTEED COMPENSATION PER DEPOSITOR (1998-2008)
(at the beginning of each period, in lats)

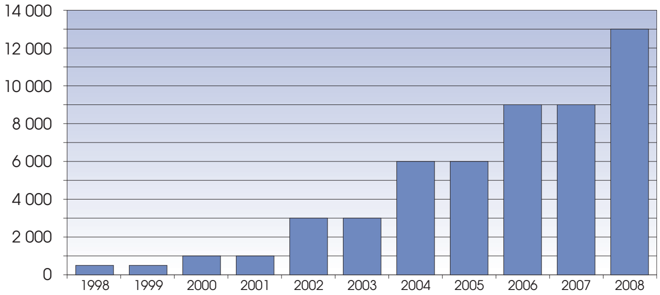
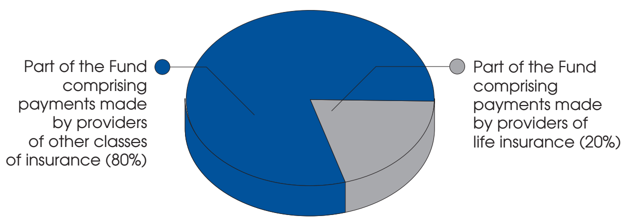


Figure 2
STRUCTURE OF THE FUND FOR THE PROTECTION OF THE INSURED
(at the end of 2004; %)



indemnity, but no more than 2 000 lats per insured person; 2) For other classes of insurance as established by law – 50% of the insurance indemnity, but no more than 2 000 lats per insured person.

Since the Protection Fund was created, 8 671 lats have been paid out to an administrator of an insolvent insurance company in guaranteed indemnity payments from the Protection Fund's assets. To date, individual insured persons have received 8 607 lats (6 588 lats in 2003 and 2 019 lats in 2004). These assets were distributed to compensate clients of the insolvent insurance stock company *AK Alianse*.

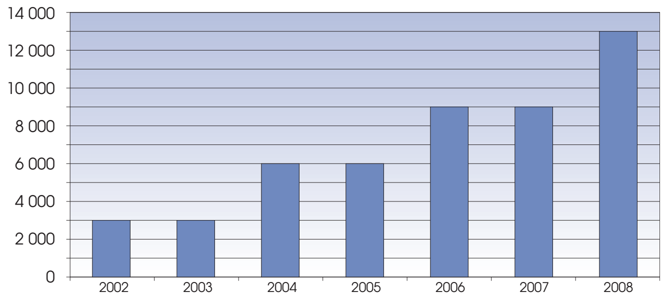
Protection of Clients (Investors) in the Financial Instrument Market

Since the coming into effect of the Investor Protection Law in Latvia on 1 January 2002, the country has had a system of protection for investors that meets EU standards. In cases when the providers of investment services (banks and brokerage firms) are incapable of fulfilling their contractual obligations, investors have the right to receive compensation. Failure to meet obligations is compensated at 90% of the irrevocably lost value of financial instruments, or of losses incurred by the non-performance of investment services.

In 2004, every investor (natural person) was guaranteed compensation at 90% of the irrevocably lost value of financial instruments, or of losses incurred by the non-performance of investment services, but to a sum not exceeding 6 000 lats per person. In July 2006, the maximum guaranteed sum will be 9 000 lats, and from 2008 it will be 13 000 lats per person (see Figure 3).

The protection mechanism created for investors does not provide for the establishment of a permanent fund; rather, in cases when an investment service provider cannot meet its obligations, the Commission calculates the proportional sum to be paid by market participants for the compensation of the affected investors, based on the quarterly reports on financial instrument portfolios submitted by the investment service providers. Since the establishment of this protection system for investors in 2002, there has been no need to effectuate such forms of compensation.

Figure 3
INCREASE IN THE AMOUNT OF GUARANTEED COMPENSATION PER INVESTOR (2002 - 2008)
(at the beginning of each period; in lats)



Principal Objectives of the Financial and Capital Market Commission in 2005

1. In 2005, the Commission, in cooperation with the Bank of Latvia, will assess the necessity of expanding the Debtors' Register and determine the type of expansion that may be necessary in order to enable banks and other market participants to more closely monitor and control credit risks.

2. The Commission, in cooperation with market participants and other relevant state institutions, will assess the necessity of creating a unified ombudsman for financial services, with the objective of expanding the spheres of operation that are currently being carried out by two existing ombudsman institutions (the Association of Latvian Commercial Banks in the sphere of finance and the Latvian Insurers' Association in the sphere of insurance). A possible new institution would oversee the investigation of clients' complaints across the entire financial services sector.

3. In 2005, the Commission intends to draft various regulations in response to amended or newly adopted EU directives pertaining to the financial and capital markets overall, as well as to specific sectors of these markets:

- in general:
  - as provided in the EU's Regulation No. 1606/2002, the option of directly applying International Accounting Standards/International Standards for Financial Reports will be made available, and the necessary amendments to the rules for the preparation of annual reports and consolidated annual reports will be drafted;
  - the Commission will draft regulations foreseen in the Law on Conglomerates;
  - in order to adhere to the new EU directive on capital adequacy (which is to take effect on 1 January 2007), the Commission will draft new Regulations on the Calculation of Capital Adequacy. In addition, the necessary amendments to the Credit Institution Law and to the Law on the Financial Instrument Market will be made;
- in the field of credit institution business:
  - amendments to the Regulations on the Calculation of Capital Adequacy will be prepared, foreseeing the utilization of the VaR models to calculate capital adequacy for market risks;
- in the field of insurance:
  - the Commission will prepare a set of Regulations on Technical Provisions and Their Coverage by Types of Currency;
  - in order to ensure that the requirements of the Law on Insurance Companies and Supervision Thereof are met by insurers, the Commission will work out new Regulations on the Preparation of Public Reports;
- in the field of the financial instrument market:
  - in order to meet the requirements of the EU Directive on Takeover Bids, the EU Prospectus Directive and the EU Transparency Directive, the necessary amendments to the Latvian Law on the Financial Instrument Market will be prepared;
  - in order to observe the EU Commission's recommendation on the use of financial derivative instruments for undertakings for collective investment in transferable securities (UCITS), the necessary changes in the Latvian Financial and Capital Market Commission's Regulations on the Preparation of Reports for Investment Funds will be made;
  - in order to improve the competitiveness of the participants in the Latvian financial and capital market, a study of the laws pertaining to securitization will be conducted and amendments proposed, if necessary;
  - in order to ensure the receipt of information necessary for supervision, the Commission will draft a set of Regulations on the Calculation of Indicators Characterizing the Operations of Investment Funds;
- in the field of pension system:
  - in order to enhance the supervision of participants in this sector, the Commission will prepare a set of Regulations on the Preparation of Quarterly Reports for Private Pension Funds, as well as Regulations on the Preparation of Reports on the Management of the Assets of State-Funded Pension Scheme;
  - in order to meet the requirements of the EU directive on the activities and supervision of institutions for occupational retirement provision, amendments to the Latvian Law on Private Pension Funds will be made.

The Commission's full work plan for the year 2005 is accessible at the Commission's Internet web site: www.fktk.lv.

The Activity of Market Participants in 2004

In 2004, Latvia continued to experience rapid economic growth and had a GDP growth rate of 8.5%, which was the highest among the EU member states.

This brisk economic development had a positive effect on Latvia's financial and capital market. At the end of the repor-ting year, the volume of assets in the finance sector reached 110.6% of Latvia's GDP,[1] or 8.14 billion lats (see Table 1). As before, bank assets made up the vast majority (96.5%) of the market's total assets.

Banks

During the reporting period, the number of banks in Latvia remained unchanged at 22, as did the number of foreign bank branches – one.

The banks' total paid-up share capital grew by 25% in 2004 and reached 384 million lats by the end of the year. All eight banks in which foreign shareholders owned more than 50% of the share capital were subsidiaries of foreign banks. The market share of these banks' assets amounted to 43.5% of total bank assets in Latvia. Five of these banks' parent companies were based in the EU member states (Germany, Sweden, Finland and Estonia – with a 39.4% market share of total bank assets), while two parent companies were in Russia and one in the Ukraine.

At the end of the year, foreign shareholders owned 57.8% of the Latvian banks' total paid-up share capital. Shareholders from Estonia owned the largest share (21.4%, compared to 15% at the end of 2003, with Estonian capital representing capital originating in Sweden), followed by shareholders from Germany (13.2%, compared to 11% the year before) and Sweden (10%, compared with 12% on 31 December 2003).

At the end of the reporting year, the state of Latvia was still the only shareholder of the state joint stock company *Latvijas Hipotēku un zemes banka* (Latvian Mortgage and Land Bank), which held 4% of total bank assets in Latvia at the end of 2004. The Latvian state owned 5.9 % of banks' total paid-up share capital at the end of the reporting period, compared to 6.5% a year earlier.

During the reporting year, the market share of Latvia's five largest banks did not change substantially and amounted to 62.4% of total bank assets (compared to 63.1% at the end of 2003), 73.6% of credits (compared to 73.4% a year earlier) and 65.9% of deposits (compared to 66.6% on 31 December 2003).

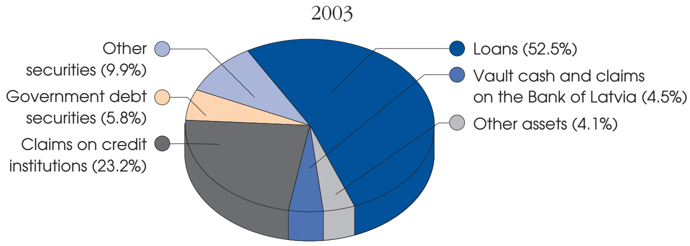
[1] According to data published in the Internet home page of the Central Statistical Bureau of Latvia (www.csb.lv), Latvia's GDP volume in 2004 was 7 359.4 million lats.
[2] Investment plans designed for second-tier pension plans (with state-funded pension scheme assets).
[3] The listed volume of assets for the year 2004 is approximate.

Table 1
FINANCIAL AND CAPITAL MARKET PARTICIPANTS*
* Financial and capital market participants subject to the supervision of the Financial and Capital Market Commission

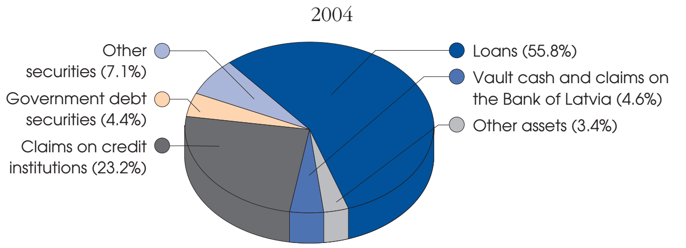
Market participants	31.12.2003			31.12.2004		
	Number	Assets, in millions of lats	Share of total assets, in %	Number	Assets, in millions of lats	Share of total assets, in %
Banks	23	5 717	96.08	23	7 850	96.49
Insurance companies	19	141	2.37	17	156	1.92
Investment management companies	8	4	0.07	10	2	0.02
Investment funds	16	27	0.45	15	36	0.44
Investment plans[2]	7	26	0.44	19	48	0.59
Private pension funds	5	2	0.03	5	2	0.02
Pension plans	12	19	0.32	12	25	0.31
Credit unions	28	4	0.07	32	5	0.06
Insurance brokerage firms[3]	29	4	0.07	31	4	0.05
Investment brokerage firms	6	4	0.10	6	5	0.10
Riga Stock Exchange	1	1	0.10	1	2	0.10
Latvian Central Depository	1	1	0.10	1	1	0.10
Issuers	88			77		
Insurance brokers – natural persons	195			238		
Total	438	5 950	100	487	8 136	100

Figure 4
STRUCTURE OF ASSETS
(end of period; %)

2003



2004



In 2004, Latvian bank assets grew by 37% and reached 7.85 billion lats or 106.7%[4] of Latvia's GDP at the end of the year (compared to 90.4% at the end of 2003). With the rapid growth of credit portfolios continuing and rising by 46% last year, the share of loans in bank assets grew from 52.5% to 55.8% (see Figure 4).

In 2004, the ratio of bank loans to residents in relation to Latvia's GDP[5] grew and reached 51.6% at the end of the year (compared to 41.9% on 31 December 2003).

In 2004, active borrowing continued in Latvia's economy, with 87% of the credit balance being issued to domestic borrowers by the end of the year. Those sectors of the economy that received the largest share of loans were trade (18.5% of the issued loan amount, compared to 20.3% at the end of 2003), real estate transactions (16.8%, compared to 12.3% a year earlier), financial intermediation (16.4%, compared to 15.8% in 2003) and the manufacturing industries (15.5%, compared to 14.8% a year earlier) (see Figure 5).

In 2004, mortgage loans continued to make up the most significant form of credit in Latvia. The volume of issued mortgage loans increased by 78% compared to the year before (when the rate of increase was 96%), and their share of bank credit portfolios rose to 33.2%, reaching 1.43 billion lats or 19.4% of Latvia's GDP by the end of the year (see Figure 6). The volume of issued loans for housing purchases, reconstruction and renovations increased by 82.5%, and their share of bank credit portfolios reached 20.3% at the end of the year (compared to 16.2% on 31 December 2003). The average loan size for housing purchases, reconstruction and renovations was 11 200 lats at the end of 2004. The ratio of housing loans to Latvia's GDP[7] increased from 7.7% at the end of 2003 to 12.1% at the end of the reporting year. This was still lower than the average ratio of housing loans to the GDP in the euro zone countries (34.4% at the end of 2004, compared to 32.5% at the end of 2003).[8]

In 2004, the term structure of loans changed in Latvia. The volume of long-term loans increased by 66%, and their share of bank credit portfolios rose from 42% at the beginning of the year to 47% on December 31.

The increase in the volume of loans was not accompanied by a deterioration of loan quality. The share of non-performing loans (substandard, doubtful or lost) in the total sum of loans granted to non-banks dropped to 1.1% (from 1.4% a year earlier). At the end of 2004, the ratio of specific provisions for non-banks to the total sum of loans issued to non-banks was 1.1% (see Figure 7). Specific provisions

[4] According to data published in the Internet home page of the Central Statistical Bureau of Latvia (www.csb.lv), Latvia's GDP volume in 2004 was 7 359.4 million lats.
[5] According to data published in the Internet home page of the Central Statistical Bureau of Latvia (www.csb.lv), Latvia's GDP volume in 2004 was 7 359.4 million lats.
[6] The banks' credit portfolios include loans granted to domestic financial institutions, state enterprises and private enterprises, as well as transit credits.
[7] According to data published in the Internet home page of the Central Statistical Bureau of Latvia (www.csb.lv), Latvia's GDP volume in 2004 was 7 359.4 million lats.
[8] Data published in the Internet home page of the European Central Bank (www.ecb.int).
[9] The banks' credit portfolios include loans granted to financial institutions, state and private enterprises, natural persons and non-profit organizations.

Figure 5
SHARE OF LOANS ISSUED TO NATIONAL ECONOMY SECTORS IN BANK LOAN PORTFOLIOS[6] AND THE ANNUAL GROWTH RATE OF THESE LOANS
(31.12.2004; %)

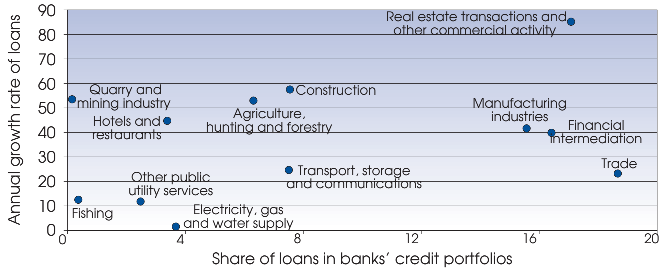


Figure 6
SHARE OF LOANS, BROKEN DOWN BY TYPE, IN BANK CREDIT PORTFOLIOS[9] AND ANNUAL GROWTH RATE OF SUCH LOANS
(31.12.2004; %)

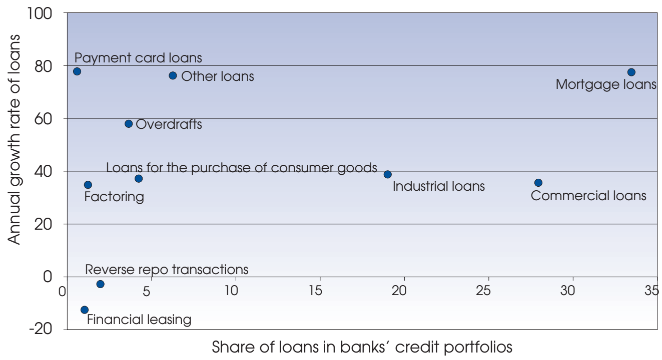
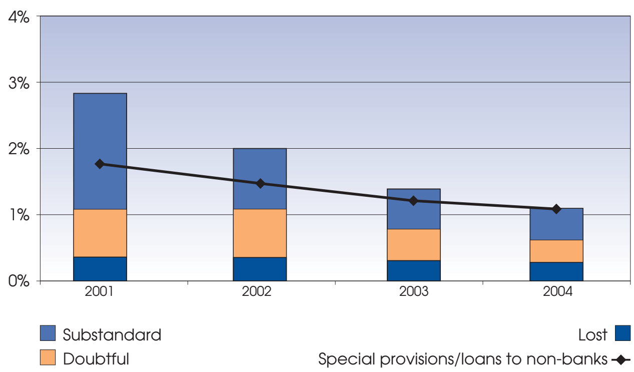


Figure 7
NON-PERFORMING LOANS TO NON-BANKS IN LATVIA
(at the end of period)



for loans to non-banks covered 99.1% of the amount of non-performing loans at the end of the reporting year.

The amount of deposits grew in 2004 by 1.36 billion lats or 36.6% and reached 5.09 billion lats at the end of the year. The amount of resident deposits grew by 35.5% and made up 46% of total deposits at the end of the year (compared to 46.4% a year earlier). The largest share of resident deposits was by natural persons (53.2% of total resident deposits compared to 52.5% a year earlier) and private enterprises (32.7% of total deposits compared to 32.2% on 31 December 2003). The largest share of total resident deposits was in lats (61.7%, compared to 63.4% at the end of 2003). Slightly over one fifth of resident deposits (21.4%, compared to 10.9% a year earlier) was in euros, while 16.1% were in US dollars (compared to 24.9% on 31 December 2003).

The amount of non-resident deposits grew in 2004 by 37.5%, of which 92% were deposits by private enterprises.

The largest share of total deposits was in demand deposits (72%).

In 2004, the profit of the banking sector[10] reached 116 million lats, or 62% more than in 2003, when profits amounted to 71.5 million lats. Since in 2004 bank profits grew much more rapidly than the amount of asset capital and reserves, both the return on assets (ROA)[11] and the return on equity (ROE)[12] grew and reached 1.7% and 21.4%, respectively (compared to 1.4% and 16.7% on 31 December 2003).

During the reporting year, the main sources of banking income were income from interest on loans to non-banks (43.3% of all banking income) and income from commission fees (24.4% of all banking income).

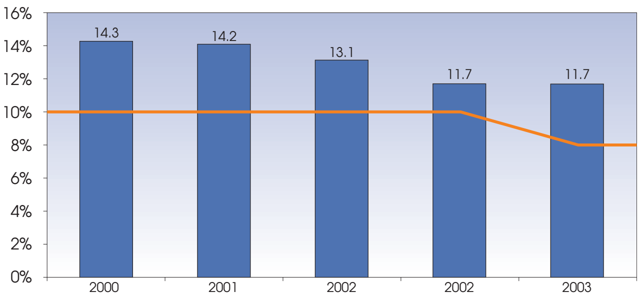
In 2004, the banking sector's capital adequacy ratio fluctuated slightly between 12.5% and the year-end figure of 11.7% (which was identical to the 11.7% recorded on 31 December 2003) (see Figure 8).

With a reduction in the minimum required capital adequacy ratio, the banks' actual capital adequacy remained unchanged at previous levels, which indicates that Latvia's banks are implementing cautious policies.

During the year 2004, with banks' liquid assets[13] growing faster than their current liabilities[14], the Latvian banking sector's liquidity ratio saw an increase and reached 58.1% by 31 December (compared to 57.9% a year earlier). The minimum regulatory requirement is 30%.

At the end of the reporting year, 10 bank groups and one

Figure 8
CAPITAL ADEQUACY RATIO OF LATVIAN BANKS
(at the end of period)



10 Non-audited profit.
11 Return on assets (ROA) – the ratio of profit/loss (after tax) of the reporting year to total average assets.
12 Return on equity (ROE) – the ratio of profit/loss (after tax) of the reporting year to total average equity and reserves.
13 Liquid assets = cash on hand + claims on central banks and other credit institutions + central governments fixed-income debt securities.
14 Current liabilities = liabilities on demand + liabilities whose remaining term does not exceed 30 days.

financial holding company group (henceforth – consolidation group) were subject to consolidated supervision. Together, these groups had 40 daughter companies (subsidiaries), including 13 leasing companies, five investment brokerage firms, three investment management companies, two banks, two pension funds, two insurance companies, five auxiliary undertakings and eight other types of financial institutions. The subsidiaries of the consolidation groups in Latvia were registered mainly in Latvia and Lithuania, as well as the EU member states, Russia, Ukraine and the USA.

At the end of 2004, the total balance sum of the consolidation group subsidiaries amounted to only 9% of banking sector assets subject to consolidated supervision.

Credit Unions

At the end of 2004, there were 32 cooperative credit unions operating in Latvia.

During the reporting year, the assets of credit unions increased by 24.5% and reached 4.9 million lats (0.06% of banking sector assets). This increase resulted largely from an influx of credit union member deposits, which grew by 21.6% in 2004 to 3.2 million lats (see Figure 9).

The main type of credit union activity was lending to credit union members. In 2004, the amount of such loans increased by 27.7% and reached 4.1 million lats at the end of the year. These formed the largest share of total credit union assets (84.6%, compared to 83% at the end of 2003).

Short-term loans of up to one year accounted for the largest share (50.2%) of the aggregate loan portfolio of Latvia's credit unions. In 2004, the volume of long-term loans (more than five years) almost doubled. Their share in the loan portfolio of credit unions grew by 8.2 percentage points to 24.4% at the end of the year.

In 2004 the total amount of mortgage loans issued to credit union members increased by 55% and reached 1.2 million lats at the end of the year. Such loans made up one third of Latvia's total credit union loan portfolio, compared to 25% on 31 December 2003. Notwithstanding the increase in mortgage loans, 67.4% of the loans contained in the aggregate credit union loan portfolio still comprised of loans for the purchase of consumer goods (compared to 69.6% at the end of 2003).

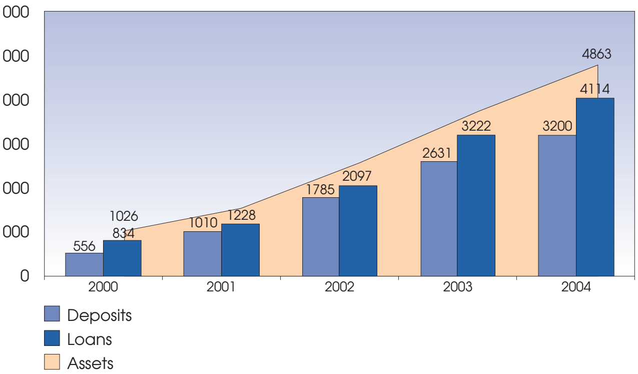
At the end of 2004, 64.5% of the loans issued by credit unions were classified as standard loans (compared to 57.7% at the end of 2003), 33.5% as close-watch loans (compared to 39.8% the year before) and 1.9% as non-performing loans (compared to 2.5% on 31 December 2003). Specific provisions made up 4.7% of the total loan amount (compared to 5.6% at the end of 2003).

At the end of the reporting year, the total capital and reserves of credit unions reached 1.2027 million lats. As a result of an increase in the number of credit union members and the consequent increase in equity of credit unions, the

Figure 9

LATVIAN CREDIT UNION ASSETS, DEPOSITS AND LOANS

(at the end of period; in thousands of lats)



paid-up share capital of Latvia's credit unions reached 911 900 lats at the end of the year.

In 2004, Latvian credit unions earned a total profit of 78 800 lats[15] (compared to 58 600 lats in 2003). Twenty-one credit unions ended the year with a profit, while the aggregate losses of 11 other credit unions amounted to 3 600 lats. (In 2003, 13 credit unions ended the year with total losses of almost 12 000 lats).

During the reporting year, the main source of income, or 69.4% of all credit union income, continued to be interest on loans issued to members. The largest share of credit union expenditures (45.2%) was taken up by administrative expenses.

Both the return on equity (ROE) and return on assets (ROA) of credit unions increased slightly in 2004. The credit union sector's ROE reached 7.5% on 31 December 2004 (compared to 7.3% a year earlier) and the ROA attained 1.8% (compared to 1.7% in 2003). At the end of 2004, the capital adequacy ratio for the credit union sector was 24.6%. The regulatory minimum is 10%.

Insurance Companies

At the end of 2004, there were 17 insurance companies in Latvia, of which five were involved in life insurance and 13 in non-life insurance operations.

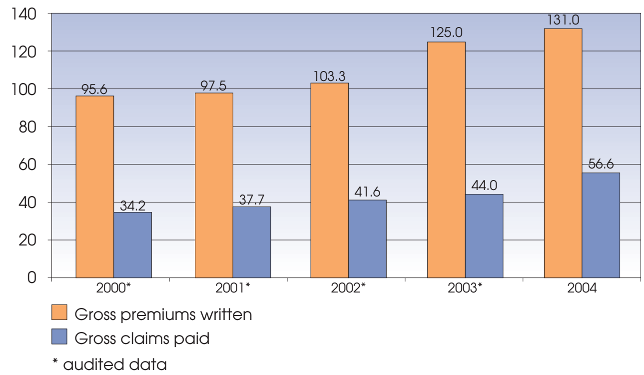
Six insurance companies were operating as subsidiaries of foreign insurers. The share capital of one insurance company was made up entirely of investments from various foreign insurance companies, while the share capital of two other insurance companies had a substantial foreign participating interest (more than 10%). At the end of 2004, the total amount of investments by foreign legal and natural persons in the share capital of insurance companies amounted to 22.4 million lats, or 54% of the total paid-up share capital of insurance companies in Latvia. Insurance companies operating as subsidiaries of European Union insurers, or whose share capital was made up of the direct investment of foreign insurers, had 47% of the market share at the end of 2004.

In 2004, the volume of gross premiums[16] written by insurance companies amounted to 131 million lats, which was 5% more than in 2003, while gross claims paid[17] amounted to 56.6 million lats, or 29% more than in 2003 (see Figure 10).

At the end of 2004, there were 31 insurance brokerage companies in the Latvian market, which provided insurance services amounting to 22.1 million lats. The share of gross premiums written through brokerage firms in 2004, when compared with the previous year, had not fluctuated and still constituted 17% of total gross premiums written.

15 Non-audited profit.
16 Gross premiums are all of the premiums written during the year in review for insurance contracts, and which have come into force during the reporting year, regardless of whether these premiums have been received or not.
17 Gross claims are all of the claims paid during the reporting year, along with paid life insurance surrender value and all expenses connected with the payment of claims during the reporting year.

Figure 10
GROSS PREMIUMS WRITTEN AND GROSS CLAIMS PAID
(at the end of period; in millions of lats)



During the reporting year, the volume of insurance premiums written by insurance brokerage firms varied widely at between 0.1% and 51% of the premiums written by insurance companies. Depending on the type of insurance required, every insurance company had used the services of a variety of insurance brokerage firms.

In 2004, of the volume of gross premiums written using brokerage firm mediation, 25% were written for land vehicle insurance. In turn, 88% of the entire volume of gross premiums written by insurance companies to cover railway liability was written with the mediation of brokerage firms.

By the end of 2004, the volume of gross insurance premiums written by insurance companies amounted to 1.8% of Latvia's Gross Domestic Product[18], or 0.2 percentage points less than in 2003. During the reporting year, the second most important indicator for establishing the significance of the insurance sector in the economy – insurance density – rose by 5%. In 2004 the volume of gross premiums written per capita reached 57 lats.

In 2004, there were no significant changes in the portfolio of gross premiums written by insurance companies. The majority of premiums (95%) were written for various forms of non-life insurance. Compared to 2003, the proportional share of gross premiums written for life insurance grew slightly to 5% (see Figure 11). In 2004, the largest share of the portfolio of gross premiums written by insurance companies (26%) consisted of gross premiums written for land vehicle insurance, followed by vehicle third party liability compulsory insurance (22%).

There was a slight drop in the combined ratio[19] from 99.9% in 2003 to 99.1% in 2004. By 31 December 2004, the own capital of insurance companies amounted to 45.3 million lats and had increased by 6% compared to 31 December 2003. The solvency indicator[20] was 128% (compared to 172% in 2003)[21]. By law, the lowest allowable indicator is 100%.

On 31 December 2004, the net technical provisions of insurance companies amounted to 75 million lats. The technical provisions were fully covered by authorized investments, and 93% of these investments were made in Latvia. The investment portfolio was conservative – the bulk of investments were made up of time deposits with credit institutions (37%) and securities issued and guaranteed by national or local governments (38%) (see Figure 12).

Figure 11
GROSS INSURANCE PREMIUMS WRITTEN BY CLASSES
(at the end of period; %)

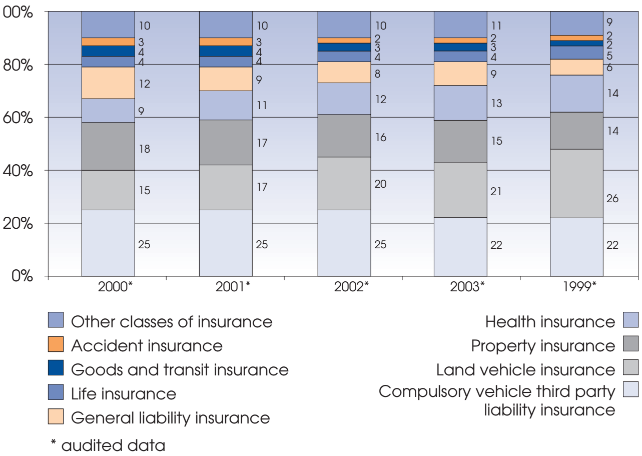
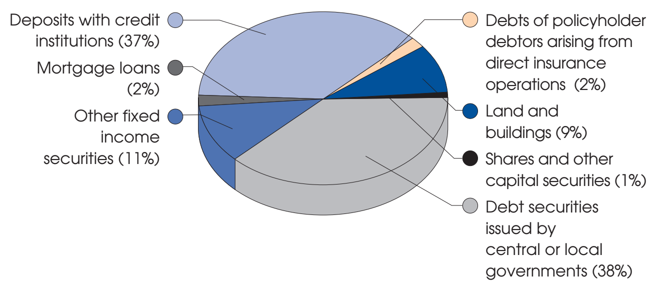


Figure 12
STRUCTURE OF INVESTMENTS COVERING NET TECHNICAL PROVISIONS
(31.12.2004; %)



18 Latvia's Gross Domestic Product in 2004 amounted to 7 359.4 million lats in 2004. Data from the Internet web page of the Central Statistical Bureau of Latvia (www.csb.lv).
19 The combined indicator refers to the cost of an insurance company's total insurance-related direct expenses divided by earned premiums.
20 The solvency indicator shows the sufficiency of a company's own capital to meet the established minimum solvency standards. The minimum solvency (or solvency norm) is the largest ratio of the calculated solvency norm.
21 The solvency norm during the year in review is calculated in accordance with the Commission's regulations of 28 May 2004 on the calculation of the solvency norm and own capital of insurance companies.

The Financial Instrument Market

At the end of 2004, the participants in Latvia's financial instrument market were the Riga Stock Exchange (RSE), the Latvian Central Depository, six investment brokerage firms and 20 banks involved in the provision of investment services, as well as 10 investment management companies managing of 15 investment funds (11 open-end funds and four closed-end funds).

The Riga Stock Exchange and the Latvian Central Depository

In realizing its goal of fully integrating into the securities market of the Nordic and Baltic countries, the Riga Stock Exchange joined the SAXESS securities exchange system of the Nordic countries in the autumn of 2004.

During the reporting year, the total turnover of the Riga Stock Exchange amounted to 198.2 million lats, which represents a reduction of 13.8% compared to the year 2003. At the end of 2004, the market value of the financial instruments in public circulation was 1 217.2 million lats. The market capitalization of shares grew by 39.5% and reached 848.7 million lats, while the market liquidity of shares[22] fell from 13.9% to 8.9%. The value of the Riga Stock Exchange's index (RIGSE) rose by 43.5% during 2004 and reached 413.6 points at the end of the year.[23]

At the end of 2004, the shares of 39 issuers were publicly traded in the Latvian financial instrument market (compared to 58 issuers a year earlier). Four issuers were in the RSE's official list, eight issuers were in the second list, while 27 were in the free list of shares.

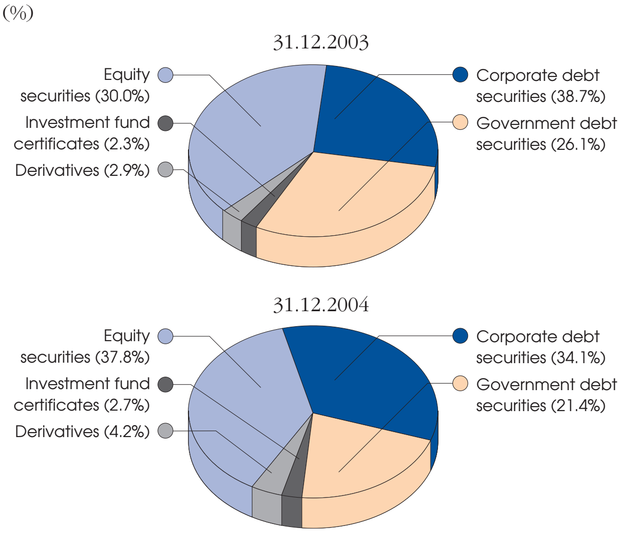
In 2004, the market value of financial instruments held at the Latvian Central Depository increased by 18.3% and reached 1 268.8 million lats at the end of the year (compared to 1 072.8 million lats at the end of 2003). Shares made up more than half (54.3%) of the total market value, followed by government debt securities (33.6%), corporate debt securities (9.2%) and investment fund certificates (2.9%). The number of holders of securities accounts decreased from 103 500 at the end of 2003 to 96 100 at the end of 2004.[24]

Investment Service Providers

The volume of the financial instrument portfolio held by investment services' providers (six investment brokerage firms and 20 banks) grew by 30.7% in 2004 and reached 2 120.7 million lats at the end of the year. Equity securities accounted for 37.6%, followed by corporate debt securities (34.1%), government debt securities (21.4%), derivatives (4.2%) and investment fund certificates (2.7%) (see Figure 13).

22 The market liquidity of shares is the ratio of their turnover against their market capitalization (turnover/market capitalization).
23 Data of the Riga Stock Exchange.
24 Data of the Latvian Central Depository.

Figure 13
STRUCTURE OF THE FINANCIAL INSTRUMENT PORTFOLIO
(%)



The value of investment service providers' operations with financial instruments increased by 10.7% in 2004. The main publicly traded financial instruments were government debt securities (45.6% of turnover), corporate debt securities (23.2%) and derivatives (21%) (see Figure 14).

Investment Brokerage Firms

During the year 2004, the proportion of the share capital of Latvian investment brokerage firms owned by foreign shareholders rose by 7.8 percentage points and reached 29% at the end of the year. All of the foreign shareholders were from the EU member states.

At the end of the reporting year, the total assets of Latvian investment brokerage firms amounted to 5.3 million lats. The total volume of client assets managed by investment brokerage firms amounted to 348.3 million lats at the end of the year. Of these, 92.5% belonged to Latvian residents. The most popular form of investment in financial instruments by Latvian residents during the reporting year was in debt securities and other fixed-income securities (91.3%).

The total profit of investment brokerage firms in 2004 amounted to 49 000 lats. The main sources of income were commissions for investment services (59.5%) and interest income (25.2%). Administrative expenses formed the largest share of expenditures (59.2%).

On 31 December 2004, the average capital adequacy ratio of investment brokerage firms was 80.4%, which far surpassed the minimum regulatory requirement of 10%.

Investment Management Companies and Investment Funds

Latvian investment management companies ended the year 2004 with a total profit of 292 400 lats (compared to a loss of 91 000 lats in the year 2003). In 2004, total investment funds' assets increased by 37% compared to 2003 and reached 36.4 million lats by the end of the year.

Investments in securities formed the largest share of investment funds' assets in 2004. The volume of investments in securities grew by 58% during the reporting year and reached 24 million lats, accounting for 66% of total investment funds' assets.

With prices continuing to rise in the Latvian real estate market, investment funds devoted more attention to real estate operations in 2004. Their investments in real estate grew threefold during the year and reached 2.6 million lats at the end of the year, or 7% of total investment funds' assets.

On 31 December 2004, the largest share of investments in the securities portfolio of investment funds was in the debt securities of central and local governments (49%, compared to 64% a year earlier) and in corporate debt securities (39%, compared to 31% in the previous year) (see Figure 15).

Figure 14
STRUCTURE OF SECURITIES TRANSACTIONS, BROKEN DOWN BY AMOUNT OF TRANSACTIONS
(%)

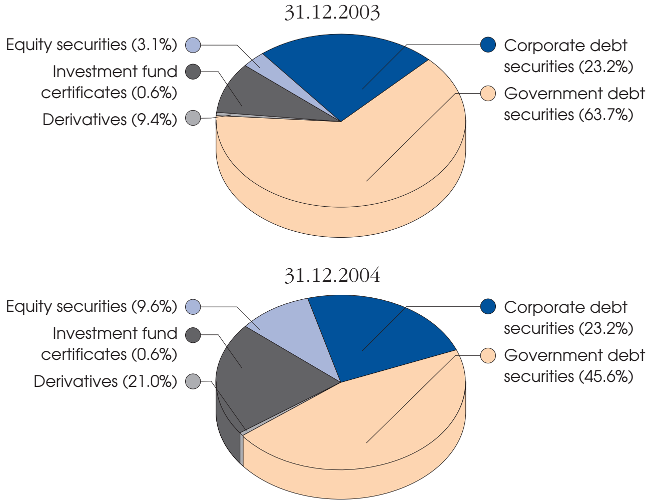
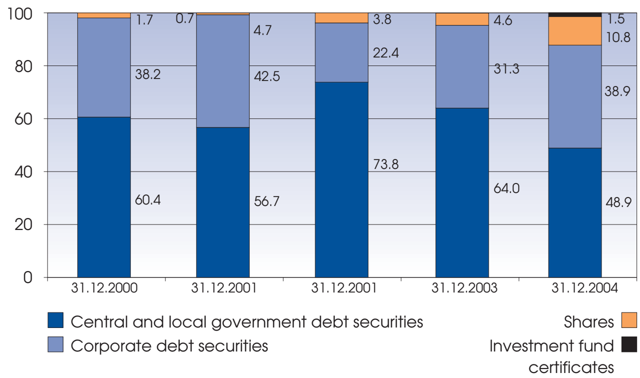


Figure 15
SECURITIES PORTFOLIO OF INVESTMENT FUNDS, BROKEN DOWN BY TYPE OF SECURITY
(at the end of period; %)



Investments in Latvian securities made up 49% of the aggregate securities portfolio of investment funds and amounted to 11.9 million lats, while investments in foreign securities grew 2.6 times and reached 12.2 million lats on 31 December 2004.

At the end of the reporting year, 19% of the aggregate securities portfolio of investment funds had been invested in Russia, while securities issued in the Ukraine, Poland and Kazakhstan each accounted for 4% of securities investments. The share of investments in the securities of other countries did not exceed 3% for any individual country, nor did investments in international financial institutions exceed 3% of total securities investments (see Figure 16).

In 2004, investment income brought about a 1.2 million-lats increase in the net assets of Latvian investment funds. This was 2.2 times more than in 2003, when the increase in net assets amounted to approximately 561 000 lats.

The largest share of expenditures for the management of investment funds was in fees to investment management companies[25], commission fees to custodian banks[26] and other investment fund management expenses[27]. During the repor-ting year, an average of 1.4% of investment plan assets were spent on their management, which was the same percentage as in 2003.

Management of State-Funded Pension Scheme Assets

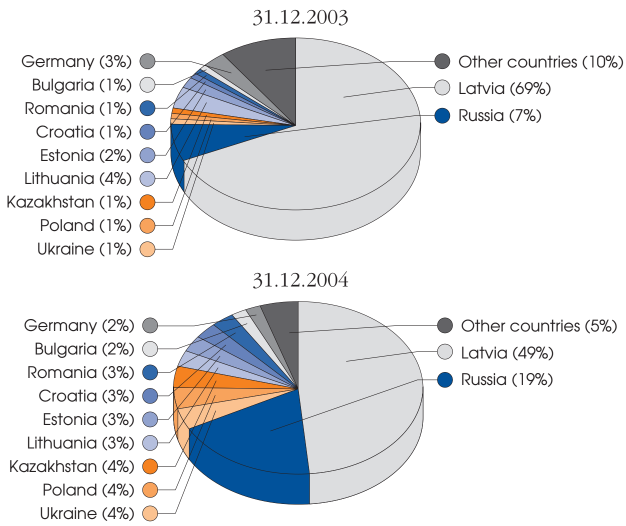
The year 2004 was a year of dynamic development in the management of the assets of state-funded pension scheme. Investment management companies, which first began to manage the assets of state-funded pension scheme in 2003, were very active in their operations.

On 31 December 2004, the assets of state-funded pension scheme were managed by eight investment management companies and by the State Treasury.

At the end of the reporting year, investment management companies and the State Treasury offered 19 investment plans to state-funded pension scheme participants (compared to 17 plans at the end of 2003).

At the end of 2004, there were 633 685[28] participants in the second-tier of the Latvian state pension scheme, or 43%[29] of the country's inhabitants of working age. One year earlier, the second-tier of the Latvian state pension scheme had 495 062 participants, or 34% of the country's inhabitants of

Figure 16
SECURITIES PORTFOLIO OF INVESTMENT FUNDS, BROKEN DOWN BY COUNTRY
(%)



25 Fees payable to the investment management company in accordance with the conditions set in the fund's prospectus.
26 Commission fees payable to the custodian banks, in accordance with the conditions set in the fund's prospectus.
27 Fees payable to the fund's auditors, as well as other management expenses.
28 This and other statistics further in the text are based on information compiled by the State Social Insurance Agency (www.vsaa.lv) regarding state-funded pension scheme participants.
29 Statistics on the number of people of working age in Latvia in 2004 have been published in the Internet website of the Central Statistical Bureau of Latvia (www.csb.lv).

working age. The gender structure of the participants corresponded with the gender structure of the Latvian population as a whole: 54% were women and 46% were men. The average age of the pension plan participants rose slightly from 30 years in 2003 to 31 years in 2004. The average age of those subject to obligatory participation in the scheme was 26 years, while the average age of voluntary participants was 42 years.

Of the second-tier pension scheme's 633 685 participants, 65% had been obliged to join the scheme by law[30], while 224 219 participants or 35% had joined it voluntarily (see Figure 17). One year earlier, 138 138 individuals, or 28% of the scheme's participants, had joined it voluntarily.

Participants had the choice of taking part in one of three types of investment plans[31] on the basis of investment policies: conservative, balanced and active. These three terms referred to the different types of investment policies that would be effected by each plan. In 2004, an increasing share (52%) of pension plan participants chose active investment plans with a dynamic investment policy to increase their future pensions.

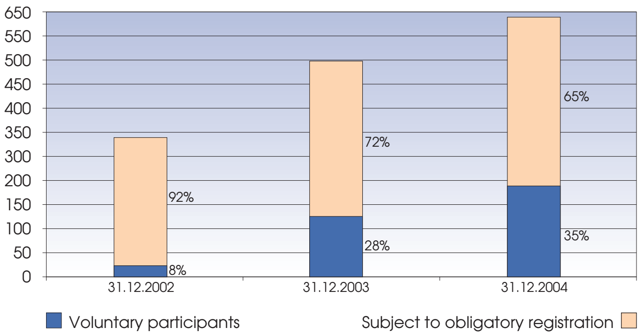
On 31 December 2004, the total volume of assets invested through state-funded pension scheme amounted to 48.2 million lats or 0.7% of Latvia's GDP[32] (compared to 0.5% of the GDP at the end of 2003).

Taking into account the relatively short period that has passed since the inception of state-funded pension scheme in the middle of 2001, the liabilities of such investment plans were not large in 2004. At the end of the year, the volume of investments under such plans had grown to 47 million lats, which represented an increase of 86% compared to the year before. The net assets of investment plans of the state-funded pension scheme grew by 89% to 48.1 million lats.

The return on investment plans[33] in 2004 varied from 0.8% to 7.0% (in 2003, return varied from – 0.2% to + 6.9%). The average weighted return for conservative investment plans was the lowest overall, at 3.5% over the course of the year. The return for balanced investment plans was 4.4%, while the return for active investment plans was the highest, at 6.1%.

The principal management expenditures for the investment plans of state-funded pension scheme were in fees to investment managers, fees to custodian banks and other management expenses. Management expenses averaged at 1.12% of investment plan assets in 2004, and varied from 0.02% to 1.68%, depending on the investment plan.

Figure 17
STATE-FUNDED PENSION SCHEME PARTICIPANTS, BROKEN DOWN BY CATEGORY
(number at the end of period, in thousands)

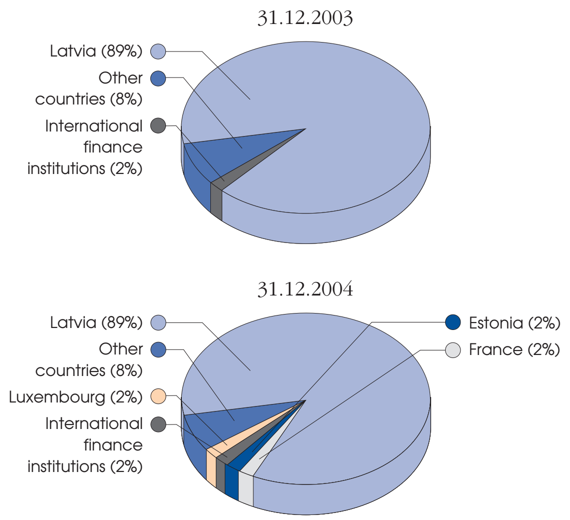


30 All inhabitants born after 1 July 1971 and who are registered for state pension insurance, are also registered on an obligatory basis in a state-funded second-tier pension scheme by the State Social Insurance Agency.
31 From information published by the Association of Latvian Commercial Banks.
32 Latvia's Gross Domestic Product in 2004 amounted to 7 359.4 million lats in 2004. Data from the Internet web page of the Central Statistical Bureau of Latvia (www.csb.lv).
33 The return on investment plans is calculated as the ratio of the change in value of the investment plan unit to its value at the beginning of the period, expressed in annual percentage terms.

Management expenses for conservative investment plans averaged at 0.81% of net assets, while for balanced and active investment plans such expenses averaged at 1.50% of the plans' net assets.

Low-risk investments continued to dominate the investment structure while the geographic concentration of investments in Latvia was less marked in 2004 than during the previous year (see Figure 18). Slightly more than half (56%) of total investments, or 26 million lats, were in debt and other fixed-income securities (compared to 73% of investments at the end of 2003). Over one-third (35%) of total investments, or 17 million lats, were in term deposits at credit institutions (compared to 26% of investments at the end of 2003). In 2004, the volume of assets invested in investment fund certificates grew considerably and reached 3 million lats, or 6% of invested assets.

Figure 18
GEOGRAPHICAL DISTRIBUTION OF STATE-FUNDED PENSION SCHEME ASSETS
(%)



Private Pension Funds

As of 31 December 2004, there were five private pension funds in Latvia that offered a total of 12 pension plans.

By the end of December 2004, there were 39 050 participants in these pension plans, or 47% more than at the end of 2003. Hence, 3% of people of working age[34] in Latvia were involved in private pension plans, compared to 2% at the end of 2003.

In 2004, contributions in the amount of 6 million lats were paid into the various pension funds, compared to 4.7 million lats in 2003. Of these payments, 88% were deposited by employers, compared to 96% in 2003.

As of 31 December 2004, the net assets, or the accrued capital of the pension plans was 25.7 million lats, or 34% more than on 31 December 2003. The profitability of the pension plans[35] was 5.4% in 2004.

In the sixth year of private pension fund activity, as the number of members reaching retirement age increased, the amount of capital paid out in pension benefits rose relatively rapidly. In 2004, compared to the previous year, the amount of capital paid out in pensions increased by 24%. By the end of the year, 484 300 lats of pension plan capital had been paid out to policy holders. About 88% of these payments were made due to the plan members reaching retirement age, and 12% due to the death of pension plan members.

Pension plan assets at the end of 2004, compared to 31 December 2003, grew by 33% and reached 25.8 million lats or 0.4% of Latvia's GDP (compared to 0.3% in 2003).

34 Statistics on the number of people of working age in Latvia in 2004 have been published in the Internet website of the Central Statistical Bureau of Latvia (www.csb.lv).
35 Return on pension plans – the results of the pension plans' annual operations in comparison to the pension plans' mean asset sum, which is calculated quarterly during each reporting year.

Pension plan assets were mainly invested in debt securities. As of 31 December 2004, this category of investments comprised 12.5 million lats, or 49% of total pension plan assets (see Figure 19). Although the investment policy of pension plan assets continued to be rather conservative – with an insignificant proportion of investments in shares and other variable-yield securities (constituting 15% of total assets at the end of 2004) – the overall volume of such investments had increased fourfold compared to 2003.

By the end of 2004, investments outside of Latvia had doubled compared to the end of 2003 and comprised 5.2 million lats. Of pension plan investments, 20.2 million lats, or 79%, had been invested in Latvia (compared to 86% on 31 December 2003) (see Figure 20). During the reporting period, 5% of the investments were made in Luxembourg, 3% in Lithuania and 2% in the securities issued by international financial institutions (the Nordic Investment Bank, the European Investment Bank and the World Bank). Estonia, Finland and the USA also each received 2% of total pension plan investments. The remaining 4% were invested in 12 other countries.

Figure 19
STRUCTURE OF PENSION PLAN ASSETS
(in millions of lats)

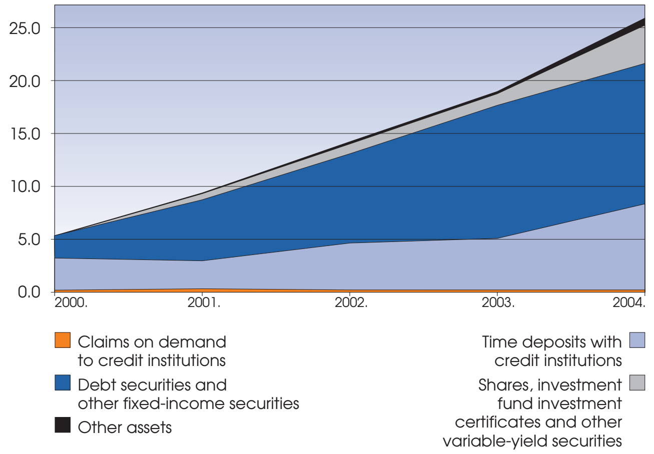
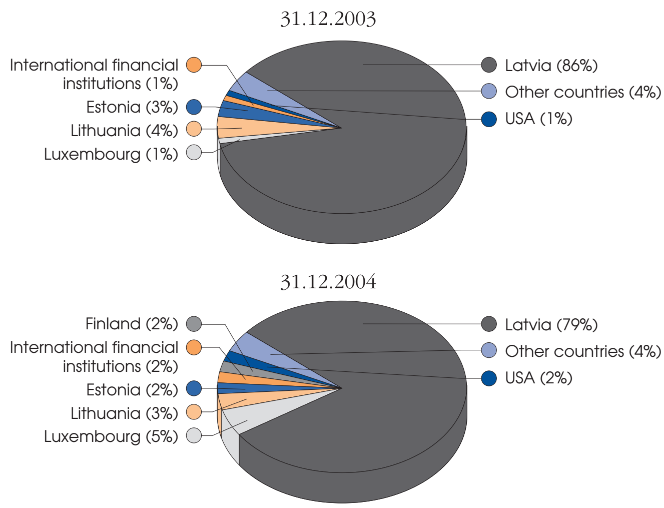


Figure 20
GEOGRAPHICAL BREAKDOWN OF PENSION PLAN INVESTMENTS
(%)



FINANCIAL STATEMENTS OF THE FINANCIAL AND CAPITAL MARKET COMMISSION FOR 2004

Management Report

The Financial and Capital Market Commission (hereinafter referred to also as the Commission) commenced its activities on 1 July 2001 in accordance with the Law on the Financial and Capital Market Commission.

On 19 December 2003, based on Article 7 of the Law on the Financial and Capital Market Commission, by Decision No. 296, the Commission's Board approved the budget of the Financial and Capital Market Commission for 2004, thereby spe-cifying the financing for activities of the Commission and the use of these funds. Pursuant to Article 5 of the Transitional Provisions of the Law on the Financial Capital Market Commission and 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 2004, approved by the Commission's Board on 19 December 2003, financial and capital market participants made payments for financing the Commission. The activities of the Commission in 2004 were also financed by the Bank of Latvia and the State budget, in accordance with the transitional provisions of the Law on the Financial and Capital Market Commission.

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 the 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 continued to manage the Deposit Guarantee Fund and the Fund for the Protection of the Insured (hereinafter referred to also as the Funds). For the purposes of a clearer perception, assets of the Funds managed by the Commission are disclosed separately in the balance sheet.

In 2004, assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured were invested in accordance with the investment policies and investment procedures specified for the Funds, approved by the Commission's Board on 7 February 2003, which stipulate asset investments only in the primary market of securities, and in the currency, in which payments from the Deposit Guarantee Fund and the Fund for the Protection of the Insured are to be made. The said investment policies provide for keeping of at least 30% of each Fund's assets liquid: either in an account held with the Bank of Latvia or invested in debt securities whose term of redemption does not exceed one year. In 2004, assets of the Funds managed by the Commission were invested in compliance with the requirements of the Agreement On Investing Assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured in Latvian State Treasury Securities, entered into between the Commission and the State Treasury.

As the Commission falls within the definition of a contracting authority provided by the Law on Procurement for State and Local Government Needs, all procurements were made in compliance with the requirements of the said law.

On 24 November 2004, an agreement on the audit of the Commission's financial statements for 2004 was entered into with Ernst & Young Baltic SIA, which was represented by Certified Auditor Diāna Krišjāne.

In 2004, the State Revenue Service conducted an audit of the Commission's accounting system. The State Audit Office did not perform any audits relating to activities of the Commission in the reporting year.

Funds of the Commission

At the end of 2004, assets of the Commission totalled 26 083 478 lats, of which 24 668 287 lats were managed trust assets, i.e. assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured. In 2004, activities of the Commission were financed from payments made by financial and capital market participants, the State budget and the Bank of Latvia. At the end of 2004, the Commission's equity or net assets accounted for 1 288 907 lats, which had increased by 224 224 lats compared to the year before.

Ensuring Activities of the Commission in 2004

In 2004, the revenues of the Commission were 2 511 230 lats, or 9% more than the planned revenues, as laid down in the Commission's budget for 2004 (2 299 143 lats). Expenses of the Commission were 2 276 656 lats, i.e. less than planned (2 281 402 lats). The largest expense items were the staff remuneration and compulsory contributions for the state social insurance (67% of expenses). The actual excess of revenues over expenses in 2004 was 234 574 lats. In 2002 and 2003, the actual revenues of the Commission were lower than the actual expenses, due to the fact that the funds allocated for the establishment of the Commission and commencement of its activities were invested in long-term assets and prepaid expenses, whose amortisation effect decreased the Commission's equity, while having no impact on the cash flow.

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 and credit union payments constituted 8 289 521 lats, while revenues of the Fund for the Protection of the Insured, received from insurers, constituted 269 795 lats. Revenues from investments made by the Deposit Guarantee Fund were 646 155 lats, while by the Fund for the Protection of the Insured, 47 513 lats. Total assets of these Funds increased by 9 250 965 lats, or 60%, that is, assets of the Deposit Guarantee Fund rose by 8 935 677 lats, or 62.4%, while assets of the Fund for the Protection of the Insured, by 315 288 lats, or 28.5%. At the end of 2004, net financial assets of the Deposit Guarantee Fund comprised 23 246 682 lats while net financial assets of the Fund for the Protection of the Insured, 1 421 605 lats.

In the reporting period, the Commission invested assets of the Funds in short-term Latvian State Treasury securities. Of the total securities portfolio of the Funds at the end of 2004, 24% were placed in long-term securities while the rest in short-term securities. Of the securities portfolio of the Deposit Guarantee Fund, 23% were invested in long-term securities while the rest in short-term securities. As regards the securities portfolio of the Fund for the Protection of the Insured, the corresponding figures were 41% for long-term securities and 59% for short-term securities. In 2004, the profitability of assets of the Deposit Guarantee Fund reached 3.50%, while that of the Fund for the Protection of the Insured, 3.86%. The profitability was calculated by dividing the sum of investment revenues (received and accrued) of the relevant Fund during 2004 by the average asset value of the Fund during 2004.

Chairman of the Financial and
Capital Market Commission

Uldis Cērps

8 April 2005

Balance Sheet (in Lats)

ASSETS

	Note	31.12.2004	31.12.2003
ASSETS OF THE FUNDS			
LONG-TERM INVESTMENS		**5 681 452**	**5 695 626**
Investments by the Funds in securities	3	5 681 452	5 695 626
CURRENT ASSETS		**18 986 835**	**9 721 696**
Receivables		**2 370 284**	**1 779 290**
Due from market participants to the Funds	5	2 370 220	1 779 207
Settlements with the administrator related to guaranteed compensation payments	2	64	83
Investments by the Funds in securities	3	**16 616 395**	**7 942 148**
Cash		**156**	**258**
TOTAL ASSETS OF THE FUNDS		**24 668 287**	**15 417 322**
ASSETS OF THE COMMISSION			
LONG-TERM INVESTMENS	4	**171 491**	**258 284**
Intangible assets		55 026	45 476
Fixed assets		98 942	145 196
Leasehold improvements		17 287	36 870
Prepayments for long-term investments		236	30 742
CURRENT ASSETS		**1 243 700**	**823 909**
Inventories		**942**	**45**
Accounts receivable		**403 136**	**204 626**
Due from market participants to the Commission	6	400 445	199 014
Other receivables		2 287	4 107
Due from the staff		404	782
Overpaid taxes	7	-	723
Prepaid expenses	8	**12 498**	**12 125**
Cash		**827 124**	**607 113**
TOTAL ASSETS OF THE COMMISSION		**1 415 191**	**1 082 193**
TOTAL ASSETS		**26 083 478**	**16 499 515**

The accompanying notes on pages 36 to 43 form an integral part of these financial statements.

Balance Sheet (in Lats)

LIABILITIES

	Note	31.12.2004	31.12.2003
LIABILITIES OF THE FUNDS			
EQUITY	9	**24 668 287**	**15 417 322**
Net financial assets of the Funds (budget result)		24 668 287	15 417 322
PAYABLES		**-**	**-**
TOTAL LIABILITIES OF THE FUNDS		**24 668 287**	**15 417 322**
LIABILITIES OF THE COMMISSION			
EQUITY	9	**1 288 907**	**1 064 683**
Net assets of the Commission		1 288 907	1 064 683
PROVISION		**113 595**	**-**
Provision for vacation		113 595	-
PAYABLES		**12 689**	**17 510**
Accounts payable to suppliers	10	12 689	17 341
Settlements with the staff		-	69
Prepayments for financing the Commission		-	100
TOTAL LIABILITIES OF THE COMMISSION		**1 415 191**	**1 082 193**
TOTAL LIABILITIES		**26 083 478**	**16 499 515**

The accompanying notes on pages 36 to 43 form an integral part of these financial statements.

Chairman of the Financial and
Capital Market Commission Uldis Cērps

Head of
the Financial Division Rita Vanaga

8 April 2005

Cash Flow Statement (in Lats)

	Note	2004	2003
REVENUES			
REVENUES RELATED TO SUPERVISION OF CREDIT INSTITUTIONS AND CREDIT UNIONS		1 532 184	1 204 567
Payments by the Bank of Latvia		960 000	1 200 000
Payments by credit institutions		566 320	-
Payments by credit unions		5 864	4 567
REVENUES RELATED TO INSURANCE SUPERVISION		740 876	649 453
Payments by life insurance companies		42 314	32 944
Payments by other insurance companies		698 562	616 509
REVENUES RELATED TO SUPERVISION OF THE SECURITIES MARKET AND PENSION FUNDS		218 227	235 558
State budget		100 000	150 000
Payments by securities market participants and private pension funds		118 227	85 558
Securities market participants		94 424	66 605
Private pension funds		23 803	18 953
OTHER[1]		19 943	1
TOTAL REVENUES		**2 511 230**	**2 089 579**
EXPENSES			
Staff remuneration and other payments		(1 539 638)	(1 485 469)
Staff remuneration and other payments	11	(1 268 430)	(1 225 698)
State social insurance compulsory contributions		(271 208)	(259 771)
Staff insurance	12	(91 702)	(82 960)
Improvements of professional skills and business trips		(88 601)	(67 381)
Telecommunication and information		(39 691)	(35 820)
Public information and external and internal communications		(17 246)	(17 615)
Maintenance expenses		(216 873[2])	(71 147)
Professional services		(6 982)	(41 682)
Participation in international organisations		(41 304[3])	(9 195)
Provision for vacation		(113 595)	-[4]
Depreciation/amortisation/write-off of capital investments	4	(22 206)	(24 021)
TOTAL EXPENSES		**(2 177 838)**	**(1 835 290)**
Excess of revenues over expenses		**333 392**	**254 289**
Expenses for the establishment of the Commission and commencement of its activities	4, 13	**(98 818)**	**(296 773)**
BUDGET RESULT		**234 574**	**(42 484)**

The accompanying notes on pages 36 to 43 form an integral part of these financial statements.

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1 Income from interest on the balance of the Commission's current account.
2 Costs for the item increased due to commencement of payments for the rent of premises from the Commission's current annual budget (145 026 lats). For the period until 9 January 2004, payments for the rent of premises were made in 2001 as a prepayment for rent of premises from the Commission establishment and commencement of activities budget.
3 Costs for the item increased due to mandatory contributions to EU organisations, the participation in which was made mandatory for the new EU member states as of 1 May 2004.
4 In 2003, provision for vacation was not set up.

Cash Flow Statement (in Lats)

	Note	2003	2002
RECEIPTS			
RECEIPTS RELATED TO SUPERVISION			
OF CREDIT INSTITUTIONS AND CREDIT UNIONS		1 371 064	1 204 177
Payments by the Bank of Latvia		960 000	1 200 000
Payments by credit institutions		405 472	
Payments by credit unions		5 592	4 177
RECEIPTS RELATED TO SUPERVISION OF INSURANCE		711 532	623 964
Payments by life insurance companies		38 707	32 100
Payments by other insurance companies		672 825	591 864
RECEIPTS RELATED TO SUPERVISION			
OF THE SECURITIES MARKET AND PENSION FUNDS		207 261	215 374
State budget		100 000	150 000
Payments by securities market participants and private pension funds		107 261	65 374
Securities market participants		85 192	48 507
Private pension funds		22 069	16 867
OTHER[5]		19 843	100
TOTAL RECEIPTS		**2 309 700**	**2 043 615**
PAYMENTS			
Staff remuneration		(1 540 219)	(1 486 148)
Staff remuneration		(1 269 011)	(1 226 376)
State social insurance compulsory contributions		(271 208)	(259 772)
Staff insurance		(91 678)	(82 962)
Improvements of professional skills and business trips		(87 386)	(70 767)
Telecommunication and information		(41 329)	(30 940)
Public awareness campaigns and			
external and internal communications expenses		(17 072)	(20 770)
Maintenance expenses		(220 439[6])	(71 086)
Professional services		(11 309)	(38 142)
Participation in international organisations		(39 805[7])	(9 159)
TOTAL PAYMENTS		**(2 049 237)**	**(1 809 974)**
INVESTMENT ACTIVITIES			
Capital expenditure		(40 452)	(40 780)
TOTAL INVESTMENT ACTIVITIES		**(40 452)**	**(40 780)**
Net change in cash during the reporting period		**220 011**	**192 861**
Cash balance at the beginning of the reporting period		**607 113**	**414 252**
Cash balance at the end of the reporting period		**827 124**	**607 113**

The accompanying notes on pages 36 to 43 form an integral part of these financial statements.

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[5] See Footnote 1.
[6] See Footnote 2. Expenses related to rent of premises in 2004 made up 148 625 lats.
[7] See Footnote 3. Direct costs of participation in various EU organisations in 2004 made up 35 898 lats.

Statement of Changes in Equity (in Lats)

	Note	Budget result of the budget for the Commission's establishment and commencement of activities	Budget result of the budget for the Commission's financing	**Equity (net assets) of the Commission**	Net financial assets of the Deposit Guarantee Fund	Net financial assets of the Fund for the Protection of the Insured	**Equity (net financial assets) of the Funds**
		13					2
Budget result 31.12.2002		**438 904**	**700 911**	**1 139 815**	**7 644 979**	**857 578**	**8 502 557**
Fixed asset depreciation/ write-off charged to the budget result	1	-	(32 648)	**(32 648)**	-	-	-
Budget result of the reporting period		(296 773)	254 289	**(42 484)**	6 666 026	248 739	**6 914 765**
Budget result 31.12.2003		**142 131**	**922 552**	**1 064 683**	**14 311 005**	**1 106 317**	**15 417 322**
Fixed asset depreciation/ write-off charged to the budget result	1, 4	-	(10 350)	**(10 350)**	-	-	-
Budget result of the reporting period		(98 818)	333 392	**234 574**	8 935 677	315 288	**9 250 965**
Budget result 31.12.2004		**43 313**	**1 245 594**	**1 288 907**	**23 246 682**	**1 421 605**	**24 668 287**

The accompanying notes on pages 36 to 43 form an integral part of these financial statements.

Chairman of the Financial and Capital Market Commission — Uldis Cērps

Head of the Financial Division — Rita Vanaga

8 April 2005

Notes to the Financial Statements

The Financial and Capital Market Commission (hereinafter – the Commission) was established and operates under the Law on the Financial and Capital Market Commission.

The objective 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 by using as guidelines the Regulation No. 999, On the Procedure for Preparing Annual Reports for State and Local Government Budgetary Institutions, issued by the Cabinet on 30 November 2004.

The accounting principles applied for the reporting period and previous years were used consistently except for the accounting for vacation expenses. The accrual basis of accounting for vacation expenses was applied for the first time in 2004. In the reporting period, accrued vacation expenses in the financial statements were shown under the item *Provision for vacation* contained in the statement of income and expenses.

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.

Budget results of the budget for the Commission's establishment and commencement of activities are disclosed in a separate note to the financial statements. The assets acquired at the launch of the Commission's activities were used to ensure activities of the Commission; consequently, these assets were included in the balance sheet of the Commission.

Principles Applied in Preparing the Financial Statements
- The financial statements, except for the cash flow statement, were prepared in compliance with the principle of accrual-based accounting. It provides for recognition of transactions and events in the financial statements at the date of their 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 and from which payments are to be calculated. Expenses are recognised at the date of their occurrence, including accrued vacation expenses proportionate to the time actually worked. Accrued vacation expenses shall be specified for each staff member for his or her paid vacation days accrued up to 31 December of the respective calendar year as well as for the fraction of a vacation allowance, which shall be proportionate to the number of days of the accrued vacation.
- Assets are recognised at historic cost. Assets are booked on the date of their acquisition in the amount of paid cash or cash equivalents, or at the 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.

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

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

The amount of depreciation calculated for fixed assets was charged to the Commission's statement of income and expenses, except for the fixed assets taken over from budgetary institutions (the Insurance Supervision Inspectorate, the Securities Market Commission and the Deposit Guarantee Fund Administration) on 1 July 2001, the depreciation of which was directly charged against the book value of fixed assets in the Commission's balance sheet and the Commission's equity (net assets). Such a method is provided by the Regulations on Fixed Asset Depreciation Rates for Budgetary Institutions, for in the respective budgetary institutions fixed assets were expensed in their full value at the date of acquisition (and a corresponding fixed asset fund for this amount was credited to equity). The depreciation for the Commission's fixed assets is calculated until their residual value reaches 5 lats.

The following annual depreciation rates were applied to leasehold improvements:

- security systems 33%;
- fixings 20%.

Depreciation/amortisation 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. The valuation of long-term securities was performed using the effective interest rate amortisation method. The valuation of short-term securities was performed by using the straight-line discount amortisation method.

Accounts Receivable

The Commission steadily follows that settlements are made in due time. 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 in which the debtor has been excluded. In the reporting period, the Commission has not excluded debtors' debts from the accounts receivable.

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)

In order to protect the interests of the insured, by 6 December 2002 Decision No. 322, On the Procedure for Making Payments from the Fund for the Protection of the Insured in the Case of AK Alianse's Bankruptcy, the Board of the Commission established the procedure for insurance indemnity payments. In protecting the interests of the insured, the insurance indemnity payments from the Fund for the Protection of the Insured in this company's bankruptcy makes up 8 607 lats (the insurance indemnities in 2003 totalled 6 588 lats while in 2004, 2 019 lats).

	Actual result of of revenues and expenses in 2004	Actual result of revenues and expenses in 2003
REVENUES		
Payments to the Deposit Guarantee Fund	8 289 521	6 263 766
Payments by credit institutions	8 283 228	6 258 796
Payments by credit unions	6 293	4 970
Payments to the Fund for the Protection of the Insured	269 795	215 915
Payments by life assurance companies	38 839	34 674
Payments by other insurance companies	230 956	181 241
Income from investments	693 668	441 672
Income of the Deposit Guarantee Fund	646 156	402 260
Income of the Fund for the Protection of the Insured	47 512	39 412
TOTAL REVENUES	**9 252 984**	**6 921 353**
EXPENSES		
Guaranteed compensation payments from the Fund for the Protection of the Insured	(2 019)	(6 588)
TOTAL EXPENSES	**(2 019)**	**(6 588)**
RESULT	**9 250 965**	**6 914 765**

	Cash flow in 2004	Cash flow in 2003
FINANCING		
Payments to the Deposit Guarantee Fund	7 714 154	5 182 573
Payments by credit institutions	7 707 891	5 179 138
Payments by credit unions	6 263	3 435
Payments to the Fund for the Protection of the Insured	254 150	204 706
Payments by life assurance companies	33 191	35 362
Payments by other insurance companies	220 959	169 344
CASH FLOW FROM FINANCING	**7 968 304**	**5 387 279**
INVESTMENT ACTIVITIES		
(Increase)/decrease in investments	(8 517 645)	(5 798 453)
(Increase)/decrease in debt securities in the Deposit Guarantee Fund	(8 221 144)	(5 523 775)
(Increase)/decrease in debt securities in the Fund for the Protection of the Insured	(296 501)	(274 678)
Income from investments	551 239	377 933
Interest payments to the Deposit Guarantee Fund	506 840	341 328
Interest payments to the Fund for the Protection of the Insured	44 399	36 605
CASH FLOW FROM INVESTMENT ACTIVITIES	**(7 966 406)**	**(5 420 520)**
EXPENSES		
Compensation payments from the Fund for the Protection of the Insured	(2 000)	(6 671)
TOTAL EXPENSES	**(2 000)**	**(6 671)**
CASH FLOW RESULT	**(102)**	**(39 912)**
Cash balance at the beginning of the reporting period	**258**	**40 170**
Cash balance at the end of the reporting period	**156**	**258**

3. Investments in Securities

This item contains purchased Latvian State Treasury securities. The value of long-term securities was disclosed in the balance sheet at amortised cost. The value of short-term securities was disclosed in the balance sheet at the value calculated by using straight-line discount amortisation method.
Securities of the Funds were placed in the following Latvian Government securities issues:

Term Structure of Investments by the Funds on 31 December 2004

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value (in lats)	Book value (in lats)
LV0000580017	14.02.2003	14.02.2013	4.89	3 785 000	3 995 081
LV0000570034	08.05.2002	08.05.2007	5.18	1 618 300	1 647 035
LV0000560035	29.08.2003	29.08.2006	3.97	38 900	39 336
				5 442 200	5 681 452

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value (in lats)	Book value (in lats)
LV0000540813	17.11.2004	17.11.2005	3.68	84 300	81 631
LV0000540805	08.10.2004	07.10.2005	3.73	3 203 500	3 114 047
LV0000540771	04.06.2004	03.06.2005	3.61	3 191 000	3 143 479
LV0000540763	23.04.2004	22.04.2005	3.87	3 685 200	3 642 452
LV0000532083	17.12.2004	17.06.2005	3.48	730 500	718 834
LV0000532075	22.10.2004	22.04.2005	3.77	2 246 900	2 221 043
LV0000532067	06.08.2004	04.02.2005	3.58	3 707 600	3 694 909
				16 849 000	16 616 395

Term Structure of Investments by the Funds on 31 December 2003

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value (in lats)	Book value (in lats)
LV0000580017	14.02.2003	14.02.2013	4.89	3 785 000	4 004 740
LV0000570034	08.05.2002	08.05.2007	5.18	1 618 300	1 651 449
LV0000560035	29.08.2003	29.08.2006	3.97	38 900	39 437
LV0000540755	03.12.2003	03.12.2004	3.62	717 800	694 272
LV0000540748	24.09.2003	24.09.2004	3.49	1 047 100	1 020 811
LV0000540730	06.08.2003	06.08.2004	3.14	1 590 300	1 560 681
LV0000540722	07.05.2003	07.05.2004	3.18	3 000 700	2 967 612
LV0000532026	22.10.2003	23.04.2004	3.31	1 680 500	1 663 181
LV0000532018	02.07.2003	02.01.2004	2.85	35 600	35 591
				13 514 200	13 637 774

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

	31.12.2004	**31.12.2003**
Accrued income of the Deposit Guarantee Fund	411 809	322 649
Accrued income of the Fund for the Protection of the Insured	30 995	32 166
	442 804	354 815

4. Long-term Investments

	Intangible assets	Fixed assets				Prepay-ments for long-term invest-ments	
	Licences and software	Computers and office equipment	Transport vehicles	Other fixed assets	Leasehold improve-ments		Total
Book value 31.12.2003	**45 476**	**62 660**	**15 036**	**67 500**	**36 870**	**30 742**	**258 284**
Additions	3 452	26 635	-	2 261	432	9 622	42 402
Revaluation	-	57	-	1 536	-	-	1 593
Write-offs and disposals	-	(22 308)	-	(16 754)	-	-	(39 062)
Re-classified[8]	40 128	-	-	-	-	(40 128)	-
On 31.12.2004	**89 056**	**67 044**	**15 036**	**54 543**	**37 302**	**236**	**263 217**
Depreciations							
Charge	34 030	45 245	5 907	22 084	20 015	-	127 281
Reversal due to disposals	-	(20 515)	-	(15 040)	-	-	(35 555)
On 31.12.2004	**34 030**	**24 730**	**5 907**	**7 044**	**20 015**	**-**	**91 726**
Book value 31.12.2004	**55 026**	**42 314**	**9 129**	**47 499**	**17 287**	**236**	**171 491**

Changes in long-term investments in 2004, showing expenses disclosed in the statement of income and expenses and the statement of changes in equity:

	Charge	Write-offs or disposals, excluding the accrued depreciation	Revaluated	Additions (exchange during the warranty period)	Total
Depreciation/amortisation/write-off of capital investments charged to the statement of income and expenses	117 262	1 581	-	(1 929)	116 914[9]
Fixed asset depreciation/write-off directly charged to the budget result (equity)	10 019	1 924	(1 593)	-	10 350
	127 281	3 505[10]	(1 593)	(1 929)	127 264

On 31 December 2004, prepayments for long-term investments were made in the amount of 236 lats, i.e. for the improvement of the Commission's accounting programme.

On 31 December 2004, the number of fixed assets, the depreciation of which decreased the book value of fixed assets in the Commission's balance sheet and the Commission's equity (net assets), amounted to 21. The residual value on 31 December 2004 of such assets was 7 243 lats, the depreciation of which will be reflected in the next reporting periods in the amount of 7 178 lats.

The number of those fixed assets whose residual value remains unchanged up to the end of their use – 5 lats per each fixed asset – at the Commission amounts to 989.

8 This line reflects inclusion of the value of particular assets in the composition of long-term investments, excluding the amount of prepayments made for these long-term investments in the previous periods and in the reporting period.

9 A total of the Commission's depreciation/amortisation/write-off of capital investments is made up of depreciation of long-term investments acquired from the funds of the Commission's establishment and commencement of its activities budget in the amount of 94 708 lats (see Note 13) and depreciation of other fixed assets, changes in their value and write-off in the amount of 22 206 lats (see the Commission's statement of income and expenses).

10 The value of write-offs and disposals for long-term investments is made up of the difference between historical cost of write-offs and depreciation write-offs.

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 2004 and the fourth quarter ended 31 December 2003, respectively.

	31.12.2004	**31.12.2003**
Due from market participants to the Deposit Guarantee Fund	2 295 400	1 720 032
Due from credit institutions	2 293 840	1 718 502
Due from credit unions	1 560	1 530
Due from market participants to the Fund for the Protection of the Insured	74 820	59 175
Due from life assurance companies	12 867	7 219
Due from other insurance companies	61 953	51 956
	2 370 220	1 779 207

6. Due from Market Participants to the Commission

This caption contains amounts due from financial and capital market participants to the Commission on the date set out in the statement for the fourth quarter ended 31 December 2004 and the fourth quarter ended 31 December 2003, respectively.

Due from different segments of financial and capital market participants to the Commission:

	31.12.2004	**31.12.2003.**
Due from credit institutions	160 848	-
Due from credit unions	1 577	1 305
Due from life assurance companies	12 407	8 800
Due from other insurance companies	189 321	163 584
Due from investment management companies	16 454	11 792
Due from investment brokerage firms	8 385	4 837
Due from the Latvian Central Depository and the Riga Stock Exchange	4 901	3 878
Due from private pension funds	6 552	4 818
	400 445	199 014

7. Taxes

Type of tax	Balance on 31.12.2003	Calculated for the reporting period	Decreased compulsory contribution result	Paid in the reporting period	Balance on 31.12.2004
Contributions to compulsory state social insurance	-	375 294	(2 012)	(373 282)	-
Personal income tax	(723)	286 685	-	(285 962)	-
	(723)	661 979	(2 012)	(659 244)	-

According to the data received from the State Revenue Service, compulsory contributions to State social insurance were decreased by the amount that exceeded the maximum limit specified by legislation.

8. Prepaid Expenses

	31.12.2004	**31.12.2003**
Prepayment for rent of premises until 9 January of the next period	3 599	4 110
Software subscription fees	3 404	3 164
Professional literature	2 125	2 177
Membership dues	-	1 499
Other prepaid expenses	3 370	1 175
	12 498	12 125

9. Equity

This item represents net assets of the Commission (total budget result) and 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 reporting year.

11. Staff Remuneration and Other Payments

This item contains remuneration to the staff of the Commission, including remuneration paid for specific work done for the Commission. Expenses related to remuneration to the Board comprised 17.20% of the total remuneration expenses in 2004, compared to 17.23% a year earlier. At the end of 2004, the Commission had 89 staff members as compared to 87 staff members the year before, and there were 89 positions at the Commission by the end of 2004, compared to 88 positions a year earlier.

	2004	**2003**
Staff remuneration and other payments	1 268 430	1 225 698
incl. remuneration to members of the Commission's Board	218 179	211 215
incl. remuneration to members of the Consultative Council of the Financial and Capital Market	3 250	-
Average number of employees per year	91	88
incl. the number of members of the Commission's Board	5	5
incl. the number of members of the Consultative Council of the Financial and Capital Market	4	-

12. Staff Insurance

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

	2004	**2003**
Endowment life insurance	67 402	60 399
Health insurance	20 356	17 051
Accident insurance	3 944	5 510
	91 702	82 960

In 2004, in accordance with the Procedure for Health Insurance, Accident Insurance and Endowment Life Insurance for the Commission's Staff, approved by the Board 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 all employees of the Commission who performed the functions of state officials.

13. Expenses Related to the Budget for Commission's Establishment and Commencement of Activities

In 2002, the Commission finished utilising the funds provided for its establishment and commencement of activities. The statement of income and expenses for 2004 includes expenses in the amount of 4 110 lats for the rent of premises, the payment for which was made in 2001 for 2.5 years in advance from the budget for the Commission's establishment and commencement of activities. Likewise, the statement of income and expenses includes expenses related to the depreciation calculated for long-term investments, which were effected from the funds allocated for the establishment of the Commission and commencement of its activities, in the amount of 94 708 lats. These expenses in the amount of 98 818 lats were disclosed separately in the statement of income and expenses for the reporting period, and its result was included in the Commission's budget result. The statement of income and expenses for 2003 includes expenses incurred on the rent of premises in the amount of 169 861 lats and the depreciation calculated in the amount of 126 912 lats.

14. 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 expenses related to the rent of the Commission's premises totalled USD 68 493 per quarter (USD 273 972 per year). Upon agreement in writing between the Commission and the lessor, the contract may be terminated before its expiry date. The Commission has no intention to terminate the contract.

15. Court Proceedings and Claims

When performing functions specified by the Law on the Financial and Capital Market Commission, the Commission may become involved in court proceedings related to supervisory activities. At the moment of signing the financial statements, the Commission, as a defendant, was involved in one court proceeding of monetary nature. On 18 March 2004, based on an application submitted by a natural person to the District Administrative Court requesting the cancellation of Decision No. 4 of the Commission's Board taken on 16 January 2004 and recovery of 19 027 lats from the Commission in favour of the said natural person, a court proceeding was initiated. The Board of the Commission is of the opinion that the said application to the court is unfounded and should be completely rejected. The court of first instance decided in favour of the Commission. Though the natural person has appealed this court adjudication under applicable appellate procedures, the Commission is of the opinion that the court judgment pending before the appellate court will be given in favour of the Commission.

AUDITORS' REPORT

We have audited the accompanying financial statements of Financial and Capital Market Commission (hereinafter – the Commission) for the year ended 31 December 2004, set out on pages 5 through 17, 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.

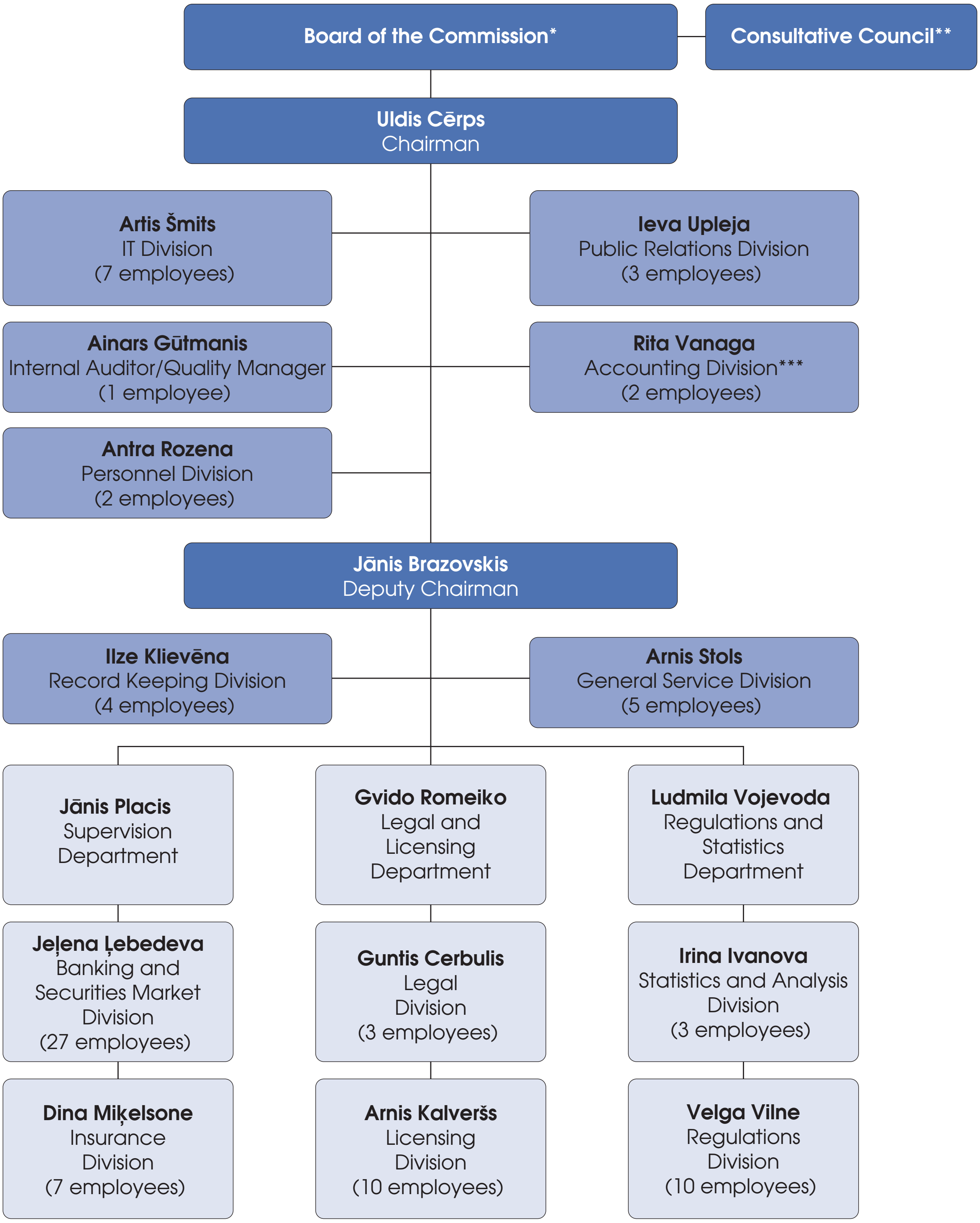
In our opinion, the financial statements referred to above give a true and fair view of the financial position of Financial and Capital Markets Commission as of 31 December 2004, and of the results of its operations and its cash flows for the year then ended in accordance with the accounting policies of the State Treasury instructions of the Republic of Latvia as adopted by the Financial and Capital Markets Commission.

Ernst & Young Baltic SIA
License No. 17

Diāna Krišjāne
Personal ID code: 250873-12964
Chairperson of the Board
Latvian Sworn Auditor
Certificate No. 124

Riga,
8 April 2005

Structure of the Financial and Capital Market Commission



* The Board consists of five Board members: Chairman of the Commission, Deputy Chairman of the Commission and three Board members, who are simultaneously directors of the departments of the Commission.
** 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.
*** Financial Division as of 3 January 2005.

Contact information:
Financial and Capital Market Commission
Kungu iela 1, Riga, LV-1050
Tel.: (+371) 777 4800
Fax: (+371) 722 5755
Internet: http://www.fktk.lv
A complete list of financial and capital market participants is available on the Internet home page of the Commission.