FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

ANNUAL REPORT OF THE FINANCIAL AND CAPITAL MARKET COMMISSION OF THE REPUBLIC OF LATVIA FOR 2006

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List of Abbreviations

Commission – Financial and Capital Market Commission
Consultative Council – Consultative Council of the Financial and Capital Market
EEA – European Economic Area
EU – European Union
EU CRD – European Union Capital Requirements Directives
Fund – Deposit Guarantee Fund
IMF – International Monetary Fund
Protection Fund – Fund for the Protection of the Insured
RSE – Riga Stock Exchange
Saeima - Latvian parliament
SFPS – State-funded Pension Scheme

Report of the Board of the Financial and Capital Market Commission

During 2006, the Financial and Capital Market Commission (the Commission) exercised supervision over the activities of banks, credit unions, insurance undertakings and insurance brokers, financial instruments market participants and private pension funds under the Law on the Financial and Capital Market Commission. According to the Commission's strategy, these supervisory activities took place to ensure the stability and development of Latvia's financial and capital market, as well as to protect the interests of investors, depositors and the insured.

The Commission continued operations in 2006 as an entirely autonomous public institution governed by its Board. The Commission commenced its activity on 1 July 2001. The membership of the Board of the Commission has remained unchanged since the inception of the Board and is as follows: Chairman – Uldis Cērps, Deputy Chairman – Jānis Brazovskis, Board members – Ludmila Vojevoda, Jānis Placis and Gvido Romeiko. On 12 October 2006, the Board's Chairman and his deputy were repeatedly appointed to a six-year term of office by the Latvian parliament (*Saeima*).

The activities of the Commission in 2006 were financed by payments from Latvia's financial and capital market participants and payments 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.

In 2006, the Board of the Commission held 59 meetings and adopted 227 decisions. 21 decisions were binding on all of the financial and capital market participants, but 158 decisions applied to individual market participants, of which 30 decisions were unfavourable but 128 decisions were favourable to them. Whereas 48 decisions referred to the management of the Commission's own activities.

During the reporting year, the Consultative Council of the Financial and Capital Market (the Consultative Council) held 15 meetings where draft legislation binding on the financial and capital market were considered, as well as amendments to the regulations drafted by the Commission and new regulations. The Consultative Council was notified on a regular basis of contributions made into the Deposit Guarantee Fund and the Fund for the Protection of the Insured, as well as of the management of assets of the Funds. Both the Commission's draft budget for 2007 and the operations plan for 2007 were submitted to the Consultative Council and the latter gave them a positive assessment.

In 2006, the Commission's specialists prepared and *Saeima* adopted the amendments to the Law on the Financial Instruments Market. Also four new regulations, issued by the Commission, and 15 regulatory amendments were drafted. In the reporting year, draft amendments to the Credit Institution Law, Law on the Financial Instruments Market, Credit Union Law, Law on Insurance Companies and Supervision Thereof, Activities of Insurance and Reinsurance Intermediaries Law, Insurance Contract Law and Law on Investment Management Companies were drawn up.

During the reporting year, the Commission continued maintaining and enhancing its Quality Management System pursuant to ISO 9001:2000 standards. The Commission's internal control system operated effectively and in 2006, several audit inspections were conducted both by internal audit and *Bureau Veritas Quality International*, both attesting conformity of the Commission's Quality Management System to ISO 9001:2000 standards.

In 2006, the Commission conducted its annual survey of the Commission's customers. According to the results of the survey, the number of the market participants (customers) who are satisfied with the activities of the Commission has grown and the Commission's work was evaluated, at large, as being good and meeting interests of customers, namely, by 96% respondents. Whereas recommendations made by the respondents were discussed at a quality management review meeting to improve the Commission's operations.

At the end of the reporting year, the number of staff positions at the Commission was 94. The Commission's specialists attended seminars to share their experience with auditing companies and improve auditing process practices as well as concerning the implementation of the new Basel Capital Accord II and other relevant financial supervision matters.

The budget for the year 2007 and the work plan for 2007 approved by the Commission are available on the Commission's website at www.fktk.lv.

Licensing

	BEGINNING OF 2006	END OF 2006	DYNAMICS
Banks	22	21	-1
Branches of foreign banks	1	3	+2
Cooperative credit unions	34	35	+1
Banking service providers from EEA	99	122	+23
Insurance companies	17	16	-1
Branches of foreign insurers	3	5	+2
Insurance service providers from EEA	190	264	+74
Investment management companies	10	13	+3
Investment management service providers from EEA	2	+4	+2
Investment brokerage firms	5	6	+1
Investment brokerage service providers from EEA	175	276	+101
Private pension funds	6	6	0
Insurance brokerage firms	35	45	+10
Insurance agents	498	626	+128

Issuers

At the close of the reporting year, 55 issuers had their prospectuses registered in Latvia or permission obtained to make public offerings in Latvia. On the basis of a single licence principle, issuers from the European Union (EU) member states commenced issuing of their financial instruments on the Latvian market; in total six notifications of intent of potential issuing financial instruments from the issuers of the EU member states were received in 2006. After making public offerings, two of above issuers started issuing of financial instruments in Latvia.

In the reporting year, 98 issues of various securities were performed in Latvia. Four issuers from the EU member states opted for issuing medium-term debt securities in Latvia while among the public offerings made by the issuers whose prospectuses were registered in Latvia or having permission to make a public offering, debt securities issued by the Latvian banks prevailed, i.e. bonds (3) and mortgage bonds (3). One bank submitted to the Commission its base prospectus (approved at the beginning of 2007), according to which the issuer would be entitled to perform one or several issues of transferable (except of capital) securities over the specified period of time.

In 2006	Number
Prospectuses registered	**7 – on admitting shares to trading on a regulated market**
	1 – on admitting bonds to trading on a regulated market
TOTAL	**8**
Public offerings issued	**2 – on admitting shares to trading on a regulated market**
	2 – on debt securities of companies
	3 – on mortgage bonds
TOTAL	**7**
Share buyout offers made	**10 mandatory share buyout offers**
	1 final share buyout offer
	1 mandatory and final share buyout offer on a consolidated basis
TOTAL	**12**

Supervision

In 2006, the supervision of the financial sector was grounded in assessing operational risks incurred by market participants on the basis of financial account analysis. Such analysis allows for evaluating the financial stability of market participants, operational risks and their trends, and the conformity of participants' operations with the requirements specified by the law. The results of this analysis were regularly submitted to the Board of the Commission, which then discussed the future tasks and priorities of supervision. The analysis of financial reports was also used to plan on-site inspections. The primary purpose of such inspections is to evaluate the financial stability of the institution under supervision, to assess its capital adequacy and to examine whether an internal control system of the institution ensures 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. All banks have been notified of main trends and deficiencies detected during inspections by the statements of the Commission.

Supervision of Banks and Credit Unions

In the reporting year, 22 banks and one branch of a foreign bank operated in Latvia as well as 35 cooperative credit unions. To protect interests of depositors, the Board of the Financial and Capital Market Commission decided to withdraw the licence granted to the joint stock company OGRES KOMERCBANKA in the Commission's extraordinary meeting on 21 December 2006, as well as to file a petition to the court for liquidation of the bank on the grounds that the bank's administration and shareholders had been unable to provide an adequate internal control system. The court ruled that the JSC OGRES KOMERCBANKA would have to be liquidated. Thus, at the close of the reporting year, there were 21 banks operating in Latvia.

During the reporting year, the Commission's staff conducted 18 bank inspections. On the basis of consolidated financial reports, the Commission supervised also the banks, which were 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 in the credit institutions, which allow for efficient management of risk exposures within a group.

Taking into account the Committee of European Banking Supervisors' (CEBS) guidance on the Application of the Supervisory Review Process under Pillar 2, the Commission approved the Bank Risk Assessment Handbook in 2006 to identify, analyze and evaluate the risks that the institutions, subject to the supervision, are exposed to and to assess the quality of the applied risk management methods, their sufficiency and adequacy to the size and complexity of activities of institutions.

In 2006, credit risk and reputation risk were in the limelight of inspections carried out in the banks.

Credit risk

The volume of issued credits grew significantly in Latvia during the reporting year, for that reason 10 inspections were carried out where the Commission's specialists examined the quality of credit portfolio and the banks' credit risk management systems (identification, assessment, management and control of credit risk) in order to timely identify any weaknesses and possible credit repayment problems. The strategies, policies and procedures for granting credits and their implementation were evaluated.

The banks were mostly admonished for deficiencies in assessing creditworthiness of individuals that, in the Commission's view, may increase risks related to housing crediting for individuals. The Commission proposed and monitored the measures to be taken to eliminate above shortcomings. Overall, the housing credit portfolio quality and credit risk management were assed as satisfactory and no additional provisions were required.

In view of the specific weight of credit portfolio in the banking assets and considerable increase in the banking assets, special attention was paid to management of concentration risk in credit portfolios of banks and procedures for stress testing. No violations of the regulatory enactments that would request applying sanctions as prescribed by the Credit Institution Law were detected during inspections of banks in 2006.

Pursuant to the plans of two Latvian banks to apply the internal ratings based approach to determine credit risk capital requirements, two inspections were performed in 2006 with an intent to assess the course of implementation of this approach.

Reputation risk

In 2006, the Commission continued paying attention to internal control systems of the market participants so that they would be drafted in the way to ensure the implementation of the Know Your Client (KYC) principle and to be able to assure the timely identification of unusual and suspicious transactions and report to the Office for the Prevention of the Legalization of Proceeds Derived from Criminal Activity of them as well as the market participants be able to refrain from execution of such transactions.

Regulations for the Formulation of an Internal Control System for the Prevention of Laundering of Proceeds Derived from Criminal Activity and Financing of Terrorism were passed in 2006, thus specifying the provisions for establishing an internal control system in the above area.

In 2006, the Commission conducted 13 inspections to probe the banks' 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. For drawbacks in the area of the prevention of laundering of proceeds derived from criminal activity in particular for shortcomings in the internal control system due to which inadequate monitoring of the clients' economic activities was detected, the Commission fined four banks in the amount of 133 000 lats.

While carrying out inspections in the reporting year, material improvements in quality and efficiency of the banks' internal control systems for the prevention of laundering of proceeds derived from criminal activity were observed. Pursuing a practice of previous years, in 2006 the Commission aggregated the cases having the typology of unusual and suspicious transactions and provided all the market participants with this information thus ensuring that that the internal control systems would be capable of ensuring timely identification of suspicious transactions.

In 2006, the Commission's specialists continued their participation in work of the Selected Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL). On Latvia's initiative, experts of the International Monetary Fund (IMF) visited Latvia in March 2006 to assess compliance of the system for the prevention of laundering of proceeds derived from criminal activity in Latvia with the recommendations of the Financial Action Task Force on Money Laundering (FATF) as prescribed by the conditions on Latvia's membership in the Council of Europe's MONEYVAL Committee. The IMF representatives drew a conclusion that owing to the application of various preventive measures the risk of money laundering in Latvia had been significantly reduced, moreover, legislative requirements in Latvia regarding this area nearly fully met the best international standards.

Supervision of Insurance Companies

By the end of 2006, 11 non-life insurance companies and five life assurance companies operated in Latvia, as well as five branches of foreign insurers.

A two-stage supervisory process has been exercised over the insurance companies; the Commission analyzes reports of the insurance companies evaluating the compliance of the activities of insurance companies with provisions of the law. The Commission scrutinizes the performance of the insurance companies and new trends in their results on a regular basis, and where appropriate issues specific instructions and measures for remedying drawbacks.

In 2006, the Commission conducted five inspections of the activities of insurance undertakings, incl. one inspection of a life insurance undertaking and four inspections of non-life insurance companies. In these inspections, special attention was paid to the adequacy of the assets of the insurance companies and their technical provisions to insurance and accepted reinsurance contracts. Also compliance of the internal control systems in place at the insurance companies with the provisions of the Law on the Prevention of the Laundering of Proceeds Derived from Criminal Activity was evaluated in the course of inspections. The Commission issued instructions for eliminating shortcomings discovered during the inspections.

During inspections at the insurance companies in 2006, the Commission detected no such failures to observe regulatory norms that require imposing sanctions or fines as prescribed in the Law on Insurance Companies and Supervision Thereof.

Supervision of Financial Instruments Market

Issuers

In supervising the operation of the financial instruments market, the Commission paid particular attention to:
- detecting market manipulation,
- detecting insider dealings,
- issuing mandatory or final share buyout offering,
- disclosing significant events timely,
- providing information about acquiring or losing a qualifying holding in public joint stock companies.

The Commission constantly monitored the market to ascertain that no market manipulations were taking place. With a purpose to enhance the supervisory process over financial instrument transactions on the regulated market, since 2005 the

Commission has been successfully cooperating with the Riga Stock Exchange (RSE) regarding the provision of information to the Commission on a regular basis about the orders submitted to the RSE trading system and the completed orders within the RSE system with financial instruments listed in the RSE regulated markets, as well as providing information on inside information bearers of issuers. The RSE keeps the list of holders of inside information holders according to information provided by issuers and makes available the list to all banks and investment brokerage firms so that they may thereby monitor transactions carried out by their customers, the holders of inside information. At the close of the reporting year, there were about 2 000 inside information bearers in Latvia.

In 2006, the Commission implemented administrative proceedings in one case regarding possible market manipulations of financial instruments or insider dealings. The Commission observed several indications implying the fact that market operations of an investor could have been carried out with a purpose to rig the RSE market, and required an assessment on whether any constituent elements of a criminal offence were spotted in the action oft the investor.

While checking whether the persons included in the list of inside information bearers had observed the requirement of the Law on the Financial Instruments Market regarding information disclosure during the reporting year, the Commission detected three violations and in three cases issued relevant administrative acts, imposing a fine of 1 000 lats per person on two persons but one person received a warning.

In the reporting year, the Commission commenced two administrative proceedings on possible non-disclosure of information regarding significant events relating to an issuer, in one instance the issuer voluntarily disclosed information already after initiating the action, but in another instance the inspection is still continuing and a decision would be taken in 2007.

In two administrative procedures in 2006, unfavourable rulings were issued to market participants regarding two offences: a failure to notify as inside information bearers and a failure to notify of decreasing a qualifying holding. A fine of 1 000 lats was imposed on persons who had sold their shares thus losing their voting rights resulting from the shares and on a joint stock company that failed to comply with the relevant provisions of the law.

In the reporting year, the Commission implemented an administrative procedure on non-disclosure of information regarding the decisions taken at the issuer's shareholders meeting and issued an unfavourable act to an addressee according to which a penalty in the amount of 10 000 lats was applied to a joint stock company.

In 2006, the Commission issued one unfavourable administrative act to an addressee because the issuer had failed to call a shareholders meeting after the exclusion of shares from the regulated market (due to breach of law) in a timely manner as stated by regulatory enactments in order to decide on withdrawal of shares from the regulated market, and applied a 10 000 lats fine.

The Commission issued three unfavourable administrative acts on non-disclosure of issuer's financial information, applying the fines of 10 000 lats and 5 000 lats in two instances, respectively, and a warning in one instance.

A 2 000 lats penalty was applied to one issuer as when initiating an administrative proceeding it was found out that the shareholders of issuer had not considered the matter at the shareholders meeting in 2005 and had not made a decision on the admission of shares to the regulated market in due time as set forth in the Law. In 2006, the shareholders of the said joint stock company decided to withdraw the shares from the public circulation and issued a mandatory share buyout offering.

Investment Brokerage Firms and Investment Management Companies

At the end of the reporting year, there were 13 investment management companies and six investment brokerage firms operating in Latvia. The Commission performed the analysis of financial accounts of investment management companies and investment brokerage firms on a regular basis that allowed for assessing the financial standing, operational risks and their trends as well as their compliance with the provisions of the Law.

In 2006, one on-site inspection at an investment management company was conducted with a view to evaluate the activities of the investment management company, as well as compliance of investment plan investments with the laws of the Republic of Latvia, Commission's regulatory enactments and instructions and other legal provisions. No offences were detected.

The Organizer of Regulated Market (RSE) and Latvian Central Depository

In carrying out its functions under the supervision, the Commission assessed the compliance of the regulations drafted by the Central Depository and RSE with the provisions of the Law on the Financial Instruments Market and other normative acts, and an effective performance of their obligations. In 2006, the Commission considered draft amendments to four regulations issued by the Central Depository and five regulations issued by RSE and did not object to their approval.

Supervision of Private Pension Funds and State-funded Pension Scheme

By the end of 2006, there were six private pension funds operating in Latvia. Supervision of the managers of personal assets of private pension funds and State-funded pension scheme (SFPS) was conducted both by receiving and assessing financial reports on a regular basis, and by conducting on-site inspections of the pension funds and managers of the SFPS private assets.

One on-site examination of a private pension fund was conducted in the reporting year. The examination sought to assess the structure of the pension fund and the operations of its management, as well as the compliance with the law and other legal requirements regarding of investments of pension scheme assets. Several deficiencies in the organisational structure of pension fund were detected during the examination as well as drawbacks in the control system and the operations of management. The pension fund considered and enhanced its internal control system and made alterations to their management.

In 2006, a licence for managing SFPS assets was issued to 10 investment management companies. In the reporting year, inspections at two investment management companies operating as managers of the SFPS assets were conducted. No violations were detected.

The Commission paid attention to advertising of the SFPS investment plans in the mass media. Two administrative matters were initiated against the managers of the SFPS assets to verify the compliance of the investment plans of the SFPS assets with the provisions of the Law on the State Funded Pensions. In one instance the Commission required the Competition Council to examine the compliance of an advertisement of one SFPS investment plan in the mass media with laws and evaluate whether the advertisement of the SFPS investment plan had involved the rights of managers of other SFPS assets. Whereas in the second case, after initiating the administrative matter and receiving request for explanations the asset manager immediately made modifications and suspended inadequate advertising so that the Commission terminated the administrative case.

Supervision of Information Systems

Under its supervision functions, the Commission carried out nine on-site inspections of information system security of market participants in the reporting year. To ensure efficiency of security audits for information systems conducted by the Commission, the audit methods based on both the compliance audit and the risk assessment audit techniques were applied.

The focus of these inspections was primarily set on verifying the priorities as follows:

– whether the market participant managers have specified information system security policy for an institution, and whether they appropriately develop and update the relevant rules and instructions on a regular basis;
– whether security solutions applied by the market participant are comprehensive, strategic and based on risk analysis instead of taking temporary measures and solving one specific problem;
– whether a market participant has implemented an independent security function for its information system;
– whether a market participant carries out planning, documenting and testing of business continuity, incl. management of IT specialist replacement.

Information acquired during inspections allows for drawing conclusions that arrangements and management of market participant security are still at different development stages but in view of potential IT risks the market participants, at large, have been paying an increasing attention to the information system security and investing more resources, moreover, the measures applied have been planned and documented accordingly.

Review of Client Complaints

The specialists of the Commission in the reporting year examined client complaints and comments regarding the participants of Latvia's financial and capital market. In the reporting year, 111 submissions were examined, including 48 concerned operations of credit institutions, 46 concerned insurers, 16 - financial instruments market participants, and 1 – management of State-funded pension scheme assets. The majority of complaints on banking services were related to account servicing in credit institutions (information provision on account, commission fee for servicing accounts) and terms of crediting, while complaints against insurance companies mainly related to the payment of indemnity, but the complaints in the financial instruments market concerned operation of issuers and repurchase of the minority shareholders' shares.

Though 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 require 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. In six cases, the Commission initiated administrative procedures on the basis of the client complaints; in one case the Commission requested law enforcement authorities to evaluate whether the activities of the relevant person do not constitute any criminal offence, and in cases when the complaints did not fall within its competence, the Commission pursuant to the Law on Procedures for Examining Applications, Complaints and Proposals in State and Municipal Authorities requested the Competition Council and Consumer Rights Protection Centre to examine the above complaints or provide information to the submitter that such case is to be mediated in the court.

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. As from 1 January 2003, the Deposit Guarantee Law has been effective, foreseeing that the assets collected in the Deposit Guarantee Fund (the Fund) are to provide guarantees not only for the deposits of natural persons, but also for the deposits of legal persons, to the extent stipulated by law. In 2006, the guaranteed compensation in every credit institution for both individuals and legal entities, amounted to EUR 15 000. As from 1 January 2008, the guaranteed compensation will total EUR 20 000.

The Commission conducts the collection and management of the Fund's assets. At the end of 2006, the Fund accounted for 48.6 million lats, incl. income from the Fund management during the reporting year amounted to 1.4 million lats.

Of total depositor accounts opened with the Latvian banking system in 2006, balance of over 96% accounts did not exceed the guaranteed compensation amount, thus in the reporting year the full compensation was guaranteed to 96% of depositors in Latvia in cases of inaccessible deposits in the Latvian banking and credit union system.

The Consultative Council of the Commission monitors the collection of assets in the Fund and the payment of compensation. Since the Fund was established, none of the Fund's assets have been used to pay compensation, as there have been no instances of inaccessible deposits in the Latvian banking and credit union system.

Fund for the Protection of the Insured

The Fund for the Protection of the Insured (the Protection Fund) was created in 1999 in order to protect the interests of insured persons in case of an insurance company's bankruptcy. 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 2006, the Protection Fund accounted for 2.5 million lats, incl. income from management in the amount 78.5 thousand lats.

The insured natural persons can claim compensation, as follows:
1) for life insurance policies – 100% of the insurance 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.

The Commission monitors the collection of assets in the Protection Fund and the payment of guaranteed insurance indemnity. Since the commencing of activities of the Protection Fund, to protect the interests of insured persons in the case of an insurance company's bankruptcy 8 671 lats of the Protection Fund assets have been paid in guaranteed insurance indemnities, physical persons have received 8 607 lats in guaranteed compensations (in 2003 – 6 588 lats, in 2004 – 2 019 lats).

Protection of Investors

As from 1 January 2002, the Investor Protection Law has been in force in Latvia providing a system of protection for investors. In cases when the providers of investment services 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. 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 other investment service providers. The Commission monitors and supervises carrying out the payments for compensations by market participants if such necessity occurs. By the end of reporting year, the Commission had received no such applications.

Formulation of Normative Acts

To ensure conformity of the normative acts, regulating Latvia's financial and capital market, with the provisions of the EU directives and better international supervisory practice, amendments to the Law on the Financial Instruments Market were drafted and took effect in 2006 along with four regulations issued by the Commission and 15 regulatory amendments. In 2006, draft amendments to seven laws were worked out, which take effect in 2007, namely, the amendments to the Credit Institution Law, Law on the Financial Instruments Market, Credit Union Law, Law on Insurance Companies and Supervision Thereof, Activities of Insurance and Reinsurance Intermediaries Law, Insurance Contract Law and Law on Investment Management Companies.

Legislation

Amendments to the Law on the Financial Instruments Market were drawn up to transpose requirements of the European Commission's Directive 2004/25/EC on takeover bids. Specifying the information that the target company and offerer shall disclose, the Law determines the rights and obligations of shareholders and the target company while making a takeover bid as well as regulates issues regarding admission of prospectuses of takeover bid offers in Latvia which are made in other country. Also certain issues were defined more precisely regarding making public offers of transferable securities, the scope of persons to be included on the list of inside information holders, time periods within which the companies whose securities are admitted to trading on a regulated market shall submit to market organizers their annual reports and the information the investment brokerage firms shall include into contracts signed with customers. The Law came into effect on 15 June 2006.

Commission's Regulations

In the reporting year, the Commission drafted and passed new regulations binding on the financial and capital market and amended existing regulations.

On the basis of the Regulation (EC) No. 1606/2002 on the application of International Accounting Standards (IAS) which provides for an option to require non-publicly traded companies to prepare their annual accounts and consolidated annual accounts in accordance with the International Financial Reporting Standards (IFRS) approved by the European Commission, the Commission developed amendments to the **Regulations on the Preparation of Annual Reports and Consolidated Annual Reports of Insurance Joint Stock Companies, Mutual Insurance Co-operative Societies and Non-Member State Insurers' Subsidiaries, Regulations on the Preparation of Annual Reports of Private Pension Funds, Regulations on the Preparation of Annual Reports of State-funded Pension Scheme Investment Plans and Regulations on the Preparation of Annual Reports of Investment Funds** and passed a new wording of the **Regulations on the Preparation of Annual Reports and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies**. The chapters on the conditions for evaluation of the financial reports and accounts and requirements for information disclosure provide only general principles, while evaluation of specific items of financial accounts and disclosing of information shall be carried out consistently applying relevant International Financial Reporting Standards.

Having regard to the principles for the management and supervision of operational risk in banks and investment brokerage firms developed by the Basel Committee on Banking Supervision (BCBS), the Commission worked out the **Guidelines for the Operational Risk Management**.

Regulations on the Procedures for the Calculation of Capital Adequacy of the Financial Conglomerate and Providing Information on Significant Risk Concentrations and Significant Intra-group Transactions were formulated in compliance with requirements of the Financial Conglomerate Law, to specify the procedures for the calculation of capital adequacy of the financial conglomerate as well as the provision of information on significant risk concentrations and significant intra-group transactions. The Regulations are binding on a parent company of a financial conglomerate whose coordinator is the Commission or on any other commercial company, which is part of a financial conglomerate, designated by the Commission. Currently there are no financial conglomerates with a parent insurance undertaking, a bank or an investment brokerage firm registered in Latvia, however there are financial and capital market participants, which are part of financial conglomerates with a parent company registered in other EU member states.

Regulations on the Preparation of Quarterly Public Reports of Insurers were developed to ensure accessibility of information on the insurers to public, and to encourage the insurers to timely disclose information about their financial condition, performance and the risks related to their activities thus increasing their reliability among the customers. The Regulations determine minimum amount of information that shall be included in the quarterly public reports, as well as a requirement to ensure accessibility of information on the insurers' Internet homepages. These Regulations were developed considering the Guidance Paper on Public Disclosure by Insurers by International Association of Insurance Supervisors.

Amendments to Regulations on Establishing and Methods for Calculating Technical Provisions of Insurers and Private Pension Funds were formulated on the basis of the amendments to the Law on Private Pension Funds which stipulate that, when receiving relevant licences, pensions funds may offer pension schemes where technical provisions shall be established in order to meet liabilities to members of pension schemes. The Regulations were supplemented with an article to determine methods for calculating technical provisions of private pension funds, which offer defined benefit schemes, defined contribution schemes with a guaranteed investment performance or pension schemes that envisage cover against biometrical risks. In the reporting year, no such pension schemes were offered in Latvia.

Regulations for Calculating Solvency Ratio and Own Funds of Private Pension Funds are binding on the private pension funds, which offer defined benefit schemes, defined contribution schemes with a guaranteed investment performance or pension schemes that envisage cover against biometrical risks. So far, no such pension schemes have been offered in Latvia.

Implementation of Basel Capital Accord II (EU directives 2006/48/EC and 2006/49/EC)

In order to implement Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions or so-called EU Capital Requirements Directives (EU CRD) in Latvia, the Commission passed amendments to the **Credit Institution Law** and the **Law on the Financial Instruments Market**, as well as to a number of regulations: Regulations on the Calculation of Minimum Capital Requirements, Regulations on the Compliance with Restrictions on Exposures, Regulations for Establishing an Internal Control System, Regulations on the Information Disclosure, Regulations on the Recognition of External Credit Assessment Institution and Regulations on Obtaining Permits for Using Internal Ratings Based Approach, Advanced Measurement Approach, Internal Model Approach and Internal Value-at-Risk Model.

EU Capital Requirements Directives attach a lot of importance to ensuring transparency and accountability to the activities of supervisory agencies. Therefore the information on rules and regulations, guidance and procedures and other relevant documents for the implementation of the provisions of the EU CRD in Latvia is available on the Commission's website (the section: Laws/Disclosure on Implementation of Directives 2006/48/EC and 2006/49/EC). This section also contains information on national discretions and options, general methodologies and criteria used in the Supervisory Review and Evaluation Process (SREP) in Latvia. Starting from 1 July 2008, this section will include the aggregated statistical data on the implementation of the EU CRD in Latvia.

In 2006, the Commission continued the process commenced in 2005: issuing permissions to use the internal model approach in calculating the capital requirement for credit risk and operational risk. In 2006, the Commission received one notification of a cross-border banking group and took up assessing the documents in conjunction with the supervisory authorities of relevant countries.

International Cooperation

European Union

In the reporting year, the Commission's experts continued their participation in the committees set up by the EU authorities and their working groups, namely European Banking Committee (EBC), European Insurance and Occupational Pensions Committee (EIOPC), European Securities Committee (ESC).

Apart from the above, the Commission also took part in the meetings of the Financial Services Committee (FSC) of the Council of Europe and their working groups devoted to the financial services.

To present Latvia's stance and make proposals for various EU draft legal enactments in the area of the supervision of the financial and capital market, the Commission's experts developed 15 national position drafts and instructions for the European Council's ECOFIN and the Permanent Representatives Committee (COREPER) meetings.

Cooperation with Foreign Financial Supervisory Institutions

Activity of the Latvian financial and capital market participants in the international area has affected consistent and efficient cooperation with foreign financial supervisory institutions.

The Commission signed also three multilateral cooperation agreements:
- Memorandum of Understanding on cooperation in financial crisis situations with the EU banking supervisory authorities, central banks and financial ministries;
- Memorandum of Understanding on cooperation between payment system supervisors and banking supervisors in stage three of Economic and Monetary Union;
- Memorandum of Understanding on cooperation in crisis management situations with the EU banking supervisory authorities and central bank.

In the reporting year, the Commission entered into three new cooperation agreements: Memorandum of Understanding with the central bank of the Netherlands *Nederlandsche Bank* (*DNB*) concerning cooperation and exchange of information, Memorandum of Understanding with the Finnish Financial Supervision Authority regarding cooperation in the supervision of *Sampo Bank* Group and Memorandum of Understanding with the Insurance Supervision Authority of Switzerland concerning cooperation and exchange of information. Thus, at the close of the reporting year, the Commission had signed 23 bilateral agreements on cooperation. The Commission had also entered into two agreements on sharing information without signing a cooperation agreement in writing.

Agreements on cooperation signed with the EU member states and foreign supervisory authorities:

Banking supervision		**Insurance supervision**		**Securities market supervision**	
Germany	2000	Estonia	1998	Lithuania	1999
Estonia	2000	Lithuania	1998	Estonia	1999
Lithuania	2000	Germany	2002	Sweden	2000
Belarus	2001	Denmark	2002	Luxembourg	2000
Sweden	2001	Finland	2002	Denmark	2002
Russia	2002	Switzerland	2006		
Denmark	2002				
Ukraine	2003				
Cyprus	2003				
Finland (on supervision of *Nordea Bank Finland Plc's*)	2005				
Finland (on supervision of *Sampo Bank* Group)	2006				
Netherlands	2006				

The Commission, in cooperation with the Swedish, Estonian and Lithuanian banking supervisory authorities, participates in three formal supervisory panels, two of which deal with evaluating applications of banks for receiving permits to use the Internal Ratings Based Approach in the calculation of credit risk capital requirement, and one of which assesses the applications of banks for receiving permits to use the Advanced Measurement Approach in the calculation of operational risk capital requirement.

International Organizations

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

On Latvia's initiative, experts of the International Monetary Fund visited Latvia in March 2006 to assess compliance of the system on prevention the laundering of proceeds derived from criminal activity in Latvia with the recommendations of the Financial Action Task Force on Money Laundering (FATF). The IMF representatives drew a conclusion that owing to the application of various preventive measures the risk of money laundering in Latvia had been significantly reduced, moreover, legislative requirements in Latvia regarding this area nearly fully met the best international standards.

Principal Objectives of the Financial and Capital Market Commission for 2007

1. In 2007, continuing to ensure transposition of several EU directives into national laws regarding the Latvian financial and capital market, the Commission is planning:
   - to develop a new draft of the Reinsurance Law in compliance with the directive of the European Council and of the Council on reinsurance;
   - to work out a new draft law in order to implement the EU directive with a view to preventing the use of the financial system for money laundering and terrorist financing;
   - to draft amendments regarding acquiring and increasing a qualifying holding in the financial sector to four laws – Credit Institution Law, Law on Insurance Companies and Supervision Thereof, Law on the Financial and Capital Market Commission and Law on Investment Management Companies;
   - to draw up amendments to the Law on Insurance Companies and Supervision Thereof related to the implementation of the directive of the European Council and of the Council on reinsurance;
   - to implement requirements of the EU Directives 2004/109/EC and 2004/39/EC, by developing and introducing:
     - the system for reporting transactions on a regulated market;
     - the mechanism for central storage of regulated information;
     - data base of inside information holders.

2. To add value to the operations of the Commission, in 2007 the E-document Circulation System will be introduced in the Commission's office documentation system for correspondence with public authorities that will result in significant enhancing of the document circulation between the institutions and economizing of resources.

The full text of the Commission's work plan in Latvian is available on the Commission's website at www.fktk.lv (Section: *Komisija/Par mums/Darba plāni*).

FINANCIAL STATEMENTS
OF THE FINANCIAL AND CAPITAL MARKET COMMISSION FOR 2006

Management Report

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

On 23 December 2005, based on Article 7 (9) of the Law on the Financial and Capital Market Commission, by Decision No. 157, the Commission's Board approved the Budget of the Financial and Capital Market Commission for 2006, thereby specifying 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 2006, approved by the Commission's Board on 23 December 2005, financial and capital market participants and the Bank of Latvia made payments for financing the Commission. In 2006, the Bank of Latvia financed the Commission's activities for the last time.

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 of accounting set out in the regulations issued by the Cabinet of Ministers.

During the reporting year, pursuant to Article 6 of the Law on the Financial and Capital Market Commission, the Commission managed the Deposit Guarantee Fund and the Fund for the Protection of the Insured (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 2006, 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 15 September 2006, 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 10% 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 2006, 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 Public Procurement, all procurements for ensuring the Commission's activities were made in compliance with the requirements of the said law.

On 1 November 2006, an agreement on the audit of the Commission's financial statements for 2006 was entered into with Ernst & Young Baltic SIA, which was represented by Sworn Auditor Diāna Krišjāne.

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 2006, assets of the Commission totalled 53 122 thousand lats, of which 51 086 thousand lats were managed trust assets, i.e. assets of the Deposit Guarantee Fund and the Fund for the Protection of the Insured. In 2006, activities of the Commission were financed from payments made by financial and capital market participants and the Bank of Latvia. At the end of 2006, the Commission's equity or net assets accounted for 1 855 thousand lats, which had increased by 98.9 thousand lats compared to the year before.

Ensuring Activities of the Commission

In 2006, the revenues of the Commission were 2 906 thousand lats, or 0.15% more than the planned revenues, as laid down in the Commission's budget for 2006 (2 902 thousand lats). When approving the budget for the year 2006, the Board of the Commission specified that if the Commission's revenues from payments of any sector of financial and capital market participants for 2006 exceed the planned revenues for the relevant sector, the Commission calculates the share of this excess payment according to the proportion of payments in the relevant sector by every financial and capital market participant in

2006 and records as prepayment for financing the Commission in 2007. The Commission's excess of revenues over the planned revenues in 2006 was mainly made of interest income earned from the cash balance in the Commission's current account. Expenses of the Commission in 2006 were 2 805 thousand lats, or 4.5% less than planned (2 902 thousand lats). The excess of revenues over expenses in 2006 was 101.7 thousand lats. Also in 2005 and 2004, the Commission's annual budget result was positive, whereas 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 in 2001 were invested in long-term assets, whose amortisation effect increased the Commission's expenses, 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 12 653 thousand lats, while revenues of the Fund for the Protection of the Insured, received from insurers, constituted 578.4 thousand lats. Revenues from investments made by the Deposit Guarantee Fund were 1 431 thousand lats, while by the Fund for the Protection of the Insured, 78.6 thousand lats. Total assets of these Funds increased by 14 740 thousand lats, or 40.5%, that is, assets of the Deposit Guarantee Fund rose by 14 083 thousand lats, or 40.8%, while assets of the Fund for the Protection of the Insured, by 656.9 thousand lats, or 35.4%. At the end of 2006, net financial assets of the Deposit Guarantee Fund comprised 48 574 thousand lats while net financial assets of the Fund for the Protection of the Insured, 2 512 thousand lats.

In the reporting period, the Commission invested assets of the Funds in both short-term and long-term Latvian State Treasury securities. Of the total securities portfolio of the Funds at the end of 2006, 72% were placed in long-term while the rest in short-term securities. Of the securities portfolio of the Deposit Guarantee Fund, 72% 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 64% for long-term securities and 36% for short-term securities. In 2006, the profitability of assets of the Deposit Guarantee Fund reached 3.4%, while that of the Fund for the Protection of the Insured, 3.6%. The profitability was calculated by dividing the sum of investment revenues of the relevant Fund during 2006 by the average asset value of the Fund during 2006.

Deputy Chairman of the Financial
and Capital Market Commission — Jānis Brazovskis

13 April 2007

Balance Sheet

ASSETS

	Note	31.12.2006	31.12.2005
			(lats)
ASSETS OF THE FUNDS			
LONG-TERM INVESTMENS		**32 275 424**	**12 603 702**
Investments by the Funds in securities	3	32 275 424	12 603 702
CURRENT ASSETS		**18 810 336**	**23 741 796**
Receivables		**3 667 016**	**2 886 356**
Due from market participants to the Funds	5	3 666 952	2 886 292
Settlements with the administrators related to guaranteed compensation payments	2	64	64
Investments by the Funds in securities	**3**	**15 142 466**	**20 855 227**
Cash		**854**	**213**
TOTAL ASSETS OF THE FUNDS		**51 085 760**	**36 345 498**
ASSETS OF THE COMMISSION			
LONG-TERM INVESTMENS	**4**	**68 108**	**105 548**
Intangible assets		29 038	36 743
Fixed assets		36 853	61 620
Leasehold improvements		-	6 949
Prepayments for long-term investments		2 217	236
CURRENT ASSETS		**1 968 163**	**1 791 950**
Inventories		**101**	**106**
Accounts receivable		**341 158**	**612 434**
Due from market participants to the Commission	6	338 037	600 063
Other receivables	11	2 199	11 835
Due from the staff		922	536
Prepaid expenses	**8**	**10 554**	**10 860**
Cash		**1 616 350**	**1 168 550**
TOTAL ASSETS OF THE COMMISSION		**2 036 271**	**1 897 498**
TOTAL ASSETS		**53 122 031**	**38 242 996**

The accompanying notes on pages 21 to 28 form an integral part of these financial statements.

Balance Sheet

LIABILITIES

	Note	31.12.2006	31.12.2005
			(lats)
LIABILITIES OF THE FUNDS			
EQUITY	**9**	**51 085 760**	**36 345 498**
Net financial assets of the Funds (budget result)		51 085 760	36 345 498
TOTAL LIABILITIES OF THE FUNDS		**51 085 760**	**36 345 498**
LIABILITIES OF THE COMMISSION			
EQUITY	**9**	**1 855 090**	**1 756 236**
Net assets of the Commission		1 855 090	1 756 236
PAYABLES		**181 181**	**141 262**
Accounts payable to suppliers	10	18 826	16 818
Overpaid taxes	7	1 168	515
Provision for vacation		161 187	123 929
TOTAL LIABILITIES OF THE COMMISSION		**2 036 271**	**1 897 498**
TOTAL LIABILITIES		**53 122 031**	**38 242 996**

The accompanying notes on pages 21 to 28 form an integral part of these financial statements.

Deputy Chairman of the Financial
and Capital Market Commission — Jānis Brazovskis

Head of
the Financial Division — Rita Vanaga

13 April 2007

Revenue and Expense Statement

	Note	2006	(lats) 2005
REVENUES			
REVENUES RELATED TO SUPERVISION OF CREDIT INSTITUTIONS AND CREDIT UNIONS		1 974 243	1 639 143
Payments by the Bank of Latvia		240 000	600 000
Payments by credit institutions		1 725 658	1 031 516
Payments by credit unions		8 585	7 627
REVENUES RELATED TO INSURANCE SUPERVISION		756 269	873 117
Payments by life assurance companies		70 161	81 083
Payments by other insurance companies		686 108	792 034
REVENUES RELATED TO SUPERVISION OF THE SECURITIES MARKET AND PENSION FUNDS		143 724	223 891
State budget		-	50 000
Payments by securities market participants		110 994	137 523
Payments by private pension funds		32 730	36 368
OVERDUE PAYMENTS		36	-
INCOME FROM INTEREST ON THE BALANCE OF THE COMMISSION'S CURRENT ACCOUNT		32 101	26 620
TOTAL REVENUES		**2 906 373**	**2 762 771**
EXPENSES			
Staff remuneration and other payments		(2 045 032)	(1 616 868)
Staff remuneration and other payments	12	(1 691 043)	(1 331 158)
State social insurance compulsory contributions		(353 989)	(285 710)
Provision for vacation		(37 258)	(10 334)
Staff insurance	13	(106 168)	(99 879)
Improvements of professional skills and business trips		(158 870)	(107 396)
Telecommunication and information		(37 166)	(40 038)
Public information and external and internal communications		(20 120)	(18 155)
Maintenance expenses		(260 946)	(224 734)
Professional services		(20 123)	(21 795)
Participation in international organisations and co-financing for attache operation in Brussels		(54 321)	(65 242)
Depreciation/amortisation/write-off of capital investments	4	(64 636)	(86 217)
TOTAL EXPENSES		**(2 804 640)**	**(2 290 658)**
EXCESS OF REVENUES OVER EXPENSES BUDGET RESULT		**101 733**	**472 113**

The accompanying notes on pages 21 to 28 form an integral part of these financial statements.

Deputy Chairman of the Financial
and Capital Market Commission — Jānis Brazovskis

Head of
the Financial Division — Rita Vanaga

13 April 2007

Cash Flow Statement

	Note	2006	(lats) 2005
RECEIPTS			
RECEIPTS RELATED TO SUPERVISION OF CREDIT INSTITUTIONS AND CREDIT UNIONS		2 012 527	1 507 878
Payments by the Bank of Latvia		240 000	600 000
Payments by credit institutions		1 764 026	900 740
Payments by credit unions		8 501	7 138
RECEIPTS RELATED TO SUPERVISION OF INSURANCE		958 488	827 795
Payments by life assurance companies		99 890	63 695
Payments by other insurance companies		858 598	764 100
RECEIPTS RELATED TO SUPERVISION OF THE SECURITIES MARKET AND PENSION FUNDS		165 245	200 861
State budget		-	50 000
Payments by securities market		115 628	119 817
Payments by private pension funds		49 617	31 044
OVERDUE PAYMENTS		36	-
INCOME FROM INTEREST ON THE BALANCE OF THE COMMISSION'S CURRENT ACCOUNT		32 101	26 620
TOTAL RECEIPTS		**3 168 397**	**2 563 154**
PAYMENTS			
Staff remuneration and other payments		(2 043 336)	(1 616 493)
Staff remuneration and other payments		(1 689 825)	(1 331 158)
State social insurance compulsory contributions		(353 511)	(285 335)
Staff insurance		(106 173)	(99 879)
Improvements of professional skills and business trips		(158 350)	(107 518)
Telecommunication and information		(37 786)	(39 998)
Public awareness campaigns and external and internal communications expenses		(22 256)	(17 386)
Maintenance expenses		(259 687)	(223 022)
Professional services		(18 432)	(22 503)
Participation in international organisations and co-financing for attache operation in Brussels		(44 533)	(69 871)
TOTAL PAYMENTS		**(2 690 553)**	**(2 196 670)**
INVESTMENT ACTIVITIES			
Capital expenditure		(30 044)	(25 058)
TOTAL INVESTMENT ACTIVITIES		**(30 044)**	**(25 058)**
Net change in cash during the reporting period		**447 800**	**341 426**
Cash balance at the beginning of the reporting period		**1 168 550**	**827 124**
Cash balance at the end of the reporting period		**1 616 350**	**1 168 550**

The accompanying notes on pages 21 to 28 form an integral part of these financial statements.

Deputy Chairman of the Financial and Capital Market Commission — Jānis Brazovskis

Head of the Financial Division — Rita Vanaga

13 April 2007

Statement of Changes in Equity

(lats)

	Note	Equity (net assets) of the Commission[1]	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
	Note	14			2
Budget result 31.12.2004		**1 288 907**	**23 246 682**	**1 421 605**	**24 668 287**
Fixed asset depreciation/ write-off in 2005 charged to the budget result	1	**(4 784)**	-	-	-
Budget result of the reporting period		**472 113**	11 244 058	433 153	**11 677 211**
Budget result 31.12.2005		**1 756 236**	**34 490 740**	**1 854 758**	**36 345 498**
Fixed asset depreciation/ write-off in 2006 charged to the budget result	1	**(2 879)**	-	-	-
Budget result of the reporting period		**101 733**	14 083 285	656 977	**14 740 262**
Budget result 31.12.2006		**1 855 090**	**48 574 025**	**2 511 735**	**51 085 760**

The accompanying notes on pages 21 to 28 form an integral part of these financial statements.

Deputy Chairman of the Financial and Capital Market Commission — Jānis Brazovskis

Head of the Financial Division — Rita Vanaga

13 April 2007

[1] The Commission's equity (net assets) comprises also the budget result of the budget for the Commission's establishment and commencement of activities (1 394 lats - at the end of 2006; 1 782 lats at the end of 2005; 43 313 lats at the end of 2004).

Notes to the Financial Statements

The Financial and Capital Market 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. 446, On the Procedure for Preparation of Annual Reports for State and Local Government Budgetary Institutions, issued by the Cabinet on 21 June 2005.

The Commission's accounting has been conducted in compliance with the Cabinet of Ministers of the Republic of Latvia Regulations No. 867 of 15 November 2005 On Accounting Procedures for Budgetary Institutions, as well as the Instructions of the Ministry of Finance of 25 June 2001 for the Accounting of State (Local Government) Budgetary Institutions and Local Government Budgets.

The accounting principles applied for the reporting period and previous years were used consistently.

The Commission presented all assets and liabilities, including those of the Deposit Guarantee Fund and the Fund for the Protection of the Insured, in a single balance sheet. The Commission reflected all revenues and expenses related to its financing as well as revenues and expenses of the Deposit Guarantee Fund and the Fund for the Protection of the Insured in a single statement of income and expenses.

Also, the cash flow statement and the statement of income and expenses of the Deposit Guarantee Fund and the Fund for the Protection of the Insured were prepared as separate notes to the financial statements.

The long-term assets acquired from the budget for the Commission's establishment and commencement of activities at the launch of the Commission's activities were used to ensure activities of the Commission; consequently, these assets were included in the general balance sheet of the Commission, as well as asset depreciation/amortisation or write-off was included in the Commission's statement of income and expenses.

Principles Applied in Preparing the Financial Statements

- The financial statements, except for the cash flow statement, are 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 of assets.
- Transactions and other events are reflected by taking into account the principle of substance over form, stating that transactions and events shall 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 an on-going concern basis.

Long-term Investments

Long-term investments were recognised by taking as guidelines the basic principles set out in the Cabinet of Minister of the Republic of Latvia Regulations No. 867 of 15 November 2005 On Accounting Procedures for Budgetary Institutions. Depreciation rates for long-term investments, acquired beginning from 2006, were applied in compliance with the Regulation No. 440, On Fixed Asset Depreciation Rates for Budgetary Institutions and Application Conditions, issued by the Cabinet of Ministers of the Republic of Latvia on 21 June 2005, which stipulates the following annual depreciation rates:

- computers and equipment 20%;
- other fixed assets 10%.

Whereas depreciation rates for long-term investments, acquired before 2006, were 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 stipulated the following annual depreciation rates:

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

The depreciation for the Commission's fixed assets is calculated until their residual value reaches 5 lats as provided for by the Regulations No. 96 of the Cabinet of Ministers of 6 March 2001 On Fixed Asset Depreciation Rates for Budgetary Institutions. For reconstructing long-term investments acquired before 2006, their depreciation rates have been changed in compliance with provisions on fixed asset depreciation rates of the Regulation No. 440, On Fixed Asset Depreciation Rates for Budgetary Institutions and Application Conditions, issued by the Cabinet of Ministers of the Republic of Latvia on 21 June 2005.

The amount of depreciation calculated for fixed assets was included into 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 No. 96 of the Cabinet of Ministers of 6 March 2001 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 following annual depreciation rates were applied to leasehold improvements:

- security systems 33%;
- fixings 20%.

Securities

Securities in the possession of the Commission are being held to maturity. The valuation of long-term securities is performed using the effective interest rate amortisation method. The valuation of short-term securities is performed 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.

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 the 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 (no payments were made from 2003 to 2004, in 2005 and 2006, consequently, accounted for the balance in the amount of 64 lats for unpaid insurance indemnities).

	Actual result of revenues and expenses in 2006	**Actual result of revenues and expenses in 2005**
REVENUES		
Payments to the Deposit Guarantee Fund	12 652 612	10 364 533
Payments by credit institutions	12 643 362	10 356 595
Payments by credit unions	9 250	7 938
Payments to the Fund for the Protection of the Insured	578 417	376 425
Payments by life assurance companies	144 444	78 241
Payments by other insurance companies	433 973	298 004
Income from investments	1 509 066	936 253
Income of the Deposit Guarantee Fund	1 430 506	879 525
Income of the Fund for the Protection of the Insured	78 560	56 728
OVERDUE PAYMENTS	167	-
TOTAL REVENUES	**14 740 262**	**11 677 211**
EXPENSES		
Guaranteed compensation payments	-	-
TOTAL EXPENSES	**-**	**-**
RESULT	**14 740 262**	**11 677 211**

	Cash flow in 2006	**Cash flow in 2005**
FINANCING		
Payments to the Deposit Guarantee Fund	11 933 964	9 899 473
Payments by credit institutions	11 924 857	9 892 169
Payments by credit unions	9 107	7 304
Payments to the Fund for the Protection of the Insured	516 405	325 412
Payments by life assurance companies	123 936	52 393
Payments by other insurance companies	392 469	273 019
OVERDUE PAYMENTS	167	-
CASH FLOW FROM FINANCING	**12 450 536**	**10 224 885**
INVESTMENT ACTIVITIES		
(Increase)/ in investments	(14 180 350)	(11 114 188)
(Increase) in debt securities in the Deposit Guarantee Fund	(13 584 540)	(10 730 643)
(Increase) in debt securities in the Fund for the Protection of the Insured	(595 810)	(383 545)
Income from investments	1 730 455	889 360
Interest payments to the Deposit Guarantee Fund	1 650 967	831 220
Interest payments to the Fund for the Protection of the Insured	79 488	58 140
CASH FLOW FROM INVESTMENT ACTIVITIES	**(12 449 895)**	**(10 224 828)**
EXPENSES		
Compensation payments from the Fund for the Protection of the Insured	-	-
TOTAL EXPENSES	**-**	**-**
CASH FLOW RESULT	**641**	**57**
Cash balance at the beginning of the reporting period	**213**	**156**
Cash balance at the end of the reporting period	**854**	**213**

3. Investments in Securities

This item contains the 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 discount amortisation method.

Securities of the Funds (in lats) were placed in the following Latvian Government securities issues:

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value	**Book value on 31 December 2006**
LV0000580033	02.12.2005	02.12.2015	4.10	20 616 600	19 432 935
LV0000580017	14.02.2003	14.02.2013	4.85	3 785 000	3 985 448
LV0000570059	03.11.2006	03.11.2011	5.04	2 572 300	2 588 581
LV0000570042	06.10.2005	06.10.2010	3.31	6 184 400	6 268 460
			Long-term investments by funds	33 158 300	**32 275 424**

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value	**Book value on 31 December 2006**
LV0000570034	08.05.2002	08.05.2007	5.49	1 618 300	1 633 907
LV0000540904	06.10.2006	06.10.2007	4.83	3 902 100	3 763 272
LV0000540896	02.06.2006	02.06.2007	4.00	7 426 000	7 305 085
LV0000532158	20.10.2006	20.04.2007	4.84	1 592 600	1 569 619
LV0000532141	07.07.2006	05.01.2007	3.75	871 200	870 583
			Short-term investments by funds	15 410 200	**15 142 466**

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value	**Book value on 31 December 2005**
LV0000580033	02.12.2005	02.12.2015	3.66	709 600	704 552
LV0000580017	14.02.2003	14.02.2013	4.96	3 785 000	3 989 822
LV0000570042	06.10.2005	06.10.2010	3.40	6 184 400	6 268 694
LV0000570034	08.05.2002	08.05.2007	5.26	1 618 300	1 640 634
			Long-term investments by funds	12 297 300	**12 603 702**

Issue No.	Issue date	Maturity date	Annual rate of return (%)	Nominal value	**Book value on 31 December 2005**
LV0000560035	29.08.2003	29.08.2006	3.97	38 900	39 377
LV0000540862	06.10.2005	06.10.2006	2.37	3 280 800	3 222 208
LV0000540854	26.08.2005	25.08.2006	2.38	2 727 300	2 685 657
LV0000540847	08.07.2005	07.07.2006	2.30	848 300	838 334
LV0000540839	03.06.2005	02.06.2006	2.45	3 274 900	3 240 762
LV0000540821	22.04.2005	21.04.2006	2.42	8 244 800	8 183 202
LV0000532125	27.10.2005	27.04.2006	2.40	2 666 200	2 645 687
			Short-term investments by funds	21 081 200	**20 855 227**

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

	31.12.2006	**31.12.2005**
Accrued income of the Deposit Guarantee Fund	545 208	486 179
Accrued income of the Fund for the Protection of the Insured	38 692	30 994
	583 900	517 173

4. Long-term Investments

	Book value 31.12.2005	Additions in the reporting period	Write-offs and disposals	Depreciation: Charge in the reporting period	Depreciation: Reversal due to disposals (since acquisition)	**Book value 31.12.2006**
Intangible assets						
Licences, software and other intangible assets	**36 743**	13 183	(298)	(20 873)	283	**29 038**
Fixed assets						
Computers and office equipment	**32 233**	11 552	(16 656)	(20 334)	16 380	**23 175**
Other fixed assets	**29 387**	3 360	(805)	(19 119)	855	**13 678**
Leasehold improvements	**6 949**	-	-	(6 949)	-	**-**
Prepayments for long-term investments	**236**	1 981	-	-	-	**2 217**
	105 548	**30 076**	**(17 759)**	**(67 274)**	**17 518**	**68 108**

Changes in long-term investments in 2006, 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	Total
Depreciation/amortisation/write-off of capital investments charged to the statement of income and expenses	64 580	56	64 636[2]
Fixed asset depreciation/write-off directly charged to the budget result (equity)	2 694	185	2 879
	67 274	241[3]	67 515

[2] A total of the Commission's depreciation/amortisation/write-off of capital investments, incl. depreciation of long-term investments acquired from the funds of the Commission's establishment and commencement of its activities budget (see Note 14).
[3] 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 2006 and the fourth quarter ended 31 December 2005, respectively.

	31.12.2006	**31.12.2005**
Due from market participants to the Deposit Guarantee Fund	3 479 107	2 760 459
Due from credit institutions	3 476 770	2 758 265
Due from credit unions	2 337	2 194
Due from market participants to the Fund for the Protection of the Insured	187 845	125 833
Due from life assurance companies	59 403	38 895
Due from other insurance companies	128 442	86 938
	3 666 952	**2 886 292**

6. Due from Market Participants to the Commission

This item contains amounts due from financial and capital market participants to the Commission on the date set out in the statement for the fourth quarter ended 31 December 2006 and the fourth quarter ended 31 December 2005, respectively.

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

	31.12.2006	**31.12.2005**
Due from credit institutions	253 256	291 624
Due from credit unions	2 149	2 066
Due from life assurance companies	66	29 795
Due from other insurance companies	44 766	217 256
Due from investment management companies	26 827	35 064
Due from investment brokerage firms	6 587	5 931
Due from the Latvian Central Depository and the Riga Stock Exchange	9 397	6 451
Due from private pension funds	(5 011)	11 876
	338 037	**600 063**

7. Taxes

Type of tax	**Balance on 31.12.2005**	Calculated for the reporting period	Decreased compulsory contribution result	Paid in the reporting period	**Balance on 31.12.2006**
Contributions to compulsory state social insurance	515	487 027	(332)	(486 038)	1 172
Personal income tax (overcharge)	-	380 068	-	(380 072)	(4)
	515	867 095	(332)	(866 110)	**1 168**

According to the data received from the State Revenue Service, compulsory contributions to State social insurance were decreased in 2005 by the amount that exceeded the maximum limit specified by legislation, i.e. 19 900 lats per tax-payer in 2005.

8. Prepaid Expenses

	31.12.2006	**31.12.2005**
Prepayment for rent of premises	-	3 933
Software subscription fees	3 290	2 347
Professional literature	1 387	1 132
Other prepaid expenses	5 877	3 448
	10 554	**10 860**

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. Accounts Payable on Other Claims

	31.12.2006	31.12.2005
Due from the Bank of Latvia to the Commission for Committee of European Banking Supervisors (CEBS) participation co-financing	-	9 383
Due from the European Commission and the Ministry of Foreign Affairs of the Republic of Latvia to the Commission for business travel expense reimbursement	2 011	1 913
Other accounts payable to the Commission	188	539
	2 199	**11 835**

12. 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 15.1% of the total remuneration expenses (in 2005 – 16.5%). At the end of 2006, the Commission had 94 staff members (in 2005 - 93), and there were 95 positions at the Commission by the end of 2005 (in 2005 - 92).

	2006	2005
Staff remuneration, incl. members of the Consultative Council of the Financial and Capital Market	1 436 532	1 331 158
incl. remuneration to members of the Commission's Board	255 846	219 352
incl. remuneration to members of the Consultative Council of the Financial and Capital Market	4 460	3 450
Average number of employees per year	92	91
incl. the number of members of the Commission's Board	5	5
The number of members of the Consultative Council of the Financial and Capital Market	6	5

13. Staff Insurance

	2006	2005
Endowment life insurance	77 934	74 575
Health insurance	24 552	21 511
Accident insurance	3 682	3 793
	106 168	99 879

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.

14. Commission's Net Assets (Budget Result)

The Commission's budget result for ensuring its activities also includes budget results for the financing allocated for the Commission's establishment and commencement of activities. When commencing the Commission's activities in 2001, the funds in the amount of 888 299 lats were allocated for the establishment of the Commission and commencement of its activities. The funds provided for the Commission's establishment and commencement of activities were utilized in 2001 and 2002. Of total funding, 426 379 lats were used for long-term investments, and their amortisation effect was gradually incorporated in the expenses of the Commission between the years 2001 and 2006.

15. 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 said contract stipulated fixed rent for first five years. Upon expiration of the mentioned five-year contract, an agreement was entered into on 18 September 2006 prescribing that as from 1 September 2006, the rent of the Commission's premises would be EUR 76 103 per quarter (EUR 304 412 per year or EUR 17.7 per square metre). The contract prescribes that the rent is revised and raised once a year in accordance with the consumer price index[4] for the Republic of Latvia. 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.

16. 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 administrative proceedings, of which only in one application a claimant requested recovery of damages from the Commission: a court proceeding was initiated on 17 May 2006, based on an application submitted by the joint stock *Baltic International Bank* to the District Administrative Court in respect of Decision No. 108 of the Commission's Board taken on 30 September 2005, under which the Commission rejected recovery of potential damages in the amount of 637 500 lats to the joint stock *Baltic International Bank*. The Board of the Commission is of the opinion that Decision No. 108 of the Commission's Board was passed justifiably and the application should be completely rejected. Consequently, the Commission made no provisions for the said amount.

On 29 December 2006, an application was submitted to the District Administrative Court calling for revoking the 21 December 2006 Decision No. 215 of the Board of the Financial and Capital Market Commission On Withdrawal of the Credit Institution Licence Granted to the JSC OGRES KOMERCBANKA regarding the paragraphs on the withdrawal of the credit institution operating license No. 06.01.02.01/104 granted to the JSC OGRES KOMERCBANKA and the Commission's application to the Riga Regional Court asking to put the JSC OGRES KOMERCBANKA into liquidation. In the said application to the court, the JSC OGRES KOMERCBANKA had neither claimed any damages from the Commission nor indicated the due amount of damages. In theory, in case of any administrative action there is an option to claim damages from an institution both by appealing the institution's administrative act to the court and by initiating separate proceedings. The JSC OGRES KOMERCBANKA (in liquidation) has not yet made a claim for recovery of damages. The Board of the Commission holds the view that the JSC OGRES KOMERCBANKA cannot provide the material and legal basis to justify claiming recovery of any damages from the Commission. Justified and legal operations of the Commission have been also verified by the 2 February 2007 ruling of the Regional Administrative Court, according to which the claim from the JSC OGRES KOMERCBANKA against the Commission's decision was rejected. The Commission is of the opinion that the eventual court ruling also after adjudication the claim of the JSC OGRES KOMERCBANKA on its merits will be in favour of the Commission.

[4] Consumer price index set by the Central Statistical Bureau of the Republic of Latvia.

ERNST & YOUNG

INDEPENDENT AUDITORS' REPORT

To the Parliament of the Republic of Latvia

Report on the Financial Statements

We have audited the accompanying financial statements of Financial and Capital Market Commission (hereinafter – the Commission) for the year ended 31 December 2006, set out on pages 7 through 17 which comprise the balance sheet as at 31 December 2006, the statements of income and expense, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

The Commission's management is responsible for the preparation and fair presentation of these financial statements in accordance with Cabinet Regulations No. 446 Procedure for Preparation of Annual Reports of State Institutions and Municipalities and the Commission's accounting policy disclosed in the Notes to these financial statements. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above give a true and fair view of the financial position of the Commission as at 31 December 2006, and of the results of their operations and their cash flows for the year then ended in accordance with Cabinet Regulations No. 446 Procedure for Preparation of Annual Reports of State Institutions and Municipalities and the Commission's accounting policy disclosed in the Notes to these financial statements.

Report on Compliance of the Management Report

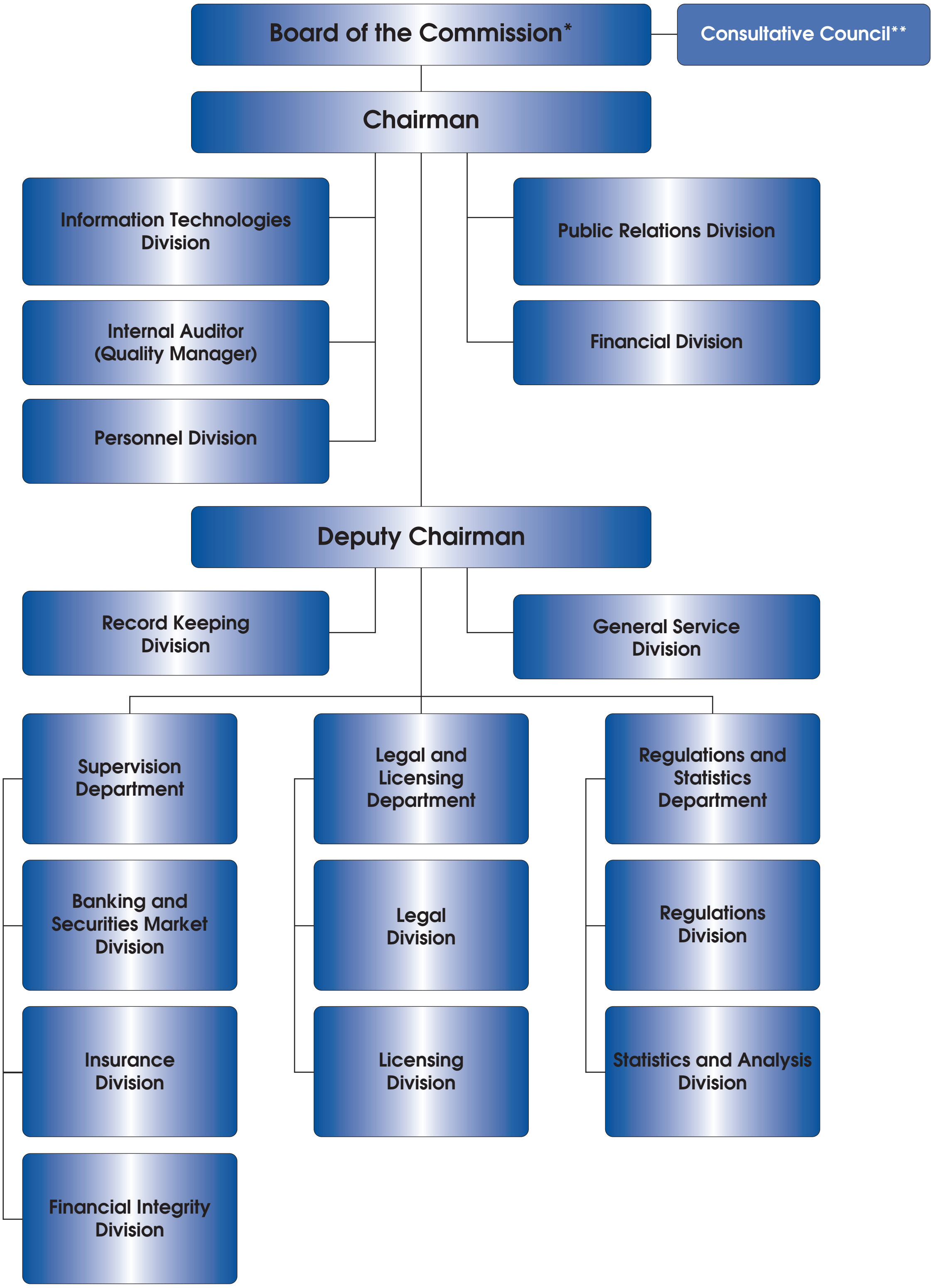
Furthermore, we have read the Management Report for the year ended 31 December 2006 (included on pages 5 through 6 of the accompanying 2006 annual report) and have not noted any material inconsistencies between the financial information included in it and the financial statements for the year ended 31 December 2006.

SIA Ernst & Young Baltic
Licence No. 17

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

Riga, 13 April 2007

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.

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