FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

ANNUAL REPORT AND ACTIVITY REPORT 2013. OF THE FINANCIAL AND CAPITAL MARKET COMMISSION

MISSION

Ensure the effective regulation and supervision of the activity of the financial and capital market and participants thereof, promote stability, competitiveness and development of the financial and capital market and as well as the protection of the interests of investors, depositors and the insured persons.

VISION

Customer-orientated and proactive supervisory authority of the financial and capital market, one of the most efficient, flexible and dynamic in its operation in Northern Europe and the Baltic region, that ensures compliance to high standards of financial services and promotes the development of the financial and capital market in Latvia.

Photo:Team of the Financial and Capital Market Commission

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INTRODUCTION

CHAIRMAN'S STATEMENT

2013 – balanced development and euro challenges

The Latvian economy continues growing, which had a favourable effect on the development of Latvian financial sector in 2013, letting us express positive forecasts this year as well. Nevertheless, external risks and instability of the situation at the beginning of the year due to the conflict of Ukraine and Russia make us quite cautious when assessing further growth.

In 2013 the financial sector passed under the sign of moderate development, as the key performance indicators of market participants continued to develop. This is evidenced by several trends: we preserved the high capitalisation and liquidity levels of the banking sector, improved the profitability and credit quality of the banking sector, and reduced the rate of decrease of the bank credit portfolio. Also the total amount of the written premiums of insurers in 2013 was close to the pre-crisis level. Last year was also successful for the State funded and private pension funds.

If we compare the mood in financial markets in 2012 when I started to manage the Financial and Capital Market Commission (FCMC), and 2014, even despite the currently changing external circumstances, market development forecasts are more promising. Though on a global scale the economies of certain countries after the crisis are still trying to achieve balanced growth, in general, the global economy is showing signs of recovery. The good news is that not only in the world, but also in Latvia, the trust of population in the financial sector is gradually being restored. Nevertheless, the customer habits are changing and it is more often the case when they prefer to cooperate with not only one, but with several financial services providers. Also the steep development of technologies and more extensive use of electronic channels in banking services are encouraging the market participants to revise the former cooperation models, laying a larger emphasis on establishing good relationship and offering modern services. A clearly defined and understandable price policy is also still topical for the customer, especially in banking services.

2013 – under the euro sign

Clearly the largest and most labour-consuming State level project in the financial sector in 2013 was the introduction of the euro, which, given the contributed resources and timely planning, was successfully implemented, ensuring the population with comfortable, simple and understandable replacement of the national currency. One of the main benefits for the population from the introduction of the euro was the reduction of currency conversion costs, because about 86% of the debt liabilities of the borrowers in Latvia were in euros. Bank customers definitely feel that the cross-border payments have become less expensive along with Latvia's accession to the Eurozone. The introduction of the euro has triggered a rapid growth in resident deposits, which can be described as the steepest rise after the crisis – 13.3% per year. In December we even reached the historically steepest monthly growth in resident deposits – ~478 million lats (~680 million euros). The introduction of the euro will influence the activities of market participants in 2014, making both financial institutions and the population adapt to the new business conditions in the Eurozone in order to fully enjoy the advantages of the new currency.

2014 WILL BRING ABOUT CONSIDERABLE CHANGES IN THE FIELD OF SUPERVISION – ECB TO SUPERVISE THE LARGEST EUROZONE BANKS IN CLOSE COOPERATION WITH NATIONAL SUPERVISORS.

Consolidation of the strongest market participants

Last year the consolidation of the banking sector continued. In 2013, due to various reasons, on the whole banks dissolved or reorganised their operation, upon their own initiative (AS "GE Money Bank", AS "UniCredit Bank", VAS "Latvijas Hipotēku un zemes banka"), which, admittedly, to a certain extent reduces the availability and versatility of the services in the market. Last year the licence of the long-term insurance market participant – AS "Balva" was annulled.

Comparing Latvia to Cyprus – unjustified myth

Last year Latvia's name was repeatedly mentioned in respect to events in the financial sector of Cyprus – both various international and local experts, as well as media, expressed their forecasts that it would affect the banking sector and the volume of non-resident deposits, comprising about one half of the total deposits attracted by the banks. It must be noted that this discussion approved the previously expressed forecast of the FCMC that the events in the banking sector of Cyprus would not influence a steep inflow of non-resident deposits in Latvia – the speed of their growth reduced by 6.3% at the end of the year. The main prerequisites for this were stringent requirements for the banks attracting foreign customer deposits. In respect to the situation in Cyprus the FCMC urged Latvian banks to focus on the improvement of the customer base and assessment of the quality of financial flows.

The total volume of deposits in Latvian banks at the end of 2013 reached 19.5 billion euros – out of which resident deposits comprised 10.28 billion euros and non-resident deposits – 9.23 billion euros.

Single bank supervision at the EU level

One of the most significant events in the field of supervision of the banking sector last year was the approval of a new banking supervision model at the European level, providing for granting broader powers to the European Central Bank (ECB). The ECB will supervise approximately 130 banks or 85% of the assets of the Eurozone banks in close cooperation with national supervisors. This is done to establish single bank supervision in the European Union (EU), which would strengthen the financial stability and expand the supervision of the banking sector. The single supervisory mechanism should start to fully operate on 4 November 2014. Also Latvia, along with accession to the Eurozone, automatically joins the single bank supervisory mechanism. This means that in autumn this year the ECB, in cooperation with FCMC, will commence supervising the largest, in terms of assets, Latvian banks – "Swedbank" AS, AS "SEB banka", ABLV Bank, AS, comprising 44% of the total assets of Latvian banks.

Streamlining the regulatory framework and strengthening supervision

JIt should be emphasised that in 2013 the considerable financial sector regulatory framework reform continued. The European Parliament and the Council adopted the Directive and the Regulation (CRDIV/CRR) regarding prudential requirements to credit institutions and investment brokerage companies, introducing the international bank supervisory standard *Basel III* to the EU laws. These requirements are also transposed at the national level, introducing voluminous amendments to the *Credit Institution Law and the Law on the Financial Instruments Market*, as well as to the number of subordinated legal acts.

Along with the introduction of the CRDIV, the FCMC will be responsible for the use of several new macroprudential instruments, which would promote the financial stability and strengthen the resistance of the banking sector in crisis situations. Without a doubt, the macroprudential supervision is one of the strategic fields to be strengthened by the FCMC within the nearest future. We will closely cooperate with the Bank of Latvia, when developing the analysis, underlying the adoption of decisions on application of macroprudential instruments.

What to expect from the year 2014?

This year will go down in history not only as the euro year, but also as the year of changes. 2014 will introduce certain changes in the field of supervision as well, due to the establishment of the association of banks and the first step thereto – single supervisory mechanism. We do not expect the scope of work of the FCMC to reduce due to the change of supervisory model, just on the contrary – it might increase. The largest challenges will be faced during the transitional period, when not only ECB has to cross new borders, but we should also learn to cooperate and the market should adapt to the new form of supervision.

I expect that the issue on the availability of the financial, especially banking services in regions will still remain topical this year as well. One of the challenges of this year will be to try to preserve the volume of attracted resident deposits in banks, which grew rapidly at the end of the last year. Improvement of the credit portfolio quality and new crediting, in line with the pace of development of economy, will also remain topical.

We look at the year 2014 with confidence and, expecting new challenges, we know that we are able to handle them.

With appreciation for the FCMC team for the work contribution in 2013 and sincerely,

Kristaps Zakulis
FCMC Chairman

Pēters Putniņš

Jeļena Ļebedeva

Kristaps Zakulis

Ludmila Vojevoda

Gvido Romeiko

REPORT OF THE BOARD

The FCMC, as an autonomous public institution, has been operating since 1 July 2001, regulating and supervising the Latvian financial and capital market, safeguarding the interests of the customers of market participants and promoting the stability, competitiveness and development of the sector in general.

The activities of the FCMC are managed by the Board, consisting of five Members of the Board, – Chairman of the FCMC, its Deputy and three Members of the Board, who concurrently are the directors of the FCMC department. The composition of the Board remained unchanged, as compared to the previous year:

- **Kristaps Zakulis** – Chairman of the FCMC;
- **Pēters Putniņš** – Deputy Chairman of the FCMC;
- **Jeļena Ļebedeva** – Member of the Board and Director of the Supervision Department;
- **Ludmila Vojevoda** – Member of the Board and Director of the Regulations and Statistics Department;
- **Gvido Romeiko** – Member of the Board and Director of the legal and Licensing Department.

For the review of the most important issues and adoption of decisions the Chairman of the FCMC convenes and chairs the meetings of the Board on a weekly basis. In 2013, 50 meetings of the FCMC Board took place, during which 297 decisions were made (in 2012 – 46 meetings and 281 decisions).

To promote the efficiency of the monitoring of the financial and capital market and facilitate the safety, stability and development of this market, Consultative Council meetings of the financial and capital market are also held on a regular basis. In 2013, eight such meetings were held during which 50 draft laws and regulations binding on the financial and capital market were reviewed (in 2012 – 32 drafts).

The core function of the FCMC is to ensure the supervision of market participants; therewith the increased attention of the Board is continuously directed to streamlining methods and tools applied in on-site inspections and external supervision of market participants. That is why in 2013 FCMC experts continued working in various directions, improving the stress testing supervision procedure and methodology of the performance thereof, revising the assessment criteria of bank management and operational risk assessment methodology, introducing an early warning indicator system, with the purpose to timely and transparently provide information to supervisors about the most significant indicators characterising banking activities and risks and the trends of changes thereof. At the end of 2013 the FCMC commenced improving methods and tools applied in bank supervision and in 2014 it will continue, in line with the supervision methods determined within the scope of the single supervisory mechanism of the European Central Bank.

The FCMC will also continue strengthening the supervisory framework, taking risk-focussed and result-orientated supervisory measures and ensuring the possibility to timely involve in the activities of the market participants and take the necessary measures for the solution of potential and existing problems.

The on-going supervision of market participants includes both everyday supervisory measures, namely, monitoring of the performance of market participants and post-financial statement analysis, as well as on-site inspections. Overall in 2013, FCMC carried out 81 on-site inspections of market participants, of which 25 were in banks, one in an insurance company, five on-site dawn raids of insurance and reinsurance brokers (legal entities), ten inspections in credit unions, one on-site inspection in an electronic money institution, two in investment management companies and, in general, three inspections in state and private pension funds. In the field of the provision of investment services four on-site inspections were carried out in banks and two – in investment brokerage companies. To assess the conformity of the activities of financial and capital market participants to the requirements of the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing*, in 2013 the FCMC carried out 14 on-site inspections in banks and five inspections related to the supervision of payment institutions.

By streamlining the supervisory principles of the financial service providers and caring about the protection of customer interests, overall in 2013 the FCMC also carried out six mystery customer visits, to make sure that the financial and capital market participants were observing the requirements of laws and regulations in the field of the provision of investment services. The FCMC, within the scope of inspections, also performed 15 on-site information system security audits.

One of the main supervisory principles of the FCMC is risk-focussed supervision. This means that the supervisory measures are mainly directed towards the timely identification of potential problems, as well as a dialogue with market participants, and less towards the imposition of corrective measures and sanctions. However, during the previous year, fines were imposed in 14 cases on market participants in the total amount of 457.5 thousand lats (651 thousand euros), as well as sanctions of other types. The maximum fine –100,000 lats (142.3 thousand euros) – was imposed on two credit institutions for detected deficiencies in the internal control system in the field of the prevention of money laundering.

The attention of the Board was also given to streamlining the operation of the internal control system and risk management process in the FCMC, therefore in 2013 several measures were taken for strengthening the process of supervision of the activities of the private pension funds and investment management companies, supervision and control of the provision of investment services, trading in financial instruments and disclosure of information. We also continued working on streamlining the deposit guarantee scheme operation, strengthening the processes of supervision of the field of the prevention of money laundering and terrorist financing.

STRATEGY OF THE FCMC ACTIVITIES

In 2012, the FCMC Board approved amendments to the strategy of the FCMC activities for 2012 – 2014 by defining three strategic priorities aimed at the more efficient implementation of the functions of the supervisory authority – to regulate and monitor the financial and capital market and activities of its participants, promote the stability, competitiveness and development of the financial and capital market, as well as safeguard the interests of investors, depositors and the insured persons.

FCMC strategic priorities in 2012 – 2014

Streamlining the regulatory framework for the financial sector

Streamlining the regulatory framework for the financial sector prescribes the participation of the FCMC in the European financial supervisory system authorities and implementing the European Union standards in the bank and insurance sectors. Where EU directives provide for an option, the FCMC will assess the application of the most appropriate solution for the sector. The FCMC will also participate in the process of establishing a single EU framework for crisis management to ensure the representation of the national position in the process of elaborating the recovery and resolution framework for credit institutions and investment brokerage firms. It also includes promoting free and fair competition and the diversification of the financial market as well as participation in the process of the introduction of the euro to ensure the readiness of the Latvian financial market for the transition to the new currency.

FCMC STRATEGIC PRIORITIES – STREAMLINING THE REGULATORY FRAMEWORK OF THE FINANCIAL SECTOR, STRENGTHENING THE SUPERVISORY FRAMEWORK AND IMPROVING THE LEVEL OF FINANCIAL EDUCATION AND AWARENESS.

Strengthening the supervisory framework

One of the key tasks in the process of strengthening the supervisory framework is to notably enhance the macrosupervision in cooperation with the Bank of Latvia for the timely identification of systemic risks and taking preventive or mitigating measures in respect of these risks. Enhancing the supervision also includes strengthening of the monitoring of the performance of market participants and supervision of the internal control system, improving cross-border supervision of the security of information systems of market participants and enhancing cooperation with domestic and foreign supervisory authorities of the financial and capital market.

Improving the level of financial education and awareness

Being convinced that financial knowledge is a necessity for modern society, the third priority is improving the level of financial education and awareness. It includes raising customer awareness of both the financial services and the risks thereof and the nature of the activities of the financial sector, for the customer to have the possibility to make well-informed choices about each financial service. Availability of extensive information about the activities of the FCMC and the financial and capital market should also be ensured, by encouraging the market participants to publish, in time and without delay, information about their financial standing, performance and risks associated with the activities thereof.

FCMC ACTIVITIES IN 2013

SUPERVISION

Supervisory principles

The FCMC is constantly focussing on improving methods and tools applied in bank inspections and external supervision and in 2013 it continued working in several directions:

- Improved stress test monitoring procedures and an adjusted procedure for stress tests carried out by supervisors. Stress tests include various techniques (quantitative and qualitative), applied to determine the potential influence of various extraordinary, but possible adverse events or changes in market conditions on the bank. Stress tests are aimed at ensuring future-orientated risk analysis, taking into account the events and circumstances which might occur with certain probability and influence the future activities of the bank.
- Improved criteria for the assessment of bank management and revised operational risk assessment methodology. We have also adjusted and supplemented the methodology for the assessment process of bank internal capital adequacy, streamlined the procedure for inspecting the provision of continuity of activities of the banks and implemented inspection procedures for implementation of the European Systemic Risk Board recommendation regarding crediting in foreign currencies.
- Implemented the early warning indicator system to be applied for the needs of supervision, with the purpose of timely and transparently providing information to supervisors about the most significant indicators characterising banking activities and risks and trends of changes thereof. An early warning indicator system serves as a tool, helping to timely identify negative trends in bank activities and risk indicators, fields and market participants to be subject to corrective supervisory measures.
- The improvement methods and tools applied in bank supervision were commenced at the end of 2013 and will be continued in 2014, in line with the supervisory methods determined within the scope of the ECB single supervisory mechanism. Notable changes are expected in the supervisory processes of the banks, which, starting from November 2014, will be directly supervised by the ECB. Less notable changes are also expected in the supervisory processes of the rest of the banks (the supervision whereof will still be under direct responsibility of the FCMC) (risk assessment procedure, information exchange procedure, etc.), because the European Central Bank will determine the guidelines for the supervision of these banks as well.

STREAMLINING OF BANK SUPERVISION METHODS IS COMMENCED, IN LINE WITH THE METHODS DETERMINED WITHIN THE SCOPE OF THE ECB SINGLE SUPERVISORY MECHANISM.

Preparation to participate in the single supervisory mechanism

Along with Latvia's joining the Eurozone, Latvia automatically joins the single bank supervisory mechanism, which will start to fully operate on 4 November 2014. This means that the single supervisory mechanism will also influence the previous model of supervision of Latvian banks, dividing the functions between the ECB and the national supervisor. The single supervisory mechanism provides for broader powers to the ECB, who will supervise the largest credit institutions of the Eurozone, in cooperating with the national supervisors.

The single supervisory mechanism forms a part of the European bank association plan. Bank association is aimed at ensuring that the EU bank supervision policy is implemented in a single and efficient way. These are the corner stones for the successful implementation thereof: 1) single supervisory mechanism; 2) single resolution mechanism for the banks facing problems, so as to possibly reduce the attraction of the tax payers' funds for recovery of the banks in the future; 3) harmonised deposit guarantee scheme.

The gain from implementing the single supervisory mechanism can be the fact that the cross-border supervisor would minimise the fragmentation of the European financial market, reducing the national considerations in the management of assets and liabilities, promoting capital movements within the European Monetary Union and streamlining the mechanism of the implementation of the monetary policy. Prior to the commencement of operation of the single supervisory mechanism, the ECB will also carry out the quality check of bank assets, thus improving the transparency and strengthening the trust of investors in the banking sector.

In October 2013 work on the comprehensive evaluation of banks was launched, planned to take place in three, closely interrelated stages:

- **risk assessment** for supervisory purposes, to verify the main risks in terms of quality and quantity,*inter alia*, liquidity, volume of loans and financing;
- **asset quality check**, to improve the transparency of bank risk transactions, by checking the quality of bank assets,*inter alia*, conformity of the assets and collateral assessment and associated regulations;
- **stress test**, to verify the flexibility of balances of the banks under conditions of stress scenarios.

On the whole, within the scope of the single supervisory mechanisms, the ECD will directly supervise about 125 groups of credit institutions. In Latvia those would be the three largest banks in terms of assets – "Swedbank" AS, AS "SEB banka" and ABLV Bank, AS.

In the second half of 2013, having received the invitation to join the Eurozone, the FCMC participated in work groups of different levels organised by the ECB, working on the framework regulation determining the cooperation model between the ECB and the national competent authorities, as well as handbooks regarding the supervision of filing statements, collection of statistical data and other documents, necessary for the implementation of single supervision.

The ECB Supervisory Board starts to operate from 2014, where the FCMC is represented by its Chairman Kristaps Zakulis. The Supervisory Board is established to plan and implement the ECB supervisory obligations, perform the preparatory works for the successful launch of a single supervisory mechanism, as well as to fully prepare the draft decisions to be submitted for approval to the ECB Governing Council. The work will continue throughout 2014, so that the single supervisory mechanism is able to start to operate in November 2014.

Banking sector

General information

CONTINUING THE CONSOLIDATION PROCESS OF THE LATVIAN BANKING SECTOR, THREE CREDIT INSTITUTIONS WERE DISSOLVED IN 2013.

At the end of 2013 there were 19 banks and nine Member State bank branches operating in Latvia. In October 2013, AS "GE Money Bank", implementing the strategy of *General Electric* group, refused the license issued to it for the activities of a credit institution in Latvia and reorganised the bank as a commercial company, which does not provide the services of the credit institution.

Two more banks – AS "UniCredit Bank" and State JSC "Latvijas Hipotēku un zemes banka" – asked the FCMC to annul the licence issued to them for the activities of a credit institution starting from 1 January 2014. In December 2013 the FCMC adopted a decision to accept the request of the referred to banks. At the same time, AS "UniCredit Bank" asked to permit the reorganisation of the bank into a commercial company which does not provide the services of a credit institution, but the State JSC "Latvijas Hipotēku un zemes banka" asked to permit the transformation of the bank, by way of reorganisation, into a development financial institution.

The withdrawal of the said banks from the Latvian banking sector influenced not only the total amount of the share capital paid up by the banks and the structure of the countries of origin of shareholders, but also increased the level of market concentration.

One of last year's largest challenges and labour-consuming projects of the banking sector was the introduction of the euro, which was successfully implemented. Given the timely planning and contribution of work and resources, the bank customers were ensured a comfortable, simple and understandable change of the national currency.

In 2013 Latvian banks were still to consider several factors affecting the external and internal financial environment where they operated.

The gradual recovery of the national economy of Latvia continued and development trends were observed with a positive influence on the banks and their performance indicators as well. Even though on the one hand, a gradual improvement of the financial standing of the borrowers is observed in general, on the other hand, a considerable part of the borrowers, especially households, still view solvency as a topical problem, the debt burden of the borrowers is still large, and it still results in limited demand for credit, creating concerns of protractedly weak crediting. In this situation the introduction of the euro and Latvia's accession to the Eurozone is to be considered as a positive, risk mitigating factor.

The main sources of uncertainty and risks still depend upon the development of the processes in the external microfinance environment,*inter alia*, economic growth rate in other countries and in the Eurozone, progress of interest rates, aggravation of the situation in Ukraine, etc.

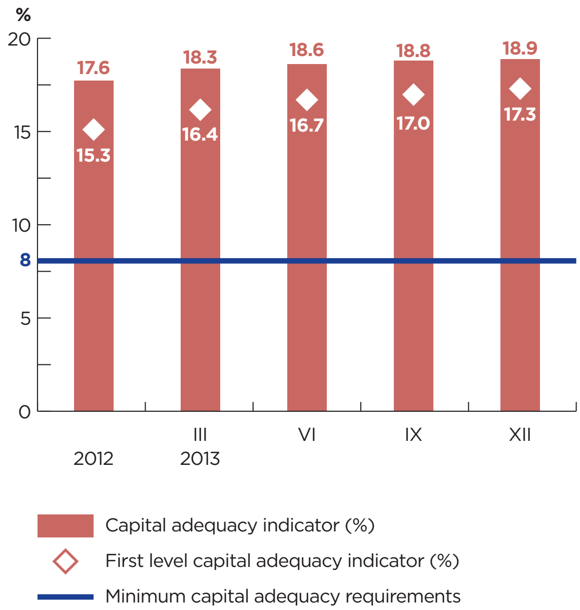
Notwithstanding the influence of these internal and external financial environment factors, bank performance indicators for the reporting year continued to stabilise.

Banking sector performance indicators

Capitalisation level of the banking sector remained high. Several banks during the year made use of the opportunity to strengthen the capital base, including therein the (interim) audited profit for the current operational year, but the gradual improvement of the quality of credit portfolio and constantly declining crediting development rate, in turn promoted the reduction in the amount of bank risk weighted assets, and at the end of December the capital adequacy indicator reached 18.9% (minimum capital requirements – 8%), and the first level capital adequacy indicator, in turn, comprised 17.3%[1] (at the end of 2012 –17.6% and 15.3 % correspondingly). During 2013 the banks repaid the subordinated investments, which reduced the sum total of the second level capital by 34%. Thus, the specific weight of the first level capital in the bank equity structure increased even more (from 87% at the beginning of the year to 91% at the end of December), which conforms to the new requirements governing the capital adequacy directed towards the increase of the specific weight of the first level basic capital in equity (in effect from 1 January 2014).

Image 1.

Bank capital adequacy indicator (%)



Bank liquidity

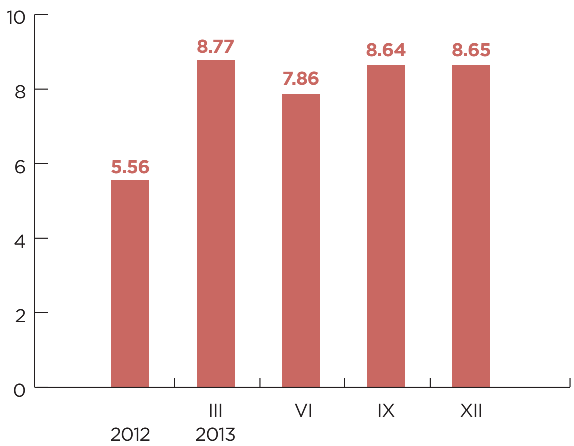
Notwithstanding the growing demand, the volume of deposits and also the specific weight in the total deposits, through the growth of liquid assets the liquidity risk remained limited. At the end of December 2013 the liquidity indicator reached 64.4% (minimum requirement – 30%), growing by 4.7 percentage points year on year.

[1] The first level capital only includes the highest quality capital elements: paid up share capital and reserves, as well as retained profit for the previous years.

Profit and losses

The year 2013 was already the second in a row (following three loss-yielding years), when the banking sector was generally operating at a profit and the amount thereof achieved 173 million lats or 246.2 million euros (in 2012 the profit reached 122.3 million lats). Among them 15 Latvian banks and five branches of foreign banks, the assets whereof comprised almost 95% of the assets of the banking sector, on the whole in 2013 gained profit in the amount of 213.1 million lats. The profitability improved within the course of 2013 and the return on equity (ROE) indicator of the banking sector at the end of December reached 8.65% (at the end of 2012 – 5.56%).

Image 2.
Dynamics of the bank return on equity indicator (ROE), %



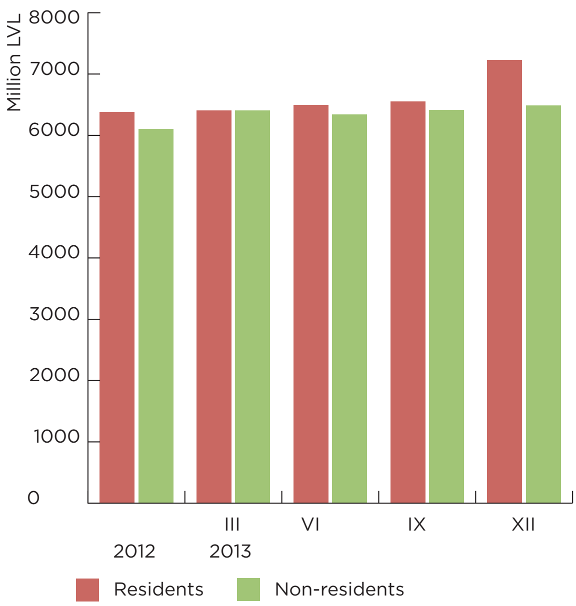
There were no considerable changes in the income and expenses structure of the banks. In light of the interest rate decline, the interest income continued reducing, whereas the amounts of bank liabilities towards monetary financial institutions (MFI), which decreased by almost one fourth within a year, as well as the low interest rate environment, allowed the banks to considerably reduce the interest expenses for attracted funds, thus increasing the net interest income by 10.4%. In 2013 the profitability of the banks was also positively influenced by the increase in the net commissions income (by 13.6%) and gradual improvement of the quality of the credit portfolio (still the most significant item of expenses of the banks, i.e. net expenses of provisions for doubtful debts, decreased by 10.9%).

Deposit volume

The introduction of the euro facilitated the steep growth of resident deposits – 848 million lats (1.2 billion euros) or 13.3%, and, by non-resident deposits increasing by 384 million lats (546 million euros) or 6.3%, the total amount of deposits at the end of 2013 reached 13.7 billion lats (19.5 billion euros). At the beginning of 2013 a moderate resident household deposit growth resumed, but in the last quarter before the introduction of the euro, a steep growth was observed in both household and corporate deposits – in 2013, on the whole, they grew correspondingly by 390 million lats (556 million euros) and 332 million lats (472 million euros). The governmental and financial institution deposits grew as well.

Despite the developments in Cyprus, no increased non-resident deposit flow to Latvia was observed in 2013. The pace of increase in non-resident deposits slowed down, which was also influenced by the withdrawal of the State JSC "Latvijas Hipotēku un zemes banka" and AS "UniCredit Bank", as well as the depreciation of the US dollar.

Image 3.
Dynamics of bank deposits, million LVL



Financing attracted by the banks

In 2013 the liabilities towards the MFIs continued to decrease, which was mainly determined by the decrease in financing attracted by the subsidiaries and branches of the foreign banks from the parent banks by 923 million lats (1.3 billion euros), facilitated by the consolidation of the banking sector, growth in resident deposits and decrease in the credit portfolio.

By the growth of the specific weight of the demand deposits in total deposits, in order to balance the term structure of financing, the long-term bonds were issued more actively – even though the proportion thereof to the total assets was still low, during the year the volume thereof had grown by 68% or 95 million lats (135 million euros), achieving 234 million lats (333 million euros).

Credit portfolio

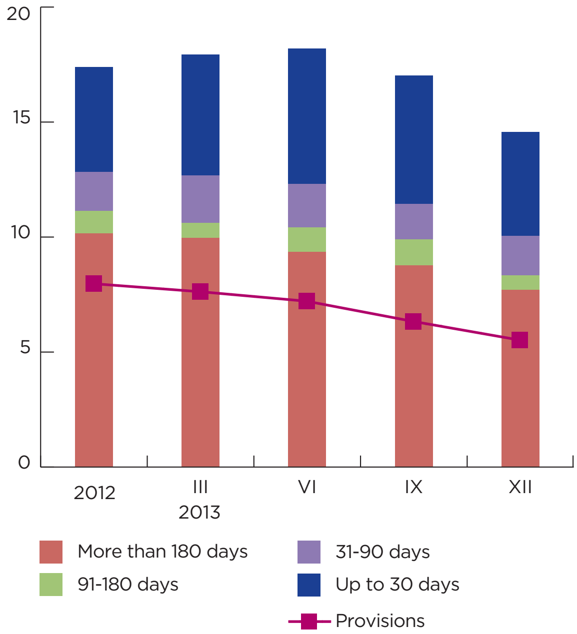
The credit portfolio shrank by 6.5% in 2013. Except for the written-off credit effect, which was more the closing stage of the process of arrangement of the balances of the banks for the previous crisis years, rather than a reflection of the existing situation, the credit portfolio shrank by 3.1% (i.e., of resident non-financial companies – by 1.8%, of resident households – by 4.5%).

Newly granted credits of the banks to the resident non-financial companies and households in 2013 reached 1.6 billion lats (2.3 billion euros) – 5% more than in the previous year. Growth was observed in the real estate, construction, trade and transport industries. Credit funds granted to households for home acquisition, reconstruction and/or repairs in the amount of more than 191 million lats (270 million euros) – 21.8% more than the year before.

Overdue loans

The specific weight of the loan overdue for more than 90 days in the total credit portfolio of the banking sector continued shrinking and at the end of December comprised 8.3% (at the end of 2012 – 11.2%). Such a specific weight of credits in the household credit portfolio reached 12%, whereas in the portfolio of resident non-financial companies – 7%. The total specific weight of overdue loans in the credit portfolio of the banking sector during the year decreased from 17.4% to 14.6%. The balance of provisions formed by the banks for doubtful loans at the end of 2013 decreased to 674 million lats (958 million euros) or 6.1% of the total credit portfolio of the banks (at the end of 2012 – 8%), but the proportion of provisions against the balance of the loans overdue by more than 90 days remained at a high level – 73.6%.

Image 4.
Overdue loans and provisions, % of the credit portfolio



Bank supervisory measures

Last year the FCMC continued strengthening in the intensive supervisory framework established in 2009, aimed at the taking of risk-focussed and result-orientated supervisory measures and ensure the FCMC with the possibility to timely be involved in the activities of the banks and take the necessary measures for the solution of potential and existing measures or minimisation of losses.

During the reporting year the priorities for supervising banks in Latvia were as follows:

- assess the adequacy of the capital base of Latvian banks;
- assess liquidity maintenance, administration adequacy and quality thereof, taking into account the business model chosen by the bank;
- assess the adequacy of the quality of bank activities with problem loans and recognition of loan impairment losses in bank statements;
- assess the potential impact of the bank operating strategy on the structure and volume of risks;

- assess the ability of the banks to ensure the successful introduction of the euro and supervise the process of introduction of the euro;
- initiate the development of the bank recovery plan and to assess it, maintaining the dialogue with the banks.

In 2013 the supervision of banks was based on the following related techniques: bank performance off-site monitoring on the basis of the analysis of their financial statements and other operative information at the disposal of the FCMC, and on-site inspections.

Bank performance off-site monitoring

In 2013 the FCMC continued to enhance its off-site monitoring of bank activities, on the basis of the analysis of regular reports submitted by banks and the analysis of the following additional operative overviews, information and activity reports of the banks:

- daily reports about deposit dynamics;
- reports about liabilities to related financial institutions;
- minutes of the meetings of bank credit committees, management boards and supervisory boards as well as bank internal audit reports about the performed inspections;
- credit risk, liquidity and market risk reports and stress test results.

Banks were also invited to present part of the said operative information, thus promoting on-site dialogue between the FCMC and the banks.

In 2013, the FCMC paid particular attention to the balance of the bank's correspondent accounts and their availability through both on-site and off-site inspections in banks.

In cooperation with the Bank of Latvia, the FCMC continued to carry out regular stress tests of credit risk and liquidity risk. Stress tests for credit risk were carried out by taking into account macroeconomic forecasts. The outcomes of these tests were used to determine the likely losses in the credit portfolio under different scenarios and assumptions about economic development, as well as to assess the capacity of the banks to absorb the said losses. Stress tests in respect to liquidity risk were also carried out. Within these tests several customer behaviour patterns were analysed along with the bank's ability to ensure the timely fulfilment of legal claims by the customer. Where necessary, the FCMC maintained a dialogue with banks about their plans to ensure appropriate capital adequacy and liquidity in emergency situations.

Risk-orientated supervision is one of the main principles of supervision. In line with this principle and on the basis of reports and other information, the FCMC assessed, on a quarterly basis, the bank performance, level of risks and their management quality. Risk monitoring tests were used to plan the necessary supervision, including on-site inspections.

THE FCMC, ON THE BASIS OF THE BANK BUSINESS ANALYSIS AND RESULTS OF THE PERFORMED INSPECTIONS, HAS BEEN ASSESSING THE BANK RISKS FOR SEVERAL YEARS ALREADY, ASSIGNING EACH BANK A RATING, WHICH CONFORMS TO ITS RISK VOLUME AND THE QUALITY OF MANAGEMENT THEREOF.

For several years already the FCMC has been assessing the risks of banks by assigning a rating to each bank according to its risk size and risk management quality. The rating system is a tool used by the FCMC to identify, analyse and assess risks inherent to the activities of the institutions subject to supervision and to assess the quality, adequacy and appropriateness of risk management techniques in view of the volume and complexity of the bank's operations.

The main objectives of the rating system are as follows:

- assess the risks inherent to the activities of the institutions subject to supervision and risk management systems;
- introduce a standard supervisory approach to identify, analyse and assess the risks;

- make a brief and comparable summary of assessment results (i.e., by assigning a rating to each institution subject to supervision);
- ensure efficient and targeted planning of supervision;
- ensure continuity and transparency of the supervision process;
- promote the introduction of a more advance approach to risk management in the institutions subject to supervision;
- promote communication and dialogue with the institutions subject to supervision.

As a result of the rating assignment process, for supervisory purposes, a rating was assigned to each institution subject to supervision ranging from 1.0 to 4.0, where 1.0 was the highest assessment and 4.0 was the lowest. According to the rating assigned to an institution, the supervision thereof is planned – where an institution was assigned a high rating (the institution's activities were characterised by low risk and its risk management was sufficient), the required supervisory measures were minimal, whereas for an institution with the lowest rating (with high risks inherent to institution's operations and weak risk management) the supervisory control should be on-going and enhanced.

In 2013, on the basis of the FCMC's inspection results, the ratings of five banks were revised. One bank was assigned a rating for the first time. Overall, at the end of the reporting year, banks were assigned the following ratings:

Rating scale	1–2	2.1–3	3.1–4
Number of banks	6	12	1

In 2013, the main risks associated with the activities of the banks were still credit risk, liquidity risk, strategy and business risks. In particular, attention was paid to strategies of banks and their profitability.

Within the supervision of the banks, in 2013 the FCMC applied the sanctions prescribed by the *Credit Institution Law* to banks,*inter alia*:

- imposing a fine on one bank in the amount of 5 thousand lats (7.1 thousand euros) for exceeding the limit of risk transactions;
- imposing a fine on seven banks in the total amount of 345 thousand lats (490.9 thousand euros) for deficiencies in the operation of the internal control system,*inter alia*, for four banks fines in the total amount of 230 thousand lats (327.3 thousand euros) were imposed for deficiencies in the operation of the internal control system in the area of money laundering;
- imposing a legal obligation on one bank to improve the internal control system in the field of the provision of the functions of the investment fund holding bank;
- imposing a legal obligation on one bank to perform improvements in its strategy to attract deposits;
- expressing a warning to one bank regarding the cases of failure to observe the prescribed regulatory requirements.

The FCMC also applied corrective measures, by setting additional requirements to four banks in the area of credit risk.

Group supervision

In 2013, the FCMC cooperated with the supervisory authorities of credit institutions of the Member States, which according to the requirements of laws and regulations implement the supervision of groups of credit institutions. In 2013, the FCMC staff participated in six colleges of supervisory authorities of the credit institutions of the Member States, as well as chaired one college of supervisory authorities as a supervisory authority in charge. The most topical issues on the agenda of the work of colleges were the coordination of supervisory measures, process of banks' internal capital adequacy assessment and risk profile assessment at a group level.

On-site inspections in credit institutions

In the reporting year, the FCMC carried out 25 on-site inspections in banks and paid particular attention to assessing capital adequacy, the lending process and also the risk management functions – management of credit risk, operational risk, liquidity risk, strategy and business risk and the operational compliance control function. Another 14 on-site inspections were carried out to assess the conformity of bank activities to the requirements of laws and regulations in the field of the prevention of money laundering.

The strategic task of supervision was to accurately identify, as quickly as possible, the material risks and, if necessary, take immediate measures for the mitigation of the impact of these risks.

Weaknesses and inconsistencies detected during the inspections were discussed with the managements of banks and action plans were agreed to correct them. Follow-up supervision was carried out within the scope of off-site supervision by controlling the implementation of the action plan in the field of the prevention of weaknesses.

DURING THE REPORTING YEAR THE FCMC CARRIED OUT 39 ON-SITE INSPECTIONS IN BANKS.

Capital adequacy

In 2013 the capitalisation level of the banking sector remained high. Several banks during the year used the opportunity to strengthen the capital base, including therein the audited (interim) profit for the current operating year. Growth of the capitalisation level was also triggered by the gradual improvement of the quality of the bank credit portfolio and still lingering lending development rates. In 2013 the paid-up share capital was increased by six banks in total by 41 million lats (58.34 million euros).

THE PAID-UP SHARE CAPITAL IN 2013 WAS INCREASED BY SIX BANKS IN TOTAL BY 41 MILLION LATS.

The FCMC carried out an enhanced assessment of the adequacy of the bank provisions for expected losses. A positive difference between the volume of expected losses and the provisions made in line with the requirements of accounting standards was taken into account when assessing the capital adequacy of banks. In 2013, corrections were made in the capital adequacy calculation of eight banks.

In addition to the minimum capital adequacy requirements banks also assessed their internal capital adequacy to establish that the capital of the bank, in terms of its scope, elements and specific weight, is adequate for covering the risks inherent to the current and planned activity of the bank and potential risks thereof. As a result of the capital adequacy assessment, all banks concluded that their capital was sufficient to cover the risks inherent to their current operations and also ensured a sufficient capital buffer in the case of an occurrence of potential significantly adverse scenarios affecting their operations.

During 2013, within the scope of the supervisory inspection and assessment process, in all banks the capital adequacy assessment process performed by the banks was assessed, as well as the conformity of the assessment process of the banks' internal capital adequacy to the requirements of laws and regulations. FCMC inspection results uncovered areas where banks needed improvements (*inter alia*, procedure for the determination of the size of capital necessary for the covering of material risks inherent to the current and planned operations of the banks, methods applied in stress testing and analysis of the results thereof). The FCMC continues dialogue with several banks about their strategies and capital planning process.

During the assessment of bank capital adequacy, the FCMC paid particular attention to whether capital adequacy was consistent with the further activity strategy of the banks and with the size of the risks inherent to the bank's planned operations as well as to the methods for managing these risks. When the FCMC uncovered that banks had assumed an unduly high risk, in 2013 the FCMC, in line with the rights vested to it in accordance with the Credit Institution Law, imposed an obligation on fourteen banks to maintain their own funds above the minimum capital requirement.

Credit risk

In its supervision work, the FCMC's priority was still to ensure that Latvian banks maintained a sufficient capital base, promoting efficient customer debt restructuring. Like before, the supervisory methods in 2013 were also based upon the risk assessment of the activities of market participants, using the related techniques – bank performance results monitoring on the basis of the analysis of the financial statement, and on-site inspections.

In view of the large proportion of problem loans in the credit portfolio, during inspections additional attention was paid to the work by banks with overdue and problem loans, i.e. justification for and efficiency of loan restructuring. As a result of the inspections, the FCMC required that banks additionally recognise loan impairment losses by making provisions or capital corrections. Additional impairment was mainly uncovered in respect of loans that depended on collateral. In view of the increase in the volume of new loans to non-residents and additional risks associated with loans to non-residents, during the inspections, lending practice to non-residents was assessed, i.e. the criteria for issuing a loan, credit quality monitoring and the quality of issued loans.

IN ITS SUPERVISION WORK, THE FCMC'S PRIORITY WAS STILL TO ENSURE THAT LATVIAN BANKS MAINTAINED A SUFFICIENT CAPITAL BASE, PROMOTING EFFICIENT CUSTOMER DEBT RESTRUCTURING.

Five of the bank on-site inspections in 2013 were carried out to precisely assess the quality of credit portfolios and credit risk management. These inspections covered 21.5% (or a portfolio of 2.4 billion lats) of the total credit portfolio of the banking sector. Particular attention was paid to the timely recognition of loan impairment losses (adequacy of the established provisions) or volume of the capital correction made where the expected losses exceeded the volume of the provisions made. The quality of monitoring of the real estate pledged for the benefit of banks was assessed because the results of that monitoring directly affected the timely recognition of loan impairment losses.

Liquidity risk

Protracted uncertainty in the global financial markets and the Eurozone was also the reason for the FCMC to continue paying more attention to bank liquidity in 2013.

In order to control bank cash flows, in 2013, the FCMC continued to require that banks submit daily operative information about deposit dynamics and paid particular information to the liquidity management quality of foreign bank subsidiaries at a group level as these banks mainly relied on the resources allocated to them by their parent banks. Thereby the FCMC managed liquidity risk in the banking system in general and, where necessary, required that banks took preventative measures to improve their liquidity risk management.

TO CONTROL THE BANK CASH FLOW, IN 2013 THE FCMC CONTINUED REQUESTING THE BANKS TO PROVIDE OPERATIVE INFORMATION ABOUT DEPOSIT DYNAMICS ON A DAILY BASIS.

When the FCMC uncovered that banks had assumed an unduly high risk, in 2013 FCMC, in line with the rights vested to it in accordance with the Credit Institution Law, imposed an obligation on fourteen banks to maintain the liquidity level above the minimum liquidity requirement.

Market risk

As compared to other countries, Latvian banks also did not have significant investments in financial instruments in 2013 (overall, shares and debt securities did not exceed 10.6% of bank assets). Even though market risk was insignificant in the banking system in general, in view of the persisting national debt obligations risk that could affect the banking system, in 2013, the FCMC continued to perform an enhanced assessment of the banks' portfolios of financial instruments to ensure that banks were disclosing them prudently in their financial statements and assessing the liquidity of their existing securities.

Risk management function

When providing financial services, banks have to ensure the efficiency of every business unit or activity type and also establish and efficiently implement the overall risk management function that is important for the bank's activities. During bank inspections in 2013, the FCMC continued to pay more attention to the quality of managing each material risk. When assessing each risk management function, the size of the particular risk was assessed along with the effect of its changes on the bank's overall activity, as well as the efficiency of the internal control system and of the efficiency of the management's work when identifying, measuring and managing each relevant risk. Particular attention was paid to establishing whether banks were using the results of various stress tests and stress scenarios when managing their material risks; the quality of those stress tests and suitability to the nature of each bank were assessed as well.

Bank recovery plans

The FCMC, taking into account the recommendations developed by the European Central Bank regarding the development of recovery plans of bank groups, aimed at stabilising the financial standing of the bank groups in general or, alternately, significant institutions of the bank, each separately, which, in turn would ensure the financial stability in the financial sector in general, invited the banks to develop a single set of documents "Bank Group Recovery Plan". Banks performed this task in several stages, submitting the interim results to the FCMC for revision, maintaining dialogue with the FCMC and hearing directions about the detected weakness therein, to prepare quality and viable recovery plans. The said dialogue with separate banks will also continue in 2014.

DURING THE REPORTING YEAR THE INSURANCE SECTOR CONTINUED TO FACE GRADUAL GROWTH AND THE VOLUME OF PREMIUMS WRITTEN WAS APPROACHING THE PRE-CRISIS LEVEL.

Insurance sector

Performance indicators of insurance companies

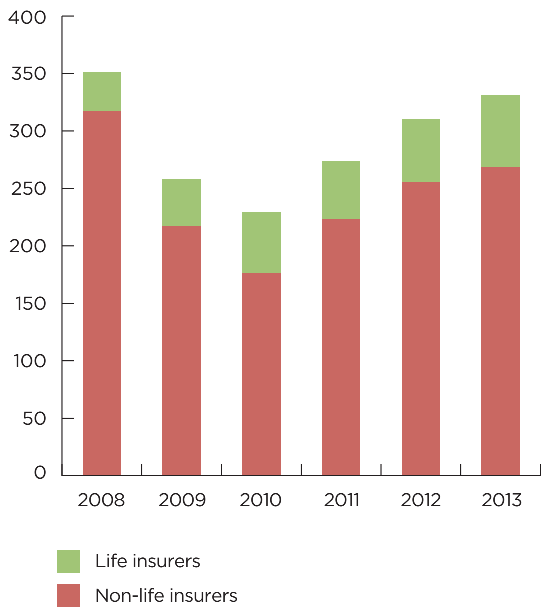
At the end of 2013 there were seven insurance companies operating in Latvia (two life insurance and five non-life insurance companies) as well as 13 branches of EU Member State insurance companies (five life insurance and eight non-life insurance company branches).

Three insurance companies (AAS "Gjensidige Baltic", AAS "Balta", AAS "SEB Dzīvības apdrošināšana") are subsidiaries of EU Member State insurance companies, and the market share of these insurance companies in the total insurance premiums written at the end of 2013 comprised 43% (at the end of 2012 – 36%).

During the reporting year the insurance sector continued to face gradual growth and the volume of premiums written was approaching the pre-crisis level. The more rapid development of the insurance market was ensured by the services rendered in other EU Member States (Lithuania, Estonia, Poland, France, Spain, Germany and Italy). The provision of outsourced insurance services in the Member States increased by 10.6%, but the services rendered in Latvia – by 2.9%. Therewith the proportion of the services provided abroad in the premiums written reached 33.5%.

The total volume of gross written premiums of the insurers (insurance companies and branches of foreign insurance companies) at the end of the year reached 331 million lats or were 5% more than in the previous year (*inter alia*, the gross written premiums of the branches of foreign insurance companies grew by 30% and reached 85 million lats or 25.7% of the total premiums written), whereas the volume of disbursed gross indemnities grew by 9%, comprising 184 million lats.

Image 5.
Dynamics of the premiums written in breakdown by life and non-life insurers (million lats)



Compared to the previous year, growth of the gross written premiums was observed in all of the largest insurance types. Even though the most rapid growth was observed in property insurance against fire and natural disaster damages, it did not materially affect the structure of the portfolio of the gross written premiums in the insurance market. The largest proportion of the gross written premiums was still for civil liability insurance of the owners of motor vehicles, for the insurance of motor vehicles, as well as for life and health insurance (19.9%, 17.5%, 14.4% and 12.1% correspondingly).

The largest fall in the gross written premiums was for general civil liability insurance and ship insurance (by 2.5 million lats and 1.1 million lats correspondingly).

Image 6.
Gross written premiums in breakdown by types of insurance (million lats)

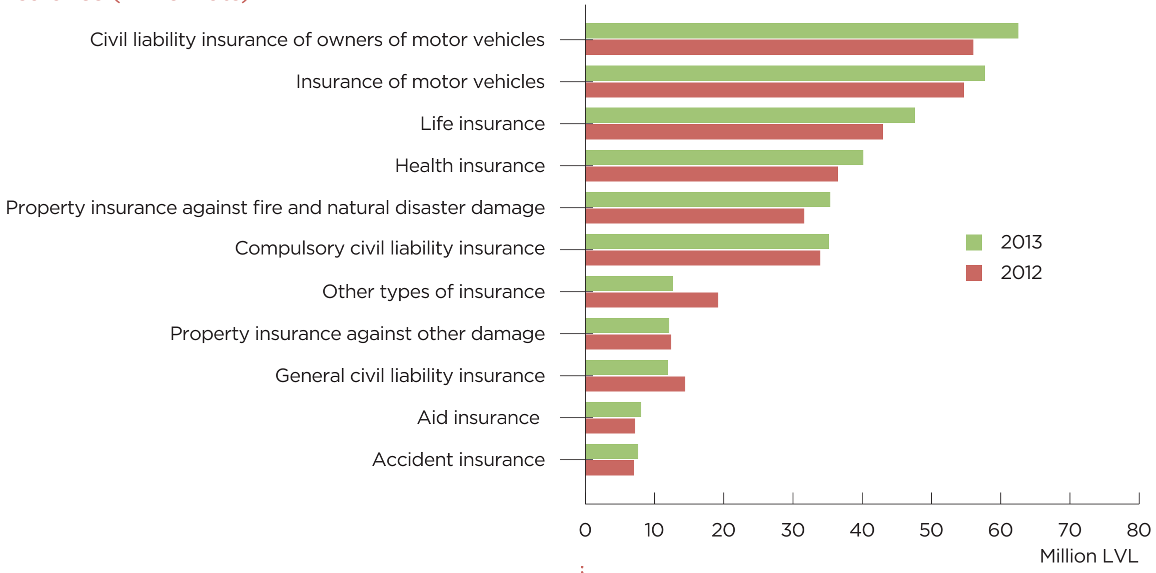
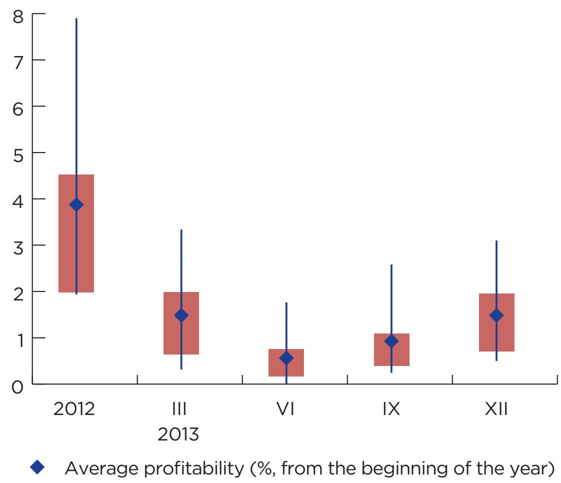


Image 7.
Average annual profitability (%, from the beginning of the year)



Income of insurance companies from investments was not as large as in the previous year, nevertheless, following the fall in the first six months it considerably improved and the average annual profitability reached 1.5% (in 2012 – 3.9%),*inter alia*, for life insurance companies it comprised 1.6%, whereas for non-life insurance companies – 2.1% (in 2012 correspondingly – 7.7% and 3.9%).

On the whole, in 2013 insurance companies earned 5.8 million lats, i.e. 43% less than in the previous year. Besides, the profit of non-life insurance companies comprised 6.2 million lats (two out of five companies operated with losses), but life insurance companies during the reporting year operated with losses in the amount of -0.4 million lats.

During the reporting year the insurance companies gained profit mainly from the civil liability insurance of the owners of motor vehicles (2.2 million lats), general civil liability insurance (2.1 million lats), as well as property insurance against fire and natural disaster damage (1.9 million lats).

In turn, losses were caused mainly by motor vehicle insurance (minus 1.7 million lats), compulsory civil liability insurance (minus 1.3 million lats), as well as cargo and health insurance (0.3 million lats and 0.2 million lats correspondingly).

IN 2013 ALL THE LICENCES OF ONE INSURANCE COMPANY FOR THE PERFORMANCE OF INSURANCE WERE ANNULLED.

Supervisory measures of insurance companies

The FCMC follows, on a regular basis, the fulfilment of the requirements for the solvency margin and the cover for technical provisions as established in the *Law on Insurance Companies and Supervision Thereof*, also carrying out a full-scope inspection of the activities of one non-life insurance company in 2013.

In 2013, having detected significant violations of the requirements of laws and regulations, the FCMC applied the sanctions prescribed by the Law on Insurance Companies and Supervision Thereofto one insurance company – the activities thereof were suspended and afterwards all the licences for the performance of insurance were also annulled.

In 2013, the FCMC cooperated with the supervisory authorities of insurance and reinsurance companies of the countries of the European Economic Area (EEA) that carried out the supervision of those insurance groups and reinsurance groups whose members were insurance companies licensed in Latvia. During 2013, the FCMC's employees ensured the participation in three meetings of colleges of supervisory authorities of insurance and reinsurance companies of EEA countries. The topical issue in the work of these colleges was the assessment of the financial standing of an insurance and reinsurance group, the development of an internal model for an insurance group or a reinsurance group and the expected approval thereof in relation to the implementation of the requirements of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) as well as information exchange among supervisory authorities.

In 2013, the FCMC also cooperated with the insurance supervisory authorities in Estonia and Lithuania, by participating in jointly organised discussions on topical issues and ensuring the provision of information to insurance supervisory authorities in Estonia and Lithuania, in line with the cooperation agreement concluded in 2013 regarding supervisory authorities of cross-border insurance companies.

In 2013, the FCMC participated in the work of the European Insurance and Occupational Pension Authority (EIOPA) in the field of insurance supervision, ensuring the provision of information in accordance with the requests of the EIOPA, taking part in the comparative assessment of the EIOPA Peer Review on Colleges and adjusting the EIOPA *Solvency II Preparatory Guidelines* translation into Latvian.

THE CONFORMITY INSPECTION OF THE ESTABLISHMENT, ACCRUAL AND ADMINISTRATION PROCEDURES OF THE GUARANTEE FUND OF THE COMPULSORY CIVIL LIABILITY OF OWNERS OF MOTOR VEHICLES ADMINISTERED BY THE SOCIETY "LATVIJAS TRANSPORTLĪDZEKĻU APDROŠINĀTĀJU BIROJS" (MOTOR INSURERS' BUREAU OF LATVIA) WAS CARRIED OUT.

Guarantee fund of the compulsory civil liability insurance of owners of motor vehicles

In accordance with Section 51 of the *Compulsory Civil Liability Insurance of Owners of Motor Vehicles Law* and Paragraph 19 of Regulation No. 195 of the Cabinet of Ministers "*On the Procedure for Establishing the Guarantee Fund of the Compulsory Civil Liability Insurance of Owners of Motor Vehicles, for Accruing Assets in the Fund and Managing the Fund*" of 22 March 2005, in 2013 the FCMC carried out the conformity inspection of the establishment, accrual and administration procedures of the guarantee fund of the compulsory civil liability of owners of motor vehicles administered by the society "Latvijas Transportlīdzekļu apdrošinātāju birojs" (Motor Insurers' Bureau of Latvia) and notified the Ministry of Finance and the society Motor Insurers' Bureau of Latvia about the inspection results.

Insurance and reinsurance intermediaries

In 2013, the FCMC carried out one off-site inspection of all the insurance and reinsurance brokers (legal entities) to assess compliance with the requirements of the Activities of Insurance and Reinsurance Intermediaries Law about keeping the funds acquired from insurance and reinsurance mediation distinct from the funds of the market participant itself. Also, five on-site dawn-raids of insurance and reinsurance brokers (legal entities) were carried out, assessing the compliance of their activities to the requirements prescribed by the above mentioned Law.

During the inspections, material violations of the requirements of laws and regulations were uncovered, for which administrative cases were initiated against two insurance and reinsurance brokers for a violation of the requirements stated by the Law.

Cooperative credit unions

Performance indicators of cooperative credit unions

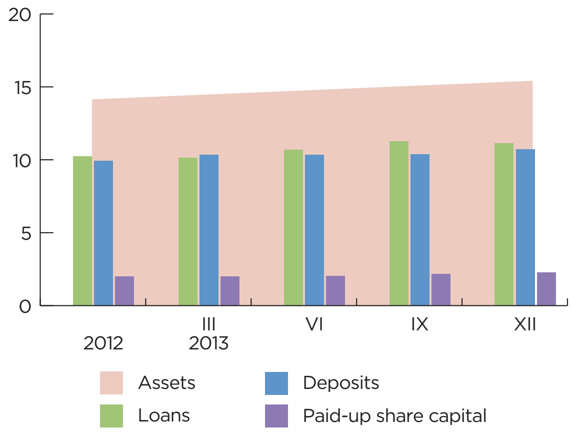
At the end of 2013 there were 35 cooperative credit unions operating in Latvia and the amount of their assets at the end of the year achieved 15.4 million lats (i.e., 0.1% of the total assets of the financial and capital market).

The proportion of the equity of the cooperative credit unions to the sum total of the assets and off-balance items, i.e. capital adequacy, remained high in the fourth quarter of 2013 and at the end of December it comprised 21.3% (at the end of 2012 – 20.1%) (the set minimum capital adequacy requirement is 10%).

During the year 2013 credit unions earned in total 249 thousand lats or 354 thousand euros (the year previous the profit reached 160 thousand lats). In 2013, 21 credit unions operated with profit and their market share in the total assets of credit unions comprised 95.4%.

The main source of income of credit unions was interest income from the loans issued to the members of the credit unions (67.1%), whereas the most considerable expense items of the associations, i.e. administrative expenses, expenses for provisions for doubtful debts and interest expenses for deposits at the end of December comprised, correspondingly, 40%, 34.2% and 17.2% of the total expenses of the associations.

Image 8.
Assets, loans, deposits and paid-up share capital of credit unions (million lats)



The main type of activity of the credit unions is lending to their own members. The balance of loans issued to the members during the period of the fourth quarter of 2013 slightly decreased (by 1.4%) and at the end of December comprised 11.1 million lats (15.9 million euros), nevertheless during the year the balance of the credit portfolio has considerably grown overall, i.e. by 8.7% or 894 thousand lats (1.3 million euros).

At the end of December 62.4% of the credit portfolio of credit unions was assessed as standard, 31.5% – as subject to supervision and 6.1% was below standard, the sum total of doubtful and bad loans (at the end of 2012, correspondingly – 64%, 29.3% and 6.8%). The volume of the established special provisions for doubtful debts at the end of December comprised 7.7% of the total credit portfolio of the associations (at the end of 2012 – 7.9%).

The financing structure of the associations was 97.4% comprised of member deposits – their balance during the reporting quarter increased by 3.1% or 321 thousand lats, whereas since the beginning of 2013 it has grown by 8% or 798 thousand lats (1.1 million euros) and at the end of December reached 10.7 million lats (15.3 million euros).

Supervisory measures of cooperative credit unions

In 2013 the supervision of cooperative credit unions was performed both by applying the performance results monitoring based on the analysis of the financial statement, paying special attention to the sufficiency of the provisions established by the associations for doubtful debts, and by performing on-site inspections.

During the reporting year the FCMC's experts carried out 10 on-site inspections (in the previous year – four), with the purpose to assess the financial standing of the cooperative credit unions, management work, asset quality and structure of expenses thereof, as well as compliance of their activities to the requirements of laws and regulations, especially the *Credit Union Law*.

In 2013, the FCMC applied the following sanctions to one credit union: it was prohibited from provision of financial services, except for the disbursement of existing deposits; a legal obligation was imposed to take particular measures by the specified date; a warning expressed regarding the inability of the management to ensure the activities in compliance with the requirements of the laws and regulations.

Payment institutions and electronic money institutions

Performance indicators of the payment institutions and electronic money institutions

At the end of the reporting year there were 24 registered payment institutions and 11 registered electronic money institutions operating in Latvia, *inter alia*, eight electronic money institutions with the rights to provide payment services (in total there were 36 payment institutions and 14 electronic money institutions registered).

In 2013 the total amount of payments performed by the payment institutions increased by 23.7% and reached 83.9 million lats (119.4 million euros), but the total amount of payments performed by electronic money institutions remained unchanged and comprised 24.5 million lats (34.9 million euros), whereas the total amount of electronic money in the circulation of these institutions decreased by 8%, reaching 1.2 million lats (1.8 million euros).

Supervisory measures of the payment institutions and electronic money institutions

Supervision of payment institutions and electronic money institutions in 2013 was performed mainly by means of performance results monitoring based on the analysis of financial statements, paying special attention to the total amount of payments performed by payment institutions and electronic money institutions and the average volumes of electronic money in circulation. Registered payment institutions and electronic money institutions are obliged to submit a report regarding liquid investments of the institution, in which the payment institutions reflect information about transactions commenced and accomplished by the institution, specifying the average arithmetic value of the payments performed within the previous 12 months, but electronic money institutions reflect the average volume of electronic money in circulation for the last six months.

During the reporting year on-site inspections were carried out in nine payment institutions and one electronic money institution. The purpose of the inspections was to assess the conformity of the operational model and management work of the payment institutions and electronic money institutions to the requirements of laws and regulations, especially to the requirements of the *Law on Payment Services and Electronic Money and Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing*.

In 2013 six administrative cases were initiated – against five payment institutions and one electronic money institution. In 2013, the FCMC applied the following sanctions to the payment institutions and electronic money institutions – restrictions were set for three payment institutions and one electronic money institution for the provision of payment services or issuance of electronic money, and to one payment institution, the FCMC had applied a fine in the amount of 10 thousand lats (14.2 thousand euros) for violations in the field of money laundering. In 2013 the registration in the FCMC Register of Payment Institutions and Electronic Money Institutions was annulled for three payment institutions.

In 2013 an on-site inspection was carried out in one credit institution registered in the Republic of Latvia, which ensured its customers (payment institutions and internet traders, accepting payment cards for the payment of their goods or services) with the services related to the acceptance of payment cards (*acquiring*).

Investment management companies and investment funds

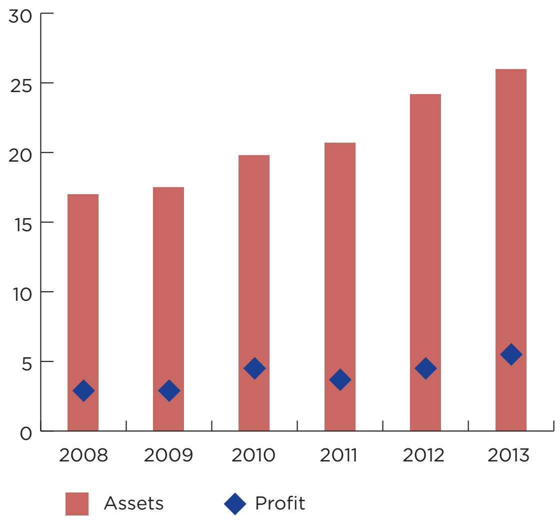
Performance indicators of the investment management companies and investment funds

At the end of 2013 there were 12 investment management companies operating in Latvia, managing 37 investment funds (28 open-end and nine closed-end funds).

In 2013 the investment management companies earned 5.5 million lats, i.e., by 23% more than in the previous year, which was triggered by the growth of commission income, through increasing the volume of funds under management of the companies. Their assets during the year grew by 7.6%, reaching 26 million lats at the end of the year.

In 2013 the assets of investment funds grew by 25.6%, reaching 292.9 million lats at the end of the year. Such an increase was mainly triggered by closed funds. The assets of the open-end investment funds during the year grew by 7.5%, reaching 148.6 million lats at the end of the year. Whereas, the assets of the closed funds during the year grew by 52%, reaching 144.3 million lats at the end of the year.

Image 9.
Assets and profit of investment management



companies (million LVL)

The events of 2013 largely affected the performance results of the investment funds, facing both ups and downs during the year. At the beginning of the year there was an expressly positive mood dominating in the financial markets, largely promoted by the decision of the US politicians regarding prevention of the *fiscal rock*, but the stress in financial markets was increased by events in Cyprus in the second half of the first quarter. Also overall, during the year, the investor concerns grew and fell from time to time in respect to the limitation of measures for stimulating the bank economy.

IN 2013 THE INVESTMENT MANAGEMENT COMPANIES EARNED 5.5 MILLION LATS, I.E., 23% MORE THAN IN THE PREVIOUS YEAR.

Open-end bond and money market funds

At the end of December of 2013 the three-month profitability[2] of the open ended bond and money market funds[3] ranged from minus 1.7% to plus 2.5% (11 out of 14 funds - positive), whereas the 12 months' profitability ranged from minus 6.8% to plus 3.0%

[2] Profitability is calculated as the changes in the value of the investment certificate for the reporting period in respect to the value of the fund investment certificate at the beginning of the reporting period, expressing it in percentage terms.

[3] The breakdown of investment funds corresponds to the breakdown of investment funds posted on the website of the Bank of Latvia according to investment policy: http://www.bank.lv/statistika/mfi-un-citu-finansu-starpnieku-saraksti/latvijas-republikas-ieguldijumu-fondu-saraksts.

(negative for five funds). Like in the previous quarter, a better performance was shown by those funds, which had a basic investment currency other than the US dollar, as it was impaired in respect to the lat both during the quarter, and during the year. The total investment portfolio of the open-end bond funds and money market funds at the end of December reached 125.1 million lats (178 million euros), growing by 6.1% over the year, which was mainly influenced by the establishment of three new bond funds.

Open-end mixed funds

As on 31 December 2013 the three-month profitability of the open-end mixed funds3 (three funds) was ranging from minus 0.3% to plus 1.7% (positive for two funds), whereas the 12-month profitability ranged from minus 4.0% to plus 2.1% (positive for two funds). At the end of December the total investment portfolio of these funds comprised 1.6 million lats (2.3 million euros), and over the year it decreased by 53%, which was influenced by the liquidation of two funds. The proportion of investment certificates grew and the proportion of cash funds and shares decreased in the mixed fund portfolio compared to the end of the previous year.

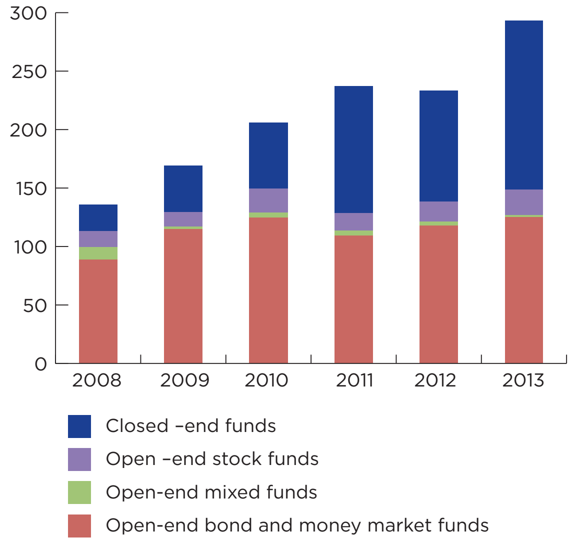
Open-end stock funds

The most considerable stock indices of the open-end stock funds3 over the year showed very different dynamics (RTS: -5.5%, Micex: +2%, Eurostoxx 50: +17.9%, S&P 500: +26.9%, OMXBBGI: +12.1%, KASE: -5.3%, UX: -4.3%), that is why the open-end stock funds showed quite different performances depending on the regional focus thereof. As on 31 December 2013 the three-month profitability of the open-end stock funds (eight funds) ranged from minus 0.7% to plus 5.9% (negative for three funds), whereas the 12-month profitability ranged from minus 19.9% to plus 9.1%, and it was positive for four funds. The proportion of the cash funds in the total open-end stock funds portfolio fell from 16.1% at the end of 2012 to 12.1% at the end of 2013, evidencing that the mood of fund managers became more optimistic than at the end of the previous year. At the end of December the total investment portfolio of those funds reached 21.9 million lats (31.2 million euros), growing by 30% over the year.

Closed-end funds

At the end of 2013 the portfolio of the closed-end funds reached 144 million lats (205 million euros) and grew by 52% over the year. At the end of December 72.8% of the resources of the closed-end funds were invested in Latvia, and, compared to the end of the previous year, the proportion of investments in Latvia had grown (at the end of 2012 – 69.6%).

Image 10.
Dynamics of the assets of investment funds (million LVL)



Supervisory measures of investment management companies and investment funds

During the reporting year, the FCMC carried out off-site supervision of investment management companies and investment funds to assess their financial standing, asset quality, structure of income and expenses and compliance of activities with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, as well as other laws and regulations.

The supervisors paid special attention to the conformity assessment of key investor information, as well as assessed whether the synthetic indicators[4] of the investment funds as indicated by investment complied with the profitability fluctuations of the funds.

[4] Synthetic indicator – indicator showing the fund risk category on the scale from 1 (lower profitability, usually lower risk) to 7 (higher profitability, usually higher risk), on the basis of indicators of the profitability fluctuations of the fund.

Also, more attention was paid to off-site analysis of the internal control system and internal audit of investment management companies.

The FCMC carried out a large exposure profile assessment of investment management companies and investment funds to plan future supervisory measures.

During the reporting year, additional measures were also ensured to verify the preparedness of investment management companies for the transition to the euro currency, performing enhanced monitoring and requiring information about system tests.

During the reporting year, the FCMC also carried out two on-site inspections of investment management companies. The inspections were aimed at assessing the material operating areas of those companies, their compliance with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, as well as other laws and regulations. During each inspection, particular attention was paid to the established internal control system and risk management by also assessing the appropriateness and applicability of the internal regulatory basis. During the inspections, the transparency of operations of the company and its compliance with the best practice principles, as well as the respecting of customer interests was also assessed. Concurrently, an inspection of operation of the holding banks of the investment funds was also carried out.

The weaknesses and inconsistencies uncovered during the inspections were discussed with company management and action plans for necessary corrections were agreed to ensure the successful functioning of the companies.

In one instance the FCMC also imposed a fine in the amount of 5 thousand lats (7.1 thousand euros) and set additional requirements in the field of internal control system.

Follow-up monitoring is carried out within off-site supervision by controlling the implementation of the action plan and, where necessary, suggesting the necessary corrections.

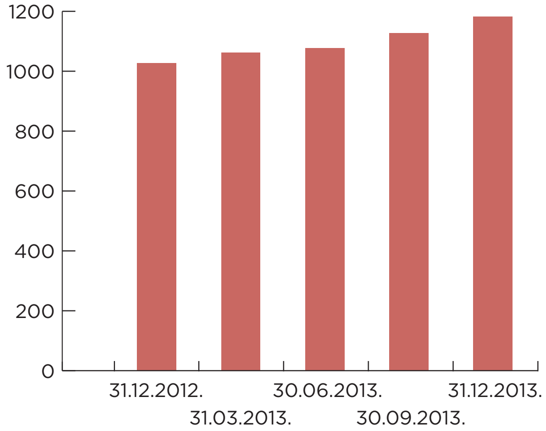
State-funded pension scheme

Performance indicators of the managers of assets of the state-funded private pension scheme

The pension capital growth accrued in the state-funded pension scheme or second level pension investment plans in 2013 was mainly triggered by the growth of employment and work remuneration of the employed, as well as the increase of the rate of contributions into the funded pension scheme from 2% to 4%.

In 2013, the number of participants grew by 31,037 participants, and at the end of the year 1,225,137 participants had joined the second level of the state-funded pension scheme,*inter alia*, 60% had joined under the compulsory procedure. Whereas the pension capital accrued in the investment plans, i.e. net assets of investment plans in 2013 grew by 15.1%, reaching 1.18 billion lats at the end of December. Over the year the number of investment plans offered by the managers of assets of the state-funded pension scheme reduced from 26 to 23, because separate companies carried out the consolidation of the investment plans with a similar investment strategy to optimise costs and reach better profitability indicators.

Image 11.
Pension capital accrued in the second level investment plans (million LVL)

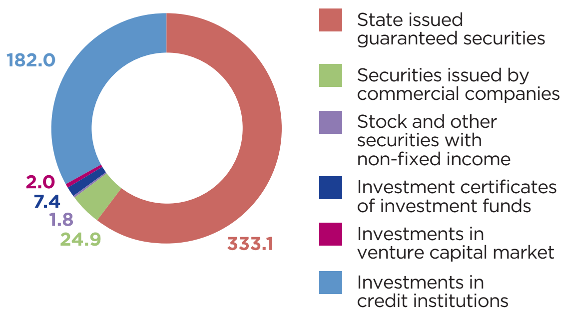


Along with the rise in stock markets in 2013 a better performance was also shown by the active plans (the average weighted profitability of the group of active plans comprised +3.3%, in the group of balanced plans +1.8%, in the group of conservative plans +0.2%). In 2013 the profitability of investment plans was much lower than in 2012, when it was expressly high after the fall in financial markets in 2011. Approximately 60% of participants had joined the active plans, where the risk of short-term changes of investment value is larger than in plans with more conservative investment policy. The proportion of participants who changed the investment plan was decreasing, showing that the participants were more satisfied with the selected plan. The number of participants who changed investment plans in 2013, reached 179 thousand, which was 18% less than in the previous year.

The amount of investments made in Latvia compared to the end of the previous year grew by 13.6%, reaching 46.5% of the total investments or 551.4 million lats (784.6 million euros) at the end of December (*inter alia*, 333.1 million lats were invested into state issued or guaranteed securities, 24.9 million lats – in debt securities issued by commercial companies, 1.8 million lats – in shares, 7.4 million lats – in investment funds, million lats – in Latvian venture capital market, but 182 million lats were placed in credit institutions). Whereas, 93% out of all investments in foreign countries were investments in other Member States of the European Union.

Image 12.

Investments of the second level pension plans in Latvia as on 31 December 2013 (million LVL)



Over the year the proportion of claims to demand and term-deposits in credit institutions decreased in the total investment portfolio of the investment plans, but the debt securities proportion, in turn grew, reaching 47.9% at the end of the year. The second largest proportion was that of the investment certificates of investment funds (35.6%).

Supervisory measures of the managers of assets of the state-funded pension scheme

In the reporting year, the off-site supervision of the managers of assets of the state-funded pension schemes (hereafter, also SFPS) was performed to assess the asset quality of the investment plans they managed, structure of income and expenses and compliance of activities with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, as well as other laws and regulations.

In the reporting year, one on-site inspection of the manager of assets of the SFPS was carried out. During the inspection, particular attention was paid to assessing the internal control system of the manager of assets, compliance of distribution of functions of the manager of assets with the established organisational structure, the decision-making and implementation of management decisions, appropriateness and applicability of the internal regulatory basis and the established reporting system. The FCMC paid particular attention to the attraction and use of outsourced services by assessing the control systems established by the asset manager to assess outsourced services. The performance of the asset holder was also assessed.

Weaknesses and inconsistencies detected during the inspections were discussed with the management of the asset manager of the SFPS and action plans were agreed for the improvement needed to ensure the successful functioning of the asset manager. Follow-up monitoring was carried out by the FCMC within the scope of off-site supervision by controlling the implementation of the action plan and, where necessary, suggesting the required corrections.

During off-site supervision in the reporting year the FCMC also assessed the critical situation (stress) analysis submitted by the asset managers of the SFPS for the investment portfolio of each investment plan. The identified risk drivers, assessed scenarios and expected activities in case of adverse scenarios were assessed.

While carrying out off-site supervision, the internal audit function of asset managers was assessed by assessing the internal audit plans and prepared opinions. Also, meetings were held with the management of asset managers to follow the more significant events in the activities of market participants and the fulfilment of business strategies in between on-site inspections.

The large-scale assessment of the risk portfolio of the SFPS investment plans was carried out to plan further supervisory measures.

In the reporting year, additional measures were also taken to verify the preparedness of asset managers of the SFPS for the transition to the euro currency, paying particular attention to the adaptation of the accounts of investment plans. Enhanced monitoring was carried out and information on system tests was requested.

In 2013, the FCMC's representatives visited the Estonian competent supervisory authority to get acquainted with the legal framework established in Estonia in the field of the state-funded pensions, as well as to inspect the applied supervisory tools, in order to assess the experience of the neighbouring country and perform a comparative analysis.

Representatives of the FCMC also participated in a working group that was assessing the potential changes in the procedure whereby the commission fee of asset managers was calculated and changes in restrictions on investments were also assessed.

Private pension funds

Performance indicators of the private pension funds

In 2013, the contributions of the participants of the pension third level reached a new historical maximum, which was triggered by the improvement of the economic situation of the population, the growth of awareness and interest in long-term investment products, as well as the possibility to get a tax refund; the impact of the introduction of the euro is also possible, like in the case with the rise in deposits.

Image 13.
Contributions into third level pension plans (million LVL)

At the end of 2013, there were six open-end pension funds and one closed-end pension fund operating in Latvia.

Over the year, 29 million lats were paid into the pension plans, or 37% more than during the respective period last year. Mainly, the contributions of participants of the pension plans continued to grow steeply (by 51%), while the employers' contributions increased only by 4%. At the end of 2013 the capital accrued in the pension plans comprised 165.6 million lats, increasing by 16.3% over the year.

During the year, 9.2 million lats were disbursed from the capital of pension plans or by 14.6% more than in the respective period last year,*inter alia*, the major part or 95% were disbursed in respect to the participants of the plans reaching the pension age.

Average profitability of pension funds in 2013 comprised 2.8% (in 2012 – 8.5%), and for individual plans it was ranging from minus 2.9% to plus 10.1%.

At the end of 2013 almost one half of the portfolio of pension funds was comprised of investment fund certificates (49%),*inter alia*, approximately one half consisted of certificates of the investment funds mainly investing into fixed income instruments, and 43% comprised the certificates of funds focusing on shares. At the end of 2013 one third of the portfolio consisted of investments into debt securities and other securities with fixed income (34%). Over the year the proportion of investment into debt securities grew and a slight rise was also observed in the proportion of deposits and claims against credit institutions.

The volume of investments made in Latvia grew, reaching 63.3 million lats or 38.2% of the total investments at the end of 2013. Whereas, 96.3% out of all investments in foreign countries were investments in other member countries of the European Economic Area.

At the end of the year the total number of participants who joined the private pension plans reached 220,646, i.e., 22% of economically active Latvian residents, or 13.4 thousand participants more than the year before.

Image 14.

Number of participants of the third level pension plans

Supervisory measures of private pension funds

In the reporting year, off-site supervision of private pension funds (hereafter, also pension fund) was carried out to assess the financial standing of pension funds, quality of pension plan assets, income and expenses structure and compliance of activities with the requirements of laws of the Republic of Latvia, FCMC regulations and guidelines and other laws and regulations.

In the reporting year, two on-site inspections of private pension funds were also carried out to assess the activities of the pension fund when carrying out the function set out in the *Law on Private Pension Funds*. During the inspections, particular attention was paid to the appropriateness and sustainability of the internal control system established by the pension fund and identification and management of material risks. Distribution of functions and compliance with the established organisational structure were analysed as well as the capacity of information exchange and the reporting system established by the pension fund to ensure sufficient and easily traceable information to internal and external users. In particular, attention was paid to choosing providers of outsourced services and using such services by assessing the control system established by the pension fund for assessing the outsourced services. The FCMC assessed the activities of both asset managers and asset holders. During the inspections, the FCMC also assessed the risk trends of the products offered by the pension funds.

Weaknesses and inconsistencies uncovered during the inspection were discussed with the management of the pension fund and action plans were agreed for the needed improvements to ensure successful functioning of the pension fund. Follow-up monitoring was carried out within off-site supervision by controlling the implementation of the action plan and, where necessary, suggesting the necessary corrections.

When carrying out off-site supervision, the FCMC also assessed the stress scenario analysis submitted by pension funds for the investment portfolio of each pension plan. The identified risk drivers, assessed scenarios and expected actions in the case of adverse scenarios were assessed.

Within the scope of off-site supervision in the reporting year the functioning of the internal audit of the private pension funds was also assessed, assessing the internal audit plans and prepared opinions.

To plan further supervisory measures, the large exposure profile assessment of the pension plans of the private pension funds was also carried out.

In the reporting year, additional measures were also taken to verify the preparedness of the private pension funds for the transition to the euro currency, paying particular attention to the adaptation of the accounts of pension plans. Enhanced monitoring was carried out and information on system tests was requested.

In the reporting active work was carried out in the area of pension fund supervision in committees at the European level. FCMC representatives participated actively in the work of the European Insurance and Occupational Pensions Authority in the area of pension fund supervision and also of the Occupational Pensions Committee that dealt with topical pension fund supervision issues at the European level. One FCMC staff member started working in the OPC SG "*Costs and Charges applicable to IORPs*" as the head of the working group. Active participation in the EIOPA *Task Force on Personal Pensions* was also taking place.

Investment service providers

Performance indicators of investment service providers

At the end of the reporting period the rights to provide investment services in Latvia were held by four investment brokerage firms licensed in Latvia, 17 banks registered in Latvia, who had obtained the corresponding permit, 12 investment management companies registered in Latvia and having a corresponding licence. Also one branch of a foreign investment brokerage firm, six branches of foreign banks, as well as over 1,600 investment service providers from the countries of the European Economic Area were entitled to provide investment services according to the freedom to provide services.

In 2013 four investment brokerage firms in total earned 2.8 million lats or 4 million euros,*inter alia*, all investment brokerage companies operated at a profit (in 2012 the profit reached 1.5 million lats). 96% of all income of investment brokerage firms consisted of income from commission fees, and other similar income for the services rendered to customers, whereas administrative expenses comprised the most significant expenses item (53.2%).

In 2013, two investment brokerage firms were still engaged in the holding of financial instruments of the customers, which is prescribed by the licences granted to them for the performance of investment non-core services, but no customer assets were delivered into the management of any of the companies during the reporting year, even though two investment brokerage firms had licences for the individual management of investors' financial instruments.

The amount of monetary funds of the customers held by the brokerage firms for the performance of transactions in financial instruments reached 3.6 million lats at the end of the reporting year (at the end of 2012 – 1.9 million lats).

At the end of 2013, the capital adequacy indicator of investment brokerage firms comprised 23.3% (at the end of 2012 – 24.6%) (minimum capital adequacy requirement – 8%).

Supervisory measures of investment service providers

In 2013, in the field of the provision of investment services the FCMC carried out four on-site inspections in the banks (two planned and two targeted inspections) and two inspections in the investment brokerage firms (one planned and one targeted inspection). Targeted inspections were mainly carried out in response to customer complaints and also to ensure that the obligations set by the FCMC were fulfilled. During the inspections, the FCMC assessed the compliance of the provided investment services with the requirements of laws and regulations, for example, disclosing information to the customer about financial instruments and risks pertaining thereto, ensuring the customers with the best result, the determination of the suitability and appropriateness of an investment service to the customer's knowledge, experience, investment objective and financial ability to assume a particular risk. FCMC's experts also assessed the topicality of internal processes and documents of investment service providers and their compliance with the requirements of legal acts.

By streamlining the principles of supervision of the financial service providers and caring about the protection of customer interests, the FCMC in 2013, in general, also performed six mystery customer visits to verify how the financial and capital market participants complied with the requirements of laws and regulations in the field of investment services. These inspections were mainly focussed on how and what kind of information had bee provided to customers regarding investing in financial instruments,inter alia, information about risks and costs. Mystery shopping is one of the most efficient ways of how to get to know the actual course of provision of the service. It provides that the inspector does not disclose his/her identity, but as a regular customer uses the services provided by the market participants, paying attention to examining particular issues and tasks.

In 2013, on the whole, sanctions were imposed on five financial and capital market participants for violations in the field of the provision of investment services. Four banks had a fine imposed in the total amount of 92.5 thousand lats (131.6 thousand euros) and the licence for the provision of investment services was annulled for one investment brokerage firm.

The FCMC continued the commenced tradition and held seminars, as well as question and answer sessions to the providers of investment services on topical issues in view of the observations made during the supervision process.

Financial instruments market

Activities and supervisory measures of issuers of the financial instruments admitted to trading on the regulated market

At the end of the reporting year, JSC "NASDAQ OMX Riga" (Stock Exchange) was operating in Latvia as the only regulated market. At the end of the year, shares of JSC 'Liepājas metalurgs" were excluded from the Stock Exchange and at the end of the year shares of 30 issuers were listed on the Stock Exchange. The listing of debt securities included seven issuers for a total of 48 various debt security issues: Latvian government debt securities (25), corporate debt securities and bonds (23).

The FCMC followed whether issuers disclosed information in a timely manner and in compliance with requirements of the Law on the Financial Instruments Market on a regular basis, in line with the provisions of the Law on the Financial Instruments Market. In 2013, when detecting violations and after considering the essence of the violations, in seven cases the FCMC required that issuers took measures to eliminate the weaknesses in disclosing mandatory information in the future, and instituted two administrative processes for violations in disclosing mandatory information, and, as a result, issued respective administrative rulings by expressing a warning to an issuer and in one instance imposing a legal obligation to disclose information prescribed by law within the set term.

Trading in financial instruments

On JSC "NASDAQ OMX Riga", the regulated market of Latvia, after a decrease in 2012 the increase in stock market trading activity was again evident in 2013. In comparison with 2012, in 2013 the total number of transactions in the stock market increased by 8.3% and the number of traded shares increased by 30.6%, whereas the total turnover in the share market in 2013 was 15.2 million lats (21.6 million euros), which was 31.1% more than in 2012. At the end of 2013, the stock market capitalisation of JSC"NASDAQ OMX Riga", compared to the end of 2012, had increased by 12.6% and comprised 666.2 million lats (948 million euros).

To promote the sound operation of the financial instruments market, the FCMC monitored, on an on-going basis, the trading in financial instruments by following and analysing the tasks submitted to the Stock Exchange and the transactions carried out therein to identify and prevent market manipulation and features of insider dealing. In two cases for possible insider dealing or disclosure of internal information the FCMC sent information to the Police for assessment and the adoption of a decision regarding the initiation of criminal proceedings. In two cases the FCMC warned the investors and requested them to terminate action, which might mislead other investors regarding the share price, demand and supply.

When inspecting whether the persons listed as the holders of insider information had complied with the requirement of the Law on the Financial Instruments Market on filing notification to the FCMC on performed transactions, as well as whether the persons, in line with the Law on the Financial Instruments Market, notified regarding the acquisition or loss of a qualifying holding, in 2013, the FCMC instituted the administrative process in two cases, as a result of which a warning was issued to two persons. In other cases when minor weakness or inaccuracies were detected, instead of instituting administrative processes, the FCMC made a reprimand to the persons not to allow for weaknesses in future. In one case the FCMC adopted the decision, gave a warning to one person, regarding the failure of the said person to cooperate and submit timely information to the FCMC.

Security of financial services and information systems

In 2013, the FCMC continued to improve the processes of the supervision of the security of information systems. Over the reporting year, 10 on-site audits of the security of information systems were carried out in the banks and insurance companies, as well as five inspections related to the supervision of payment institutions.

IN 2013 15 ON-SITE AUDITS OF SECURITY OF INFORMATION SYSTEMS WERE CARRIED OUT.

Overall in the reporting year, particular attention was paid to the following aspects of information system security:

- use of outsourced services of information systems;
- secure use of remote services;
- managing security incidents of information systems;
- security of use of portable equipment.

The year 2013 was the second year when the FCMC processed the security incidents of information systems of market participants in detail. As a result of the process the topical risks were identified and the processes of incident management of the market participants were improved.

THE LARGEST FINE FOR DETECTED WEAKNESSES IN THE FIELD OF PREVENTING MONEY LAUNDERING IN 2013 – 100,000 LATS ON TWO BANKS.

Together with the experts of the Bank of Latvia, the FCMC continued to take part in the Payment Security Forum of the European Central Bank (*SecuRe Pay*). In 2013 the forum developed the guidelines for the assessment of the observance of internet payment recommendations. In view of these recommendations, the FCMC is planning to introduce amendments to the regulation of information systems security in 2014.

The FCMC maintained close cooperation with the authority for the prevention of security incidents of information technologies CERT.LV.

Preventing money laundering

To assess the compliance of participants of the financial and capital market with the requirements of the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing*, in 2013 the FCMC carried out 14 on-site inspections in banks and five inspections related to the supervision of payment institutions. In 2013, the FCMC carried out six off-site inspections (including assessment of procedures) in credit institutions and thirty five inspections (assessment of procedures) in financial institutions, of which eight inspections were related to the supervision of electronic money institutions, seventeen inspections – payment institutions, two – investment brokerage firms and eight – insurance intermediaries rendering life insurance services.

During the performed inspections, the FCMC detected several cases when the credit institutions and financial institutions failed to comply with the requirements of laws and regulations. As a sanction, the FCMC imposed a fine for the failure to observe the said requirements four times on credit institutions and one time on the payment institution, as well as suspended the provision of payment services in one payment institution. The largest fine for detected weaknesses in the field of preventing money laundering in 2013 – 100,000 lats on two banks. In turn, in one case, in view of the nature of the violation and observing the principle of commensurability, instead of the imposition of a sanction for the violation, a corrective measure was imposed on one credit institution – the obligation to improve the internal control system of a credit institution.

During 2013, for information exchange purposes, the FCMC received 26 information requests from foreign supervisory authorities of the financial and capital market, of which 13 were received from Russia, six – from the USA, five – from Germany, as well as one each from Bulgaria and Malta. The FCMC, in turn, sent 12 information requests to supervisory authorities of foreign countries – three to Lithuania, five to Estonia and one each to Cyprus, Great Britain, Switzerland and Australia.

In the framework of on-going cooperation with the Central Bank of the Russian Federation, during 2013 a meeting was organised in Moscow during which opinions were exchanged, as well as further cooperation in the field of the prevention of money laundering was discussed.

In the issues of prevention of money laundering, in 2013 the FCMC's representatives continued their participation in the activities of the European Commission's (EC) Committee for the Prevention of Money laundering and Terrorist Financing, and in the work of the sub-committee – Anti-Money Laundering Committee of the joint committee of the three EU supervisory authorities (European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA)). In 2013, the FCMC's representatives participated in the work of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures of the Council of Europe *MONEYVAL*.

In accordance with the FCMC's register of unusual and suspicious financial transactions, in 2013 the FCMC sent eighteen reports to the Office for the Prevention of laundering of Proceeds Derived from Criminal Activity.

THE AMOUNT OF FUNDS RECOVERED BY THE ADMINISTRATOR OF THE LIQUIDATED JSC "LATVIJAS KRĀJBANKA" ENSURED THE REPAYMENT OF THE LOAN GRANTED TO THE DEPOSIT GUARANTEE FUND BY THE TREASURY TO A FULL EXTENT AT THE BEGINNING OF 2014.

Supervision of the activities of the administrator of the liquidated JSC "Latvijas Krājbanka" in 2013

In accordance with Paragraph 4, Section 154 of the Credit Institution Law the FCMC is entitled to control the activities of the insolvency process administrator. For this purpose, the authorised representative of the FCMC is entitled to become acquainted with all the documentation of a credit institution and of the administrator, which is related to the bank, as well as to receive the explanations and any other necessary information from the administrator, which is associated with the insolvency proceedings of the credit institution.

For the FCMC to exercise the rights vested to it by the Credit Institution Law, the administrator of the liquidated JSC "Latvijas Krājbanka" (LKB) SIA "KPMG Baltics" submitted information to the FCMC on a monthly basis about the most significant liquidation processes – asset recovery and realisation, creditor claims, litigations, cooperation with the major customers of the LKB, staff-related and other issues. In 2013 the LKB administrator recovered funds in the amount of 46.8 million lats, which were mainly comprised of money from recovered credits, the sale of real estate and movable property. In turn, the expenses of the insolvency procedure comprised 7.6 million lats, including the remuneration of the LKB administrator in the amount of 2.3 million lats.

The established group of proxies of the FCMC continued its work, exercising the off-site supervision of the administrator – analysed the LKB administrator performance reports and submitted a monthly statement about them to the FCMC management, as well as solved topical issues in respect to the activities of the LKB administrator.

In 2013, the FCMC gave its consent to the transfer of the LKB Company – largest portfolios – into the ownership of SIA "B2 Kapital" and SIA "Baltics Credit Solutions Latvia".

Riga Regional Court reviewed six complaints regarding the activities of the LKB administrator. The court found all of the complaints as unsubstantiated.

In general, the FCMC assesses the work of the LKB administrator in 2013 positively. The LKB administrator had acted in the interests of creditors, ensuring the lawful and efficient course of the insolvency proceedings of the LKB. The amount of funds recovered by the LKB administrator ensured the repayment of the loan granted to the Deposit Guarantee Fund by the Treasury to a full extent at the beginning of 2014. The Treasury lent 185.6 million lats to the Deposit Guarantee Fund for repayment of the guaranteed compensation.

LICENSING

In 2013 changes were observed in all segments of the financial market.

Last year three banks announced termination of activities of the credit institution in the Latvian market: In October, upon the request of AS "GE Money Bank", the FCMC annulled the licence issued to it for the activities of a credit institution and approved the reorganisation of the bank into another commercial company not related to the activities of a credit institution, whereas the licences of AS "UniCredit Bank" and VAS "Latvijas Hipotēku un zemes banka" were annulled starting from 1 January 2014. The refusal of the licence was also prescribed by the strategy of the shareholders of AS "UniCredit Bank", and, having terminated the activities of a credit institution, the company focussed on the provision of leasing services, by a merger with SIA "UniCredit Leasing". VAS "Latvijas Hipotēku un zemes banka", in turn, was reorganised into a development financial institution.

Thus, at the end of 2013, there were 19 banks and nine branches of the EU Member State banks operating in Latvia. Comparing the number of banks in the Baltic States, the banking sector in Latvia still holds the leading position – in Latvia there are almost as many banks as in Lithuania and Estonia put together. There are eight banks and nine branches of the EU Member State banks operating in both Estonia and Lithuania.

The number of cooperative credit unions grew to 35 companies, as the licence for activities was also received by the cooperative credit union of Kekava Municipality.

The year 2013 also introduced corrections in the insurance market, as the number of insurance companies reduced from nine to seven over the year, after the annulment of the licences of AAS "Balva" and AAS "ERGO Latvija". Nevertheless, in view of the decision of AAS "ERGO Latvija" to join *ERGO Insurance SE*, by way of cross-border reorganisation, the insurance company continued working in compliance with the licences of *ERGO Insurance SE* issued in Estonia after the annulment of the licences issued by the FCMC.

Changes in the number of licensed market participants in 2013 are aggregated in the table below.

Table 1.
Changes in the number of licensed market participants in 2013.

	AS AT THE BEGINNING OF 2013	AS AT THE END OF 2013	NEW MARKET PARTICIPANTS IN 2013
Banks	20	19	-1[5]
Branches of the EU Member State banks	9	9	0
Cooperative credit unions	34	35	+1[6]
Providers of banking services from the EEA	285	301 (-2 companies)	+18
Insurance companies	9	7	-2[7]
Branches of the EU Member State insurers	13	13	0
Providers of insurance services from the EEA	485	491 (-20 companies)	+26
Investment management companies	14	12	-2[8]
Providers of investment management services from the EEA	22	22	0
Investment brokerage firms	5	4	-1[9]
Branches of investment brokerage firms of the EU Member States	1	1	0
Providers of investment brokerage services from the EEA	1693	1808 (-81 companies)	+196
Tied agents of providers of investment services from the EEA	16	19 (-1)	+4
Private pension funds	7	7	0
Insurance brokerage firms	86	88 (cancelled – 8)	+11[10]
Insurance agents	591	539 (cancelled – 92)	+31
Providers of payment services from the EEA	134	189 (-2 companies)	+57
Payment institutions (registered)	34	36 (3 cancelled entries in the register)	+5[11]
Electronic money institutions (registered)	14	14 (1 cancelled entry in the register)	+1[12]
Electronic money institutions from the EEA	26	40	+14

[5] Banks:
AS "GE Money Bank" - on 24 October 2013 the FCMC adopted a decision to cancel the credit institution operating licence starting from 28 October 2013.
It is important to note for AS "UniCredit Bank" on 12 December 2013 the FCMC adopted the decision to cancel the credit institution operating licence starting from1 January 2014 and for VAS "Latvijas Hipotēku un zemes banka" on 19 December 2013 adopted the decision to cancel the credit institution operating licence starting from 1 January 2014.

[6] Cooperative savings and loan companies:
On 7 August 2013 the FCMC issued a credit union operating licence to the cooperative credit union of Kekava Municipality.
[7] Insurance companies:
On 31 January 2013 the FCMC cancelled all credit union operating licences granted to the performance of insurance for AAS "ERGO Latvija".
On 13 June 2013 the FCMC cancelled all operating licences issued to the insurer AAS "Balva".
[8] Investment management companies:
On 26 April 2013 the FCMC adopted the decision "Re: Commencement of the Liquidation Procedure of the Joint Stock Company "IPS Norvik Alternative Investments" and Cancellation of the Operating Licence for the Performance of Investment Management Services."
On 7 June 2013 the FCMC adopted the decision "Re: Commencement of the Liquidation Procedure of the Joint Stock Company Investment Management Company "Baltikums Asset Management" and Cancellation of the Operating Licence for the Performance of Investment Management Services".
[9] Investment brokerage firms:
On 1 April 2013 the FCMC cancelled the operating licence for the provision of investment services and investment non-core services for SIA IBS REAL TRADE.

[10] Insurance brokers:
In 2013 the following insurance brokerage firms were registered in the register of insurance and reinsurance intermediaries:
SIA "MONEY EXPRESS BROKERIS" – on 7 January 2013;
SIA "North Commodities Insurance Group" – on 9 April 2013;
SIA "Marine Underwriting Services" – on 21 May 2013;
SIA "ITF Group" – on 22 May 2013;
SIA "BB BROKER SYSTEMS" – on 8 August 2013;
SIA "Amserv Financial Services" – on 22 August 2013;
SIA "RD AB" – on 27 September 2013;
SIA "RC7 Brokeri" – on 9 October 2013;
SIA "Investment Broker" – on 16 October 2013;
SIA "Maximus brokers" – on 24 October 2013;
SIA "KOREN" – on 5 December 2013.
[11] Payment institutions:
In 2013 the following payment institutions were registered:
SIA "TransferMoney" – on 10 April 2013;
SIA "Ecommpay" – on 9 May 2013;
SIA "Nextpay" – on 16 May 2013;
SIA "QRPay" – on 11 September 2013;
SIA "Quinto Finance" – on 22 November 2013.
The FCMC cancelled the entries in the payment institutions register for the following payment institutions:
SIA "Maiden" – on 15 February 2013;
SIA "Delator" – on 6 December 2013;
SIA "E kredīts" – on 19 December 2013.
[12] Electronic money institutions:
On 30 January 2013 the FCMC registered the electronic payment institution SIA "Rīgas Karte".
On 7 March 2013 the FCMC cancelled the entry in the e-money institutions register regarding SIA "E-karte".

DEVELOPMENT OF LAWS AND REGULATIONS

National legislation

CRDIV/CRR

In 2013 the European Union was still at a significant stage of financial sector regulatory reform, aimed at preventing the weaknesses spotlighted by the crisis and the strengthening of the financial system. On 26 June 2013, Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (Directive 2013/36/EU) and Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (Regulation No. 575/2013) were approved, implementing the *Basel III* requirements in the EU. The recent financial crisis showed that the microsupervision is not sufficient for the mitigation (prevention) of cyclical and structural (systemic) risks, therewith Directive 2013/36/ES implements the macroprudential supervision, prescribing the performance of appropriate measures in the case of the increase of cyclical or structural systemic risks. In such cases the countercyclical capital buffer, systemic risk buffer, requirements for capital reserves of systemically important institutions or increased minimum capital and liquidity requirements may be applied, as well as more stringent limits to large exposures or

ACTIVE PREPARATION WAS CONTINUING FOR THE FINANCIAL SECTOR REGULATORY REFORM *BASEL III* AND *SOLVENCY II*.

information disclosure requirements may be determined.

To ensure the application of the harmonised regulation in the EU and promote the development of a single financial services market, the majority of prudential requirements are prescribed by Regulation No. 575/2013, which is the directly applicable EU legal act (see Image 15).

Image 15.
BASEL III IN THE EU LEGISLATION

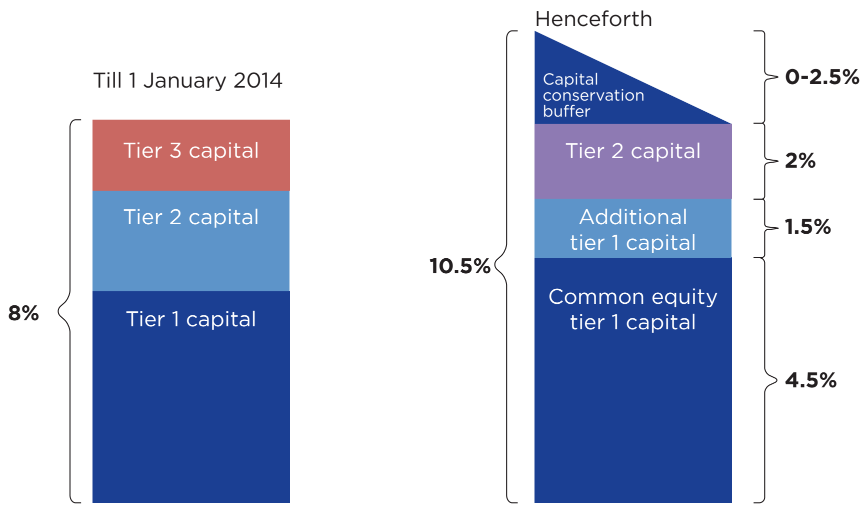
	Before	Henceforth	
- CRD IV (Directive 2013/36/EU) is transposed in the Credit Institution Law (CIL) and FCMC regulations **- CRR** (regulation No. 575/2013) is directly applicable, except for national discretions and transitional provisions	**CRD I-III**	**CRD IV**	**CRR**
Licensing	•	•	
Regulatory requirements:	•		•
- capital adequacy	•		•
- large exposure limits	•		•
- qualifying holding in a non-financial sector	•		•
Capital buffer requirements		•	
Liquidity regulation			•
Leverage ratio			•
Consolidated supervision	•	partially	partially
Pillar II	•	•	
Pillar III	•	partially	partially

To introduce the legal provisions prescribed by Directive 2013/36/EU into Latvian law, two draft laws are developed – ***Amendments to the Credit Institution Law and Amendments to the Financial Instrument Market Law*** (Draft Laws). Draft Laws state the following:

- to exclude those norms, which are prescribed by Regulation No. 575/2013 (capital adequacy requirements, limits on large exposures, restrictions for a qualifying holding in the non-financial undertakings and terminology related to the prudential requirements of credit institutions and investment brokerage firms);
- to adjust and expand the supervisory powers and duties;
- to set requirements for institutions (credit institutions and investment brokerage firms) to develop the recovery plans and the FCMC obligation to develop the resolution plans for institutions;
- to increase the penalties for breach of the Credit Institution Law on the Financial Instrument Market Law, regulations arising out of them and Regulation No. 575/2013, as well as the obligation and rights of the FCMC to publish the imposed penalties on the website of the FCMC;
- to introduce capital buffer requirements: capital conservation buffer, countercyclical capital buffer, a globally systemically important institution buffer, an other systemically important institution buffer, systemic risk buffer and the combined buffer requirement arising out of these reserves. By exercising the rights given to the Member States by Directive 2013/36/EU, it is planned to introduce the capital conservation buffer in full extent (2.5%) in 2014, after the coming into effect of the amendments to the Credit Institution Law (see Image 16);

- to state the restrictions of the distribution of elements included in the common equity tier 1 capital, if the institution fails to observe the combined buffer requirements, for example, by restricting or prohibiting to perform dividend distribution, purchise or redemption of own shares or other instruments of the common equity tier 1 capital, distribution of elements included in the common equity tier 1 capital;
- to appoint the FCMC as the authority in charge of the determination and revision of capital buffer requirements.

Image 16.
Minimum capital adequacy indicators and capital conservation buffer



To harmonise Regulation No. 575/2013 with the regulations of Latvia, in 2013 the FCMC approved new regulations, introduced amendments to ten regulations and cancelled six regulations. The most significant of them are as follows:

"Regulations on the Application of National Discretions and Transitional Provisions Provided for by Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulations (EU) No. 648/2012", stating the application of national discretions and transitional provisions provided for by Regulation No. 575/2013 in the republic of Latvia, inter alia, in respect to capital adequacy calculation; applicable risk weight to exposures secured by commercial property, when calculating capital requirement for credit risk; limits on large exposures; and the application of liquidity requirements to investment brokerage firms.

Solvency II

In 2013, the FCMC organised a quantitative impact assessment, with the purpose of obtaining information to assess the possible impact on the insurance market, if the conditions contained in *Solvency II* which will take effect in 2016would be applied in the capital adequacy assessment of insurance companies. All insurance companies took part in the impact assessment. Data submitted by the insurance companies show that the industry should pay increased attention to the fulfilment of the capital requirement in the *Solvency II* regime. By participating in the quantitative impact assessment, the companies had the possibility to timely identify the areas where improvements are needed, as well as to assess its activities, in order to mitigate risks in future, which affect the solvency capital requirement.

To ensure the gradual implementation of the *Solvency II* regime, in 2014 the FCMC plans to introduce the EIOPA *Solvency II Preparatory Guidelines* in respect to the governance system, own risk and solvency assessment, preparation of the preparatory period statements and pre-application process of internal models. In 2014 the work will continue on the draft Insurance and reinsurance Law, in order to implement the requirements of *Solvency II* and *Omnibus II* in national laws by 31 March 2015.

Law on Alternative Investment Funds and Their Managers

On 9 July 2013 the Saeima adopted, and on 7 August the law on Alternative Investment Funds and Their Managers took effect, which contains legal provisions arising out of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and on amendments to Directive 2003/41/EC, Directive 2009/65/EK, Regulation (EC) No. 1060/2009 and Regulation (EC) No. 1095/2010. The purpose of the Law is to promote the stability and development of the financial system, preventing the impacts on the financial system of the probable risks related to the activities of alternative investment fund (AIF) managers, as well as to ensure efficient cooperation between the supervisory authorities within the supervision and mitigation of these risks.

By this law a single legal framework will be introduced for those financial market participants who provide fund management services in compliance with the provisions of the EU directive. The Law applies to investment management companies managing closed-end investment funds, as well as venture capital fund managers, the activities whereof up to now were not subject to FCMC supervision. The Law prescribes to state to all AIF managers, according to whether the manager would be registered or licensed, the regulatory requirements of their activities, responsibility and supervision, as well as uniform requirements for the disclosure of information to investors. The registered manager, whose activities are subject to preferential requirements, will only be allowed to provide AIF management services in Latvia. If the AIF assets managed by the manager exceed the thresholds of the amount of assets set for a registered manager or the manager is willing to operate outside Latvia, but within the scope of the EU, the AIF manager needs to obtain a licence. The Law provides for the possibility to establish alternative investment fund, not only as an unit trusts, but also as a legal entity, as well as to establish an open-end AIF.

The most important new regulations

In 2013, the FCMC approved amendments to several FCMC regulations to adapt them to the introduction of the euro.

The FCMC also continued to streamline the regulatory framework of the financial and capital market participants, on the basis of the guidelines of the EU authorities, best international practice and taking into account the specificity of the Latvian financial sector. The most significant of the prepared regulations are as follows:

"Regulations on the preparation and Submission of Information about the Occurrence of Events of Operational Risk", developed to ensure the information necessary for the supervisory needs of the FCMC regarding the occurrence of events of operational risk.

Taking into account the *Guidelines on the assessment of the suitability of members of the management body and key function holders* adopted by the European Banking Authority on 22 November 2012, there are **"Recommendations for the Assessment of the Suitability of the Board and Council Members and Persons Performing Core Functions"** developed, stating criteria and processes recommended to be observed by the institutions, when assessing the elected (appointed) Board and Council members and persons performing core functions in the credit institution (employees, whose job position gives them the possibility to considerably influence the direction of activities of the credit institution, but who are not Council or Board members, for example, the head of the internal audit service or risk director).

To ensure implementation in the Latvian regulations the requirements set by *Guidelines for competent authorities and UCITS management companies on ETF's and other UCITS issues* (ESMA/2012/832) issued by the European Securities and Markets Authority, **"Regulatsions on Requirements for Investment Objects of Investment Funds, Transactions and Funds of Certain Type of Activities"** are developed, which are applicable to the companies when establishing and managing investment funds in Latvia. The provisions state the requirements for investment objects of investment funds and transactions performed by investment management company on behalf of the fund, funds that replicate the composition of securities index, index- tracking funds , index- tracking leveraged funds, exchange-traded funds, as well as requirements for the disclosure of information in the fund prospectus, key investor information and other marketing communications regarding the mentioned funds and transactions.

In 2013, active work was continued on regulatory and implementing technical standards adjusting and supplementing the requirements of Regulation No. 575/2013. In view of the trend to state a considerable part of the regulatory framework in Regulations, the FCMC employees took an active part in the development of the draft EU legal acts.

The EU directives and regulations adopted in 2013

Regulation (EU) No. 345/2013 of the European Parliament and of the Council of 17 April 2013 ***on European Venture Capital Funds*** *and Regulation (EU) No. 346/2013 of the European Parliament and of the Council of 17 April 2013* ***on European Social Entrepreneurship Funds.***

The Regulations set out which alternative investment funds may qualify as European Venture Capital Funds (EVCF) and European Social Entrepreneurship Funds (ESEF) and will be entitled to use that name. Regulations are addressed to the managers of the EVCF and ESEF that are registered with the competent authority in accordance with the requirements of *Directive 2011/61/EC on Alternative Investment Fund Managers* and whose asset management does not exceed the threshold of 500 million euros. The registration of such funds will entitle them to trade investment units of EVCF and ESEF in all Member States.

Requirements of the regulations are applicable from 22 July 2013.

Directive 2013/14/EU of the European Parliament and of the Council of 21 May 2013 amending Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision, Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers in respect of ***over-reliance on credit ratings.***

The Directive provides for the introduction of requirements to the investment management company and alternative investment fund manager, as well as the pension fund manager, to not only rely upon external ratings when assessing the credit quality, but to use them as one of the factors in this process.

The Directive took effect on 10 June 2013, and its requirements should be transposed into the laws and regulations of the Member States by 21 December 2014.

Regulation (EU) No. 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No. 1060/2009 ***on credit rating agencies***.

The Regulation establishes the requirement for certain financial institutions to carry out the credit risk assessment themselves to prevent overreliance on the ratings assigned by credit rating agencies, improves the provisions for disclosing credit rating methodology to the public and introduces stricter provisions for assigning the sovereign credit rating.

The Regulation took effect on 10 June 2013.

Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 ***on prudential requirements for credit institutions and investment firms****, and amending Regulation (EU) No. 648/2012 (incl. CRR) and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on* ***access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms****, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC* (incl. CRD IV)

Regulation No. 575/2013 and Directive 2013/36/EU provides higher equity capital quality and amount requirements, introducing several new capital adequacy ratios and stating higher requirements for the level of capital adequacy ratios, concurrently providing for the possibility of the Member States to state higher requirements for capital adequacy ratios without the transitional period, i.e. from 1 January 2014. Regulations introduce two new minimum quantitative standards for liquidity management – liquidity coverage ratio for regulating short-term liquidity and stable funding ratio for regulating long-term liquidity – as well as other requirements.

The requirements of the Directive and Regulation are applicable as of 1 January 2014. In addition, in 2013, the EC approved the implementing regulation, stating the technical standards for implementation in respect to the disclosure of information about the equity requirements set for the institutions.

Council Regulation (EU) No. 1024/2013 of 15 October 2013 ***conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions*** *and Regulation (EU) No. 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the* ***conferral of specific tasks on the European Central Bank*** *pursuant to Council Regulation (EU) No. 1024/2013.*

The Regulation is aimed at establishing a single supervisory mechanism in Europe, to be formed by the ECB and the national supervisory authorities. The ECB will be responsible for the overall functioning of the single supervisory mechanism and will have a key role in the supervision of the credit institutions of the Eurozone countries, whereas the supervision will be implemented in a differentiated manner. The mechanism prescribes, on the basis of certain criteria – the size of the credit institution, its relative importance in the economy-, singling out those credit institutions that are subject to the direct supervision of the ECB, while national supervisory authorities will have a more significant role in their supervision, retaining the possibility that any credit institution may be subject to the direct supervision of the ECB. In any case, at least three of the major most important credit institutions of the country involved in the mechanism must be supervised by the ECB. While the mechanism respects the specific circumstances of the Member States, the structure of the sector and other characteristics, it also ensures a sound basis enabling the ECB to implement its tasks and be actually and efficiently responsible for the overall functioning of the single supervisory mechanism as a system. Out of all 6,000 Eurozone banks, according to the approved criteria, approximately 130 banks will be subject to the direct supervision of ECB. In addition to this Regulation, in 2013, ECB worked on the draft framework regulation stating the cooperation mechanism between the ECB and the national supervisory authorities.

These Regulations took effect, accordingly, from 20 October and 23 October 2013. The single supervisory mechanism will take effect to a full extent from 4 November 2014.

Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European parliament and of the Council on the ***harmonisation of transparency requirements in respect to information about issuers*** *whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down rules for the implementation of certain provisions of Directive 2004/109/EC.*

The Directive provides for reducing the administrative burden for issuers, cancelling the requirements to publish the interim management reports, as well as restricts the rights of the Member States to impose requirements in addition to those prescribed by the Directive, for example, requirements to publish quarterly statements. The proposal adjusts the range of financial instruments, which are subject to reporting requirements, states more harmonised requirements for notifying qualifying holding, as well as provides for streamlining the officially recognised information storage system tool.

The Directive took effect on 11 November 2013, and its requirements are to be transposed in the national legal acts by 11 November 2015.

Directive 2013/58/EU of the European Parliament and of the Council of 11 December 2013 ***amending Directive 2009/138/EC (Solvency II) as regards the date for its transposition and the date of its application****, **and the date of repeal of certain Directives (Solvency I).***

The Directive amends Directive 2009/138/EC, by postponing the date of transposition from 30 June 2013 till 31 March 2012 and the date of application from 1 January 2014 till 1 January 2016.

At the same time, in 2013 several **regulations on implementation and delegation thereof to to the European Commission** are adopted, stating technical standards for the application of separate previously adopted EU legal provisions, *inter alia*, four delegated and implementation regulations in respect to short selling and certain credit risk swaps aspects, two regulations in respect to information contained in the prospectus, one delegated regulation in respect to the credit rating agencies, twelve regulations in respect to OTC derivative instruments, central counterparties and trade repositaries, as well as three delegated and implementation legal acts in respect to the alternative investment fund managers (http://www.fktk.lv/lv/tiesibu_akti/).

Proposals published by the EC in 2013

Credit institutions and payment services sector

Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council.

The proposal, similar to the proposal for a Directive establishing the recovery and resolution regime for credit institutions and investment companies, is mainly aimed at reducing the losses of depositors, governments and tax payers to the minimum, ensuring adequate recovery and the resolution of large and systematically significant banks. It is planned that a single resolution mechanism with a central decision-making authority would ensure that the resolution decisions in all involved Member States would be adopted faster and more efficiently, preventing the uncoordinated action, reducing the adverse effect on financial stability and restricting the need for financial support, whereas a single bank resolution fund would be able to accumulate a larger amount of resources from bank contributions and thereby protect the tax payers more efficiently than the state funds, at the same time ensuring equal competition conditions for banks in all involved Member States. This proposal is one of the three pillars forming the Banking Union (single supervisory mechanism, single resolution mechanisms, single deposit guarantee scheme), the agreement whereof is planned to be achieved in the first half of 2014.

Proposal for a Directive of the European Parliament and of the Council ***on the transparency and comparability of payment account fees, payment account switching and access to basic payment accounts.***

The main objectives of the proposal for a Directive are to improve transparency and comparability for information about payment account tariffs, facilitate the change of payment accounts, prevent discrimination and not to allow for events of refusal to open payment accounts on the basis of the citizenship or permanent residency of a consumer if it differs from the country where the service provider is situated, as well as to ensure consumers with access to payment accounts with core functions in any Member State irrespective of their permanent residence.

Proposal for a Directive of the European Parliament and of the Counci ***on payment services in the internal market****, amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC and the Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions.*

Proposals are aimed at ensuring the consumers and other market participants with larger service choice, facilitate the provision of innovative payment services and ensure secure and transparent payment services, coordinate provisions in the Member States and establish an integrated payment market, ensuring equal provisions and improving the availability of the existing payment regime to all interested parties.

Proposal for a Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of ***money laundering and terrorist financing*** *and the Proposal for a Regulation of the European Parliament and of the Council on* ***information accompanying transfers of funds.***

The purpose of development of the Directive is to harmonise the existing regulation with the revised international AML/CFT standards and supplemented *FATF* recommendations. Moreover, the provisions existing in several areas are interpreted in different manners. This creates risk in the internal market and complications in conformity recognition for the companies carrying out cross-border activities. The proposal of the regulation is largely based on the *FATF* special recommendation on electronic money funds transfers, and it is aimed at ensuring that this international provision is equally applied in the entire EU, and, especially, that there is no discrimination existing between the payments within the Member States and the cross-border payments between the Member States.

Financial instruments market sector

Proposal for a Regulation of the European Parliament and of the Council ***on indices used as benchmarks in financial instruments and financial contracts***

Proposal has been developed to improve the regulatory framework according to which the reference values of benchmarks are provided, determined and applied. It is mainly aimed at the improvement of governance and control over the process of the determination and application of reference values (benchmarks), improvement of the quality of input data and methodology used by the benchmark administrators, ensuring that the benchmark data providers are duly controlled, as well as ensuring due protection of consumers and investors, who use the reference value, by improving the disclosure of information.

Proposal for a Regulation of the European Parliament and of the Council on ***the European long-term investment funds***

The main objectives of the proposal are to improve the European long-term investment fund cross-border distribution to both private and institutional investors throughout the European Union, to provide for a uniform procedure for granting permits for activities of long-term investment funds and regulatory requirements of their operation, to state investment policy to be implemented by the long-term investment fund, permitted investment objects and requirements for their diversification, as well as to determine adequate transparency requirements and conditions for the distribution of investment certificates (units) of the fund.

Proposal for a Regulation of the European Parliament and of the Council on ***Money Market Funds***

The main objective of the draft Regulation is to strengthen the stability and liquidity of the money market fund (MMF), to improve the asset quality of the MMF and set requirements for the MMF managers to ensure the protection of investor profile, to adjust the asset assessment rules, as well as to establish capital reserve to absorb the potential losses of the MMF.

Proposals under discussion since 2012

Credit institutions sector

Proposal for a Directive of the European Parliament and of the Counci ***on credit agreements relating to residential property***

The objective of the proposal for a Directive is to set key requirements for separate aspects in respect to credit agreement concluded with consumers on housing real estate. The proposal provides for the scope of information to be provided by the creditor and credit agent to the borrower before the conclusion of the agreement and during the term of the agreement, prescribes the obligation of the creditor to perform the assessment of the creditworthiness of the borrower, as well as the obligation of the borrower to provide information to the creditor and the procedure for licensing and supervision of the credit agents, i.e. issues.

Proposal for a Directive of the European Parliament and of the Council on ***deposit guarantee schemes*** [recast wording]

The main objective of the proposal is the simplification and harmonisation of guaranteed deposits, preserving the amount of the guaranteed compensation from 100,000 euros, ensuring faster payment of the guaranteed sum (within a period of seven business days), as well as the improvement of depositor awareness about security and guarantee system operation, applying easily understandable standard template and account statements. At the same time, the proposal is aimed at ensuring the arrangement of issues on financing of the deposit guarantee schemes.

Proposal for a Directive of the European Parliament and of the Council establishing **the recovery and resolution regime of credit institutions and investment companies and amending Council Directives 77/91/EEC and 82/891/EC, Directive 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and regulation (EU) No. 1093/2010**

The proposal is aimed at the maximum reduction of the involvement of tax payers' funds in the recovery of credit institutions facing problems, preservation of financial stability and trust in credit institutions. It is planned to implement a special minimum set of instruments for the resolution of credit institutions in all Member States, for example, sale of business, asset separation, bridge bank, which would considerably increase the possibilities of institutions to achieve successful and efficient resolution, for example, managed, timely bankruptcy of credit institutions, and thereby preserve the continuity of financial services and stability of the financial system as a whole. An additional mechanism would allow for partial write-off of the bank debts or partial conversion thereof into equity (debt write-off instrument).

Financial instruments market sector

Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC

The objective of the proposal is to strengthen the safety and efficiency of securities payments, to prevent hindrances in the operation of internal market created by differences in the provisions of the countries governing the securities payments, and the operation of their central securities depositories managing the securities payment systems. It is planned to implement this objective, by introducing uniform requirements to payments for financial instruments in the EU and provisions on organisational structure and operation of central securities depositories.

Proposal for a Regulation of the European Parliament and of the Council ***on packaged retail investment products (PRIPS)***

The proposal is aimed at informing and protecting consumers, by offering more complicated investment products, and improving transparency in the investment products market for private investors. The proposal of the regulation states the key elements of the investment product, which should be reflected in the key information documents: the identity of the product and the producer thereof, the type and main features of the product,*inter alia*, whether the investor might lose the capital, the profile of its risk and profitability, costs, as well as historical indicators, in the particular case. The draft also states a single format for promotion of comparability of the products, as well as the responsibility of the producer of the product in respect to the key information document.

Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to ***undertakings for collective investment in transferable securities (UCITS)*** *in respect to* ***the functions of depository, remuneration policy and sanctions***

The objective of the proposal is to state the tasks and obligations of depositories (holding banks), adjust their responsibility and conditions according to which the function of depository may be delegated, to state requirements for the development and documentation of the remuneration policy of the UCITS, as well as for the disclosure of information about remuneration and to provide for harmonisation of the regime of sanctions in the field of UCITS.

Proposal for a Directive of the European Parliament and of the Council on ***financial instruments markets*** *and a proposal for a Regulation of the European Parliament and of the Council on* ***financial instruments markets*** *amending the regulation on derivative financial instruments not traded on the regulated market, central transaction intermediaries and trading registers*

The proposals of the Directive and Regulations prescribe to enlarge the notion of financial instruments, to state that the entire organised trading in financial instruments has to be carried out in regulated trading places – regulated markets, multilateral trading systems and organised trading places -, providing for appropriate definitions for them. The proposals provide for changes in the requirements for the disclosure of both pre-trading and post-trading information, also applying them to debt securities, structured financial products, trading of issue quotas and derivative financial instruments. Requirements for reporting transactions will be broadened, as well. Investment service providers will have to report all transactions in financial instruments to financial supervisory authorities, except for transactions where the financial instruments would be traded on regulated trading places. Whereas the regulated markets, multilateral trading systems and organised trading systems will be required to report transaction nuances in cases when the investment service provider is released from the obligation to report transactions to supervisory authorities. Transaction reporting will take place by means of an approved reporting mechanism.

Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulations (market abuse) and proposal for a Directive of the European Parliament and of the Council ***on criminal sanctions in cases of insider dealing and market manipulations***

In view of the rapid development of financial markets, the current Directive 2003/6 EC fails to provide complete regulations to ensure monitoring of insider dealing and market manipulations. The new draft Regulation is intended to modify the regulatory framework contained in the said Directive, as well as to, in the view of market development, supplement it with the inclusion of new market instruments and new markets in the regulatory framework, supplement the notions of insider information and market manipulation, as well as provide for broader and more distinct powers and cooperation of supervisory authorities within the scope of supervision. Whereas the proposal for the directive provides for minimum requirements for criminal sanctions in the most serious cases of market abuse, i.e. insider dealing and market manipulations.

Insurance and pension funds sector

Proposal for a Directive of the European Parliament and of the Council introducing amendments to directive 2003/71/EC and directive 2009/138/EC in respect of ***the powers of the European Insurance and Occupational pensions Authority and the European Securities and Markets Authority*** *(Omnibus II)*

The proposal sets out amendments to the *Solvency II* Directive in respect of the responsibilities and powers of supervisory authorities of the EU insurers, in particular, when performing group supervision, in respect to establishing EIOPA, as well as additional transitional provisions for implementing separate sections of the Solvency II Directive and additional provisions in respect to the determination of the amount of provisions under stress conditions in the financial market and for insurance products with long-term guarantees. It is planned to adopt the *Omnibus II* Directive in 2014.

Planned EU initiatives in 2014

In view of the elections of the European Parliament to be held in 2014 and the planned election of the President of the European Parliament in the first six months of 2014 enhanced work is planned so as to still achieve the final agreement between the European Commission, the Council and the European parliament in the current composition regarding still outstanding proposals, which they did not manage to close during 2013. Therewith it is not planned to actively publish any new proposals in the field of financial services next year.

At the beginning of 2014 the EC will publish two proposals, which will supplement the already commended general reforms in the EU financial sector, namely, *proposal for a Regulation of the European Parliament and of the Council* ***on structural measures*** *improving the resilience of EU credit institutions,* and on reporting (the so-called Liikanen proposal), and the *proposal for a Regulation of the European Parliament and of the Council on reporting and transparency regarding* ***securities financing transactions on structural measures*** (so-called shadow banking). The purpose of the proposals is not to allow the largest and structurally more complex banks to be involved in proprietary trading on their own behalf, as well as to strengthen information disclosure requirements for certain transactions in the shadow banking system.

To promote the financial stability and ensure efficient resolution for non-bank financial institutions in case of potential problems, without creating a systemic impact, as well as coordinating the regulatory framework with the one planned to be established in the banking sector, in 2014 the EC plans to come out with a proposal ***for crisis management and resolution framework for financial institutions other than banks.***

In 2014 the European Commission also plans to publish the proposal for a recast *Directive of the European Parliament and of the Council* ***on the activities and supervision of the institutions for occupational retirement provision*** (the so-called *IORP II*).

It is possible that at the end of 2014 the European Commission would publish the proposals for necessary amendments to regulations, by which ***the supervisory framework of European financial sector*** was established.

The European Commission also has to approve several delegated and implementing measures in the field of **the new capital framework CRDIV/CRR, financial market infrastructure, transparency requirements, prospectus, alternative funds** (incl. EVCF and ESEF), ***Solvency II*****, credit rating agencies**, i.e. fields.

GUARANTEE SYSTEM

The structure of the financial stability in Latvia is comprised of:

1. Deposit Guarantee Fund;
2. Fund for the Protection of the Insured;
3. Protection of customers of the financialinstruments market (investors);
4. Financial stability fee.

Deposit Guarantee Fund

The guaranteed compensation to customers (natural and legal persons other than the central bank or a deposit taker, a financial institution, a transit fund or an institution that is financed from the State budget or the local government budget) of Latvian banks and credit unions (deposit takers) was EUR 100,000 (or an equivalent amount in another currency) in each deposit taker. The payment of the guaranteed compensations till 2013 had been ensured in Latvian lats, but starting from 2014 – in euros.

The State guarantees that every customer of a deposit taker is compensated an amount of up to EUR 100,000 irrespective of whether there were sufficient funds in the Deposit Guarantee Fund (DGF) at that time or not. According to the *Deposit Guarantee Law*, if the funds were insufficient, they would be ensured by borrowing them through the FCMC from the Treasury.

At the end of 2013, the amount of guaranteed deposits with deposit takers in Latvia was as follows:

Table 2

	SUM	SPECIFIC WEIGHT, %
Total number of depositors	2 377 349	100.0
incl., up to the amount of the guaranteed compensation	2 358 611	99.2
incl., above the amount of the guaranteed compensation	18 738	0.8
Average deposit balance sum, in thousand lats	11 410 113	100.0
incl., up to the amount of the guaranteed compensation	3 651 442	32.0
incl., above the amount of the guaranteed compensation	7 758 672	68.0
Deposits guaranteed by DGF, in thousand lats	**4 968 348**	**43.5**

At the end of 2013, DGF guaranteed 43.5% of total deposits with Latvian banks: for 99.2% of all depositors, the full amount of their deposit was guaranteed whereas for only 0.8% of all depositors the guaranteed amount was EUR 100,000, not providing the guarantee for a deposit in full amount.

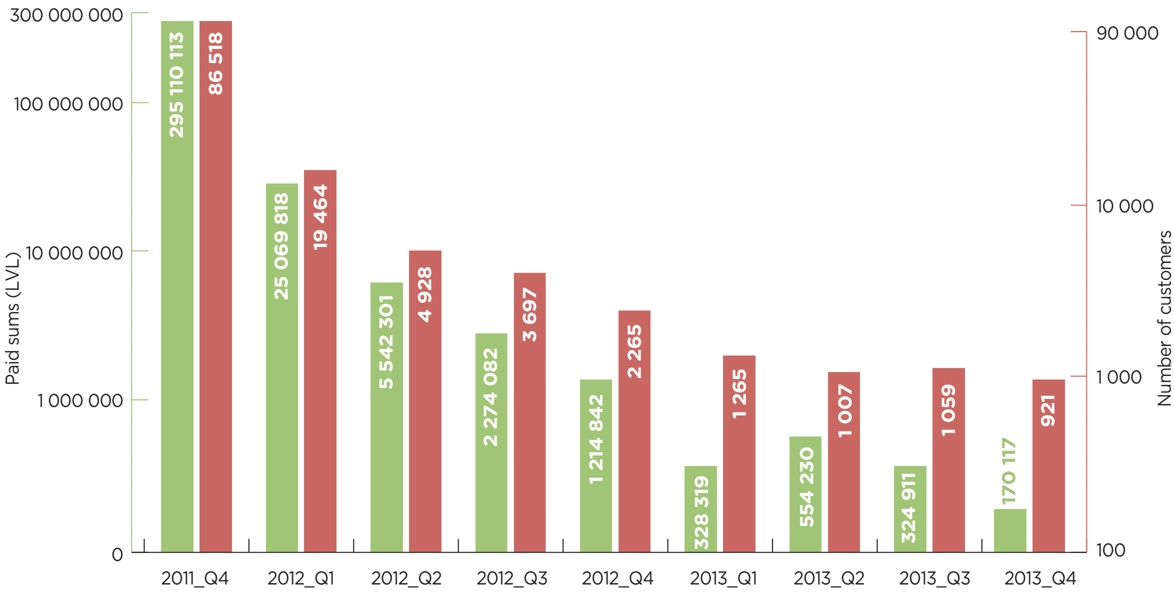
Process of payment of the guaranteed compensations after the occurrence of unavailability of deposits of JSC "Latvijas Krājbanka"

When the FCMC detected unavailability of deposits of JSC "Latvijas Krājbanka" (LKB), 220 thousand depositors were entitled to receive guaranteed compensation for the total amount of 335.6 million lats. For 99.8% of all LKB depositors, the guarantee system covers 100% of their deposits. Payments of the guaranteed compensation were organised as quickly as possible without waiting for the maximum statutory number of days to lapse (30 business days).

The most intensive payment of the guaranteed compensation took place in the first three months after the start of payments.

Image 17.

Dynamics of payments of guaranteed compensation to LKB customers

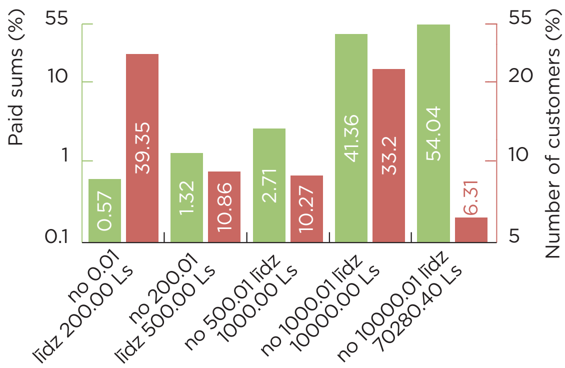


Paid guaranteed compensation by month November 2011 – December 2013: LVL 330,588,734 (EUR 470,385,390) and number of customers: 121,124

From the start of payments till the end of 2013, the paid guaranteed compensation amounted to LVL 330.35 million (98.3%) and payments were made to 121.1 thousand depositors (55%). In 2013, the amount of paid guaranteed compensation was LVL 1.1 million lats. The second largest group of recipients of the guaranteed compensation (33.2%) was comprised of LKB depositors, whose guaranteed compensation had been from 1,000 till 10,000 thousand lats, and the proportion of their payment comprised 41.4% of the sum total of payments. The largest group of recipients of the guaranteed compensation was comprised of those LKB depositors, whose deposit was up to 200 lats, - payments intended for them comprised 1.9 million lats, only 0.6% of the sum total of payments.

Image 18.

Breakdown of the paid guaranteed compensation



At the end of 2013, 99.4 thousand depositors had not yet withdrawn their outstanding deposits in LKB in the amount of 5.66 million lats. From 1 January 2014 they are paid out in euro currency, comprising 8 million euros. Mainly the deposit or the guaranteed compensation has not been received by those depositors, whose guaranteed compensation is up to 200 lats, amounting in total to 879.8 thousand lats of outstanding guaranteed deposits. There are 95.9 thousand such depositors of the 96.5% of the remaining depositors, who have not received the guaranteed compensation. Whereas 62 depositors have not received the guaranteed compensation ranging from 10 thousand lats to 70.28 thousand lats (maximum guaranteed compensation), of which seven depositors to whom the guaranteed compensation in the amount of 100,000 euro is due.

Outstanding guaranteed compensation excluded those LKB depositors to which payments had been suspended until they met their liabilities in full amount to the State Revenue Service, sworn bailiffs and other parties that had the rights to recovery from debtor' s funds; sums in the amount of 25 million lats to 1.85 thousand customers.

Process of payment of the guaranteed compensation after the occurrence of the unavailability of deposits of Rauna cooperative credit union

In 2013, payment of the guaranteed compensation was additionally recognised to three depositors of Rauna Cooperative Credit Union (Rauna CCU) amounting to 4 thousand lats. By the end of 2012 it was recognised in the amount of 20.3 thousand lats to 25 depositors.

The FCMC ensured that after the receipt of the relevant information, payment of the guaranteed compensation was made to settlement accounts of Rauna CCU depositors.

Table 3.
Provision of payment of guaranteed compensation to Rauna CCU depositors

Summary of Rauna CCU guaranteed compensation (GC) as at 31 December 2013.

INDICATORS	GC TO BE ENSURED FROM DGF	GC PAYMENTS TILL 31.12.2013	OUTSTANDING GC AS AT 31.12.2013	PROPORTION OF THE OUTSTANDING GC ,%
Number of depositors	28	15	13*	46.4
Amount of guaranteed compensation (GC), in lats	24318**	22964	1353	5.6

* depositors have not applied the compensation transfer account or the place for the receipt thereof, except one, who received the payment in 2014.
**after recognition of insolvency of Rauna CCU the GC amount has been additionally recognised in the amount of 14, 037 lats for four depositors.

When unavailability of deposits occurred at LKB, the total assets of DGF were LVL 149.9 million. Since DGF had to ensure guaranteed compensation in the amount of 335.9 million lats to LKB depositors, the shortfall of assets for the payment of guaranteed compensation in the amount of 185.6 million lats was lent to DGF (FCMC) by the Republic of Latvia. The borrowing from the Republic of Latvia is repaid from DGF assets that are supplemented quarterly with payments that deposit takers make under the procedure prescribed by the *Deposit Guarantee Law* and from the funds recovered from LKB for the paid guaranteed compensation. The DGF' s rights of claim rank first in the amount of the guaranteed compensation. In 2012 and 2013, LKB repaid LVL 125 million to DGF, but DGF repaid LVL 175.05 million, plus a borrowing fee of LVL 2.3 million in 2012 and LVL 574.9 thousand in 2013 to the Republic of Latvia.

In accordance with the *Deposit Guarantee Law* deposit takers (banks and credit unions) make a quarterly payment to DGF amounting to 0.05% of the average balance of deposits with the deposit taker in the previous quarter. If the guaranteed compensation is paid out to depositors, the FCMC is entitled to increase the amount of payment into DGF for up to one year to accelerate the accumulation of assets in DGF. After the first event of unavailability of deposits the FCMC increased the amount of payments to DGF 1.5 times, and the deposit takers performed such increased payment for the entire period of 2012. In 2013, the deposit takers performed the contributions already in compliance with the payment rate prescribed by the *Deposit Guarantee Law*. In addition, the FCMC also establishes the correction ratio that is applicable to the payment by each deposit taker.

The average arithmetic correction ratio of Latvian banks, according to which the payments of each quarter are to be performed to DGF, in 2013 comprised 102.52%, but of the CCU – 100.42%. When establishing the ratio applicable to the payment, FCMC take into account each deposit taker's capital adequacy, liquidity and large exposure indicator, as well as the quality of the credit portfolio in the previous calendar year. The deposit takers made payments to the DGF for the year 2013 in the amount of 22.6 million lats.

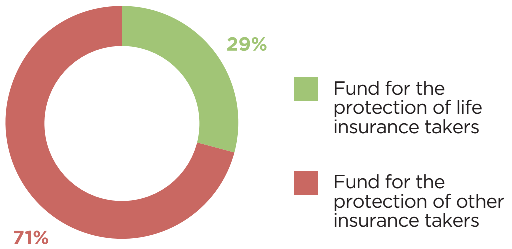
In accordance with the law the FCMC ensured the accumulation and management of the assets of DGF according to the purpose of this law, i.e. during the reporting year the FCMC ensured the transfer of payments of the deposit takers into the settlement account of DGF in the Bank of Latvia and deposited the free assets of DGF in term deposits in the Bank of Latvia, as well as performed the discharge of liabilities assumed by DGF, as well as followed the process of payment of the guaranteed compensation and the activities of the administrator of the liquidated AS "Latvijas Krājbanka" and the administrator of the insolvent Rauna Cooperative Credit Union. The FCMC has also reviewed the filed complaints regarding recognition of the guaranteed compensation and has taken part in all involved litigation proceedings on the recognition or refusal of the guaranteed compensation.

The FCMC ensures the registration of DGF according to the registration policy developed by it, which contains the description of the most significant FCMC financial accounting principle applied in the preparation of financial statements, conforming to the guideline of the International Public Sector Accounting Standards regarding the provision of accounting and financial statements to the entities of public sector. In line with the said policy, in 2013 the FCMC formed accumulations in the amount of 135 million lats. Please see the basis for the formation of accumulations in the financial statements of the Deposit Guarantee Fund for the year 2013 and the independent auditor's statement thereon on the FCMC website at: www.fktk.lv.

Fund for the Protection of the Insured

The assets of the Fund for the Protection of the Insured (FPI) are comprised of deductions of 1% of insurance companies from the total gross insurance premiums received from natural persons for the types of insurance specified in the law. At the end of 2013, LVL 10.3 million were accrued in FPI.

Image 19.
Percentage breakdown of the FPI assets (at the end of 2013)

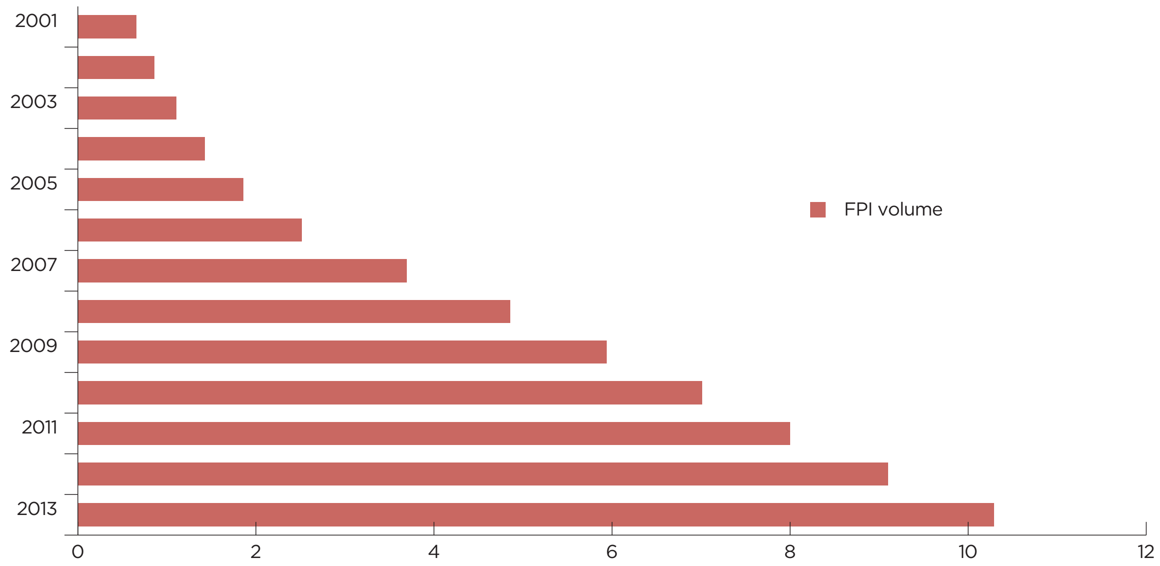


As of the beginning of the operation of FPI, the assets thereof for the payment of the guaranteed indemnities were used in the amount of 8,671 lats. The payment of insurance in the case of default on liabilities may only be received by a policyholder that is a natural person:

1) for life insurance – 100% of the insurance indemnity, but not more than 10,000 lats per policyholder, excluding insurance in respect of a market-related life insurance policy;

2) for other types of insurance set out in law – 50% of the insurance indemnity, but not more than LVL 2,000 per policyholder.

Image 20.
Dynamics of FPI volume increase, 2001 – 2013 (at the end of the year, in million lats)



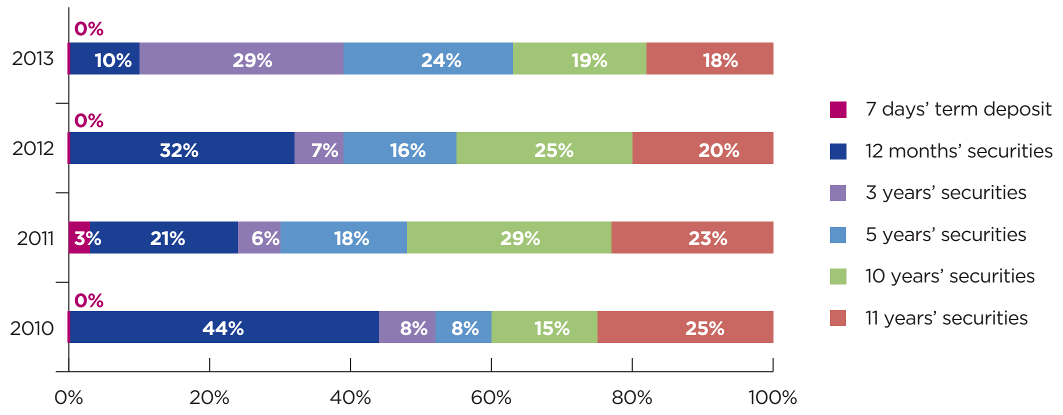
In 2013, the volume of FPI increased by 1.17 million lats, due to the contributions by fund participants and as a result of the FCMC's investment of FPI assets in Latvian government internal borrowing securities and receiving interest payments for short-term deposits in the Bank of Latvia and the cash balance in the settlement account. FPI investment structure and return on investments are comprised of Latvian government internal borrowing supply and the amount of funds of FPI at the time of supply.

Table 4.
FPI income indicators, 2008–2013

	2008	2009	2010	2011	2012	2013	STRATEGY
Payments by FPI participants, in million lats	0.9	0.7	0.6	0.7	0.7	0.8	1% of total guaranteed insurance premiums
Investment income, in million lats	0.2	0.3	0.4	0.3	0.3	0.3	Exceed the costs of maintaining deposits and making investments
Return on assets, %	5.18	6.29	6.84	4.41	4.07	3.46	In accordance with the fixed income rate fluctuations of the Latvian government internal borrowing securities

Image 21.

FPI investment structure by initial maturity, 2010–2013 (at the end of the year, %)



Protection of the customers of the financial instruments market (investors)

The investor protection scheme is based on the Investor Protection Law. Compensation per investor is calculated for irreversibly lost financial instruments of losses caused by a non-executed investment service. Compensation to one investor is 90% of the value of irreversibly lost financial instruments or of the loss caused by a non-executed investment service, but not more than 20,000 euros. Compensation payment is ensured by the FCMC, and compensation payments are monitored by the FCMC's Consultative Council.

The funds for the payment of compensation are ensured by the participants of the scheme that are legal persons to whom the FCMC, under the set procedure, has issued an authorisation (licence) for the provision of investment services. During a year, the total of these funds must not exceed 4% of the total value of the financial instruments portfolio of the scheme's participants. The payment of each scheme's participant for ensuring compensation is established in proportion to the participant's share in the joint financial instruments portfolio of the scheme's participants. Where the payments of the scheme's participants are not sufficient to pay compensation in line with the *Investor Protection Law*, the FCMC is entitled to borrow funds for the payment of compensation.

Administration of the financial stability fee

The objective of the financial stability fee (Fee) is to strengthen the financial system in general to finance, if necessary, the measures that would mitigate the negative impact of those credit institutions that have encountered financial difficulties on other participants of the financial market, as well as to partially compensate the State budget funds that have been channelled to stabilise the situation in the financial sector from which the banking sector in general benefitted directly or indirectly. The Fee is paid by banks registered in Latvia and their branches in the Member States and other foreign countries and by Latvian branches of banks registered in the Member States and other foreign countries (the Fee payers).

The FCMC controlled the payment of the Fee into the budget account, the calculation of the Fee and completeness and accuracy of information underlying the calculation. The object of the Fee is comprised of the tax payers' liabilities, excluding deposits subject to the deposit guarantee scheme of the Republic of Latvia or other Member State, issued mortgage bonds and subordinated liabilities.

In 2013, no on-site inspections were performed in respect to the accuracy of data contained in the Fee payers' return for the years 2012 and 2013. In 2013 only cross-section inspections of data were performed.

Table 5.
Fee payers' indicators, 2011–2013:

	2013	2012	2011
Fee payers	29[13]	31[14]	33[15]
Fee object, in million lats	4 889.1	6 065.1	6 572.1
Fee rate, %	0.072	0.072	0.036
Fee, lats	3 520 130	4 121 441	2 363 211
Fee payment received in the State budget, lats	3 822 305	3 329 782	2 389 931

Due to the termination of activities of credit institutions, the legal assign thereof must pay the excess of the Fee from the State budget in the following amount:

- In 2014 to three companies in the amount of 327.7 thousand euros (230.3 thousand lats);
- In 2012 to one company in the amount of 8.7 thousand lats.

COOPERATION

Intra-institutional cooperation at the national level

In 2013, the FCMC cooperated with other public institutions to ensure the efficient fulfilment of functions prescribed by the Law on the Financial and Capital Market Commission, other laws governing the activities of the financial and capital market participants and other binding laws and regulations governing the activities and set functions of the FCMC. FCMC representatives, on a regular basis, participated in the meetings of the Budget and Finance (taxation) Committee of the Saeima that reviews the draft laws related to regulatory framework and supervision of the Latvian financial sector, as well as at the meetings of the European Affairs Committee of the Saeima, when the national positions were reviewed regarding new initiatives of the European Union in the field of financial services. FCMC management also participated in the meetings of the National Security Committee of the Saeima.

THE NATIONAL COOPERATION WITH OTHER PUBLIC INSTITUTIONS WAS STRENGTHENED – RESPONSIBLE COMMITTEES OF THE SAEIMA, BANK OF LATVIA, THE TREASURY, THE CRPC, ETC.

In 2013, the FCMC continued regular information exchange between the Bank of Latvia and the Ministry of Finance. At least on a quarterly basis, the FCMC submitted aggregated information to the Bank of Latvia and the Ministry of Finance about the situation in the financial and capital market. In cooperation with the Bank of Latvia, the FCMC worked towards the strengthening of macroprudential supervision to timely identify systemic risks and take measures for the prevention or mitigation of these risks. FCMC cooperated with the Bank of Latvia in the issues of monitoring of the securities settlement system maintained by the Latvian Central Depository, as well as in the issues on the exchange of statistics of securities received from the investment management companies and managers of alternative investment funds. To explain the trends of supervision and development of the Latvian financial sector, the FCMC constantly took part in the meetings organised by the Treasury with the rating agencies. During the reporting year, the FCMC cooperated with the colleagues from the Consumer Rights Protection Centre (CRPC) to more efficiently ensure the protection of consumer rights in respect to the provision of financial services.

FCMC representatives have also participated in the working groups and councils set up by the Cabinet of Ministers and the ministries:

- the management committee set up by the

[13] Incl. JSC „ GE Money banka" for ten months in 2013.

[14] Incl. JSC "Parex banka", the Fee payer for three months in 2012, Allied Irish Bank, the Fee payer for nine months in 2012.

[15] Incl. JSC "Latvijas Krājbanka" and JSC "Banka Snoras" Branch in Latvia, the fee payers for eleven months in 2011, JSC "Pohjola Bank" Branch in Latvia that did not perform any activities and whose Fee object and the Fee was 0 lats 16 The calculated amount of the advance payment of the Financial Stability for 2014 that is not included in the budget.

Prime Minister **for the introduction of a single European Union currency in Latvia**, in the working group of the Euro Project Financial Sector and the working group of the Society Information and Communication of the Ministry of Finance, whose task was to perform the preparatory work for the introduction of euro in Latvia and the monitoring of this process;

- the working group set up by the Ministry of Finance **or the establishment of the Development Strategy of the Financial Sector**, within which the Financial Sector development Plan for 2014 – 2016 was established;
- intra-institutional working group set up by the Ministry of Justice **for the development of regulatory framework of mortgage loans**, within which the informative notice was prepared on the assessment of weaknesses of the regulatory framework of the mortgage loans and proposals for streamlining the regulatory framework. The notice was reviewed at the meeting of the Cabinet of Ministers, by assigning the ministries in charge to introduce amendments to laws and regulations and streamline the regulatory framework;
- the working group set up by the Ministry of Economics **for streamlining the regulatory framework in the field of consumer loans**, aimed at the preparation of proposals for streamlining laws and regulations in the field of consumer loans, especially in respect to fast credit lending. Proposals were developed, however, in separate points the opinions of market participants and the Ministry still differ;
- the working group set up by the Prime Minister for the development of the draft law on **amendments to the Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing**;
- in the working group set up by the order of the Prime Minister **On the Improvement of Cooperation with International Credit Rating Agencies**, managed by the Ministry of Finance. In 2013, the three largest rating agencies – *S&P*, *Moody'sandFitch* –, as well as the Japanese rating agency*R&I* increased the credit rating for Latvia, even though part of the European countries are still undergoing reductions in credit ratings. To further promote the improvement of the state credit rating and not to allow for a reduction of the rating, the task of the working group was to provide adequate information for a better understanding of the processes taking place in Latvia;
- in the Nationa **SEPA** working group set up by the Bank of Latvia, the purpose whereof was to coordinate measures related to Latvia's accession to the Eurozone, in the field of payment services and integration in the SEPA;
- **in the Financial Sector Development Council**, which in 2013 reviewed the issues on the Financial Sector Development Plan, regulatory framework of the activities of non-bank creditors and the necessary changes, necessary measures for the improvement of the system of prevention of money laundering and terrorism financing, and other issues;
- **Audit Consultative Council**, where the documents prepared by the Association of Sworn Auditors of Latvia were reviewed regarding the maintaining of the qualification of sworn auditors and control of quality of professional activities thereof, and also discussed the improvement of the audit work in the country, also resolving upon the posting of the Professional Accountants' Code of Ethics on the website of the Association.

International cooperation

In the area of international cooperation, the FCMC's priority is mainly to take part in developments in the European Region. The FCMC takes part in the discussions of draft regulatory provisions at the Council of the European Union (EU) and the committees of the European Commission, as well as in the work of European financial supervisory authorities. It was also important to continue bilateral cooperation with supervisory authorities of those countries that engage in cross-border cooperation with Latvia.

PRIORITY OF INTERNATIONAL COOPERATION – TO TAKE PART IN DEVELOPMENTS IN THE EUROPEAN REGION.

Participation in the work of the Council of the European Union and the European Commission in the area of financial services

In 2013, the EU Council continued working on proposals in the financial sector published in 2011 – the new capital requirement framework for credit institutions and investment brokerage firms (*CRD IV/ CRR*) and regulations in respect to the single supervisory mechanism of credit institutions, which it managed to adopt during 2013, amendments to directives about the financial instrument market, market abuse, *Omnibus II*, as well as proposals published in 2012 for the directive on the recovery and resolution of credit institutions, directive on indirect packaged investment products (*PRIPS*) and amendments to the directive on undertakings of collective investment in transferable securities. The work also started in respect to the new proposals published by the European Commission in 2013, namely, a single resolution mechanism and the establishment of a single banking resolution fund, proposals for comparability of payment account tariffs, payment account change and access to payment accounts with basic functions, payment services in the internal market and interbank commission fees, as well as a proposal in the field of the prevention of money laundering and terrorism financing. FCMC experts were involved in developing national positions and discussing proposals at the Financial Services Working group of the EU Council and an *Ad hoc* Working Group on the single resolution mechanisms and the establishment of a single banking resolution fund.

On several occasions, in cooperation with peers from other Member States, the changes in the initial wording were achieved according to the expressed proposals. For example, in view of the fact that major Latvian credit institutions are subsidiaries of credit institutions operating in other EU countries, during the discussions about the proposed directive on the recovery and resolution regime of credit institutions, FCMC experts made a suggestion supporting a significantly more favourable balance between the rights of the parent and subsidiary undertakings of credit institutions and rights and duties between home and host supervisory / resolution authorities (in respect of recovery plans, resolution plans, as well as the group resolution process). When reviewing the topical issues of the financial instruments market sector (for example, proposals on undertakings of collective investments into transferable securities, regulations and directive on financial instruments markets, regarding criminal sanctions in the case of insider dealing and market manipulations), FCMC experts actively expressed the opinion on the determination of sanctions in a reasonable amount, in view of the scope and activity of the Latvian financial instruments market.

At the level of the European Commission Committees whose membership included the FCMC's experts, work was carried out for European Union laws and regulations subject to directives in the areas of the new capital adequacy requirements framework for credit institutions and investment brokerage firms (CRD IV/ CRR), payment services and financial markets infrastructure (EMIR) discussions were held for the European Commission initiatives planned for the financial sector.

Out of the proposals left outstanding during the period of 2013, it is planned that by the end of 2014 the EU Council, European Parliament and the European Commission could agree upon credit agreements in respect to the housing estate, upon proposals for financial instruments markets, criminal sanctions in cases of insider dealing and market manipulations, central securities depositories, and there are also three proposals to be agreed upon, which are passed as a single package, namely, single resolution mechanism and single banking resolution fund, recovery and resolution regime of credit institutions and investment firms and deposit guarantee schemes.

Participation in the work of European supervisory authorities

Three years have passed since the establishment of the European financial supervisory system (it started operating on 1 January 2011), when a two-tier, i.e. micro and macro level supervision was set up. The representatives of national supervisory authorities have been participating in the work of the European supervisory authorities – European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority and adoption of decisions in the Supervisory Council that is supervision at a micro level. The main task of European supervisory authorities is to develop draft technical standards, issue guidelines and recommendations, ensure the application of equivalent EU legal acts. The Chairman of the FCMC, in turn, in the capacity of an observer, participates in the meetings of the European Systemic Risk Board (ESRB) that has been vested with the supervisory powers at a macro level and whose task is to assess potential threats to financial stability and ensure timely warning about the likely emergence of systemic risks.

By participating in the work of these authorities, Latvia can influence the formation of the European supervisory policy and practice, which is significant not only for ensuring the stability of the Latvian financial sector, but also for the stability of the single financial services sector of the entire of Europe. In respect to various new initiatives, market development trends and new products, the scope of work of the European financial supervisory authorities is also ambitious. It was planned that in 2013 the FCMC experts would participate in 305 meetings of the working groups of the European financial supervisory system authorities, and, in fact, the FCMC experts took part in 203 meetings (nine of them out of the scheduled ones). 46 FCMC employees took part in the work of these working groups. Participation in the working groups is decided by taking into account the principle of usefulness, i.e. to what extent the issues to be discussed are relevant for the Latvian financial market and to what extent the issue is important in the context of the EU.

In 2013, EBA, with market participants, developed and coordinated 38 draft technical standards, carried out 47 public consultations, submitted 56 draft technical standards, issued four recommendations and four opinions to the European Commission, as well as, jointly with ESMA, issued one warning. In the reporting year, the main objective of EBA was to continue working on the formation of a single rulebook of the European banking sector to improve the quality of the regulatory framework of the financial sector and functionality of a single market. The work continued regarding the development of technical standards in the field of capital adequacy of banks and investment firms (equity, liquidity, large exposure, credit risk, market risk, operational risk, internal governance, etc.). Also the development of draft technical standards is commenced according to the delegation of the Deposit Guarantee Scheme Directive and Bank Resolution Directive. In the reporting year, EBA developed a tool *Single Rulebook Q&A*, allowing each interested party to ask specific questions in respect to the new capital requirement framework CRDIV/CRR regulation. Additional information about EBA activities is available at www.eba.eiropa.eu.

In 2013, EIOPA's main priorities were continuing the work for the formation of the European single rulebook in the field of insurance and pensions, improvement of supervision convergence, issues in the field of financial stability and crisis management and consumer protection issues. Also, during the reporting year, there was on-going work on the development of technical standards for the introduction of the *Solvency II* Directive (for example, for trialogue discussions regarding the *Omnibus II* Directive the Statement of Assessment of Long-Term guarantees was developed, as well as Recommendations on the preparation for the application of the *Solvency II* Directive). To ensure the gradual introduction of the *Solvency II* regime, in 2013, EIOPA approved the *Solvency II Preparatory Guidelines*, with FCMC specialists taking an active part in the process of the development and translation thereof. In the field of pensions the first quantitative analysis was developed regarding the situation on the field of supplementary occupational pensions. In the reporting year, EIOPA also paid attention to the issue on the necessary regulatory framework and the necessary measures to established single personal pensions (participation in the private pension funds on the basis of an individual contract) market. The statement was developed and sent to the European Commission, proposing to develop a new regulatory framework at the European level (in the form of both Directive and Regulation). To ensure the convergence of the supervisory practice, EIOPA carried out peer reviews in respect to the implementation of the pre-proposal process of internal models in the supervisory authorities. In the reporting year, EIOPA continued to analyse risks, which can affect the insurance and pension market, as well as worked on 2014 stress test preparation and the development of scenarios thereof. Issues were also identified in the field of consumer protection (disproportionate commission fees, weakness in the market, etc.), the development of proposals for the solution whereof is pending. For EIOPA to be able to identify the fields of consumer protection in future as well, a guidance note is developed on how to aggregate and analyse information about the latest trends in the field of consumer protection. Additional information about EIOPA activities is available at www.eiopa.eiropa.eu.

The main fields of responsibility of ESMA are the establishment of a single rulebook, supervisory convergence, supervision of credit rating agencies and investor protection. When working on the formation of a single rulebook, in the reporting year ESMA developed 38 draft technical standards according to *EMIR* delegation, one according to the delegation of the Alternative Investment Funds Directive, 14 technical recommendations were provided to the European Commission, 11 pieces of advice and recommendations prepared in respect to the Alternative Investment Funds Directive, and also more than 100 answers to questions prepared regarding the introduction on the regulation on short selling and *EMIR*. In the field of investor protection, ESMA continued working on the development of recommendations regarding remuneration, continued aggregating and analysing information about development trends in the consumer field, as well as warning investors, for example, on the distribution of financial products on the internet. Large-scale work during the reporting period was done in respect to the regulatory framework of the Alternative Investment Funds Directive, setting the requirement to enter into cooperation and information exchange agreements with non-EU (third country) supervisory authorities. During the reporting period, 38 cooperation agreements were concluded with supervisory authorities of 42 non-EU countries. Additional information about ESMA activities is available at www.esma.eiropa.eu.

During the reporting year, ESRB continued its work aimed at the formation of a stable macrosupervision system throughout the EU, by identifying systemic risks threatening the EU financial system and taking measures to prevent them. In 2013, ESRB approved the recommendations regarding medium-term objectives and instruments of the macrosupervision policy, as well as started assessing the first ESRB recommendations on the application of lending in foreign currency. Additional information about ESRB is available at www.esrb.eiropa.eu.

In the second half of 2013 a significant role was also played by the FCMC experts participating in preparatory processes organised by the ECB for the introduction of a single supervisory mechanism (see Chapter "Preparation for participation in the single supervisory mechanism").

Cooperation with supervisory authorities of other countries

In the supervision of the financial sector, cooperation with the supervisory authorities of the financial sector of other countries is the key aspect. The priority is cooperation with the financial supervisors of the Baltic States and Nordic countries. Also, bilateral cooperation with supervisory authorities of Russia and the USA was continued.

In accordance with the cooperation agreement among relevant ministries, central banks and financial sector supervisory authorities of the Baltic States and the Nordic countries on cross-border financial stability, crisis management and resolution, work was carried out in the five established working groups. *Inter alia*, the existing regulatory framework for the exchange of confidential information among authorities of the involved countries were identified and proposals were developed for exchanging such information among authorities, proposals were prepared regarding cost sharing among countries in the case of crisis resolution, models for assessing the impact of systemic risks were developed, the cooperation agreement was developed among the authorities for cross-border crisis management and resolution within *Nordea* Group and the signing of the agreement was commenced. The meetings of one cross-border stability working group took place in which the accomplished tasks were reviewed and future tasks were approved. The FCMC was also involved in the Macroprudential Forum of the Baltic and Nordic countries in the framework of which heads of supervisory authorities together with the head of the central banks discussed the topicalities of macroprudential policy.

Bilateral cooperation among supervisory authorities relies on concluded agreements for information exchange and cooperation. Overall at present there are 76 bilateral and multilateral cooperation agreement concluded (http://www.fktk.lv/lv/komisija/sadarbiba/informacijas_apmainas_ligumi/ligumi_ar_arvalstu_iestadem/page1). The FCMC representatives are also involved in the work of supervisory colleges. In 2013, FCMC representatives participated in the work of five banking supervisory colleges and three insurance supervisory colleges and one college in the field of asset management.

By continuing cooperation with the Central Bank of the Russian Federation, during 2013 the annual meeting was held during which opinions were exchanged on supervisory issues, as well as issues were discussed regarding the strengthening of cooperation in the area of preventing money laundering. To exchange information about the development trends and topical issues regarding the financial sector, FCMC management continued the practice started in previous years to organise meetings with USA public authorities and financial supervisory authorities during the Annual Meeting of the International Monetary Fund.

Moreover, in 2013, the FCMC concluded several new cooperation agreements. In the field of credit institutions there was a memorandum of understanding concluded between FCMC and the Luxembourg's financial sector supervisory authority regarding cooperation in the field of supervision of credit institutions. In the field of insurance two bilateral agreements were concluded with the Bank of Lithuania and Estonian financial supervisory authority regarding the supervision of cross-border insurance companies and with Ukrainian financial sector supervisory authority on cooperation and information exchange within the supervision of insurance companies. To ensure information exchange in future in the field of supervision of alternative investment fund managers with the countries which are not Member States of the European Union, 38 multilateral cooperation agreements were concluded with the supervisory authorities of the European Union Member States and third countries regarding consultations, cooperation and information exchange in this area. The development of the agreement and the signing thereof was organised by the European Securities and Markets Authority.

In 2013 the negotiations were accomplished about joining the International Organisation of Securities Commissions (IOSCO) and the FCMC became the member organisation of IOSCO. This will enhance cooperation opportunities in the area of securities with the supervisory authorities of countries outside the European Union.

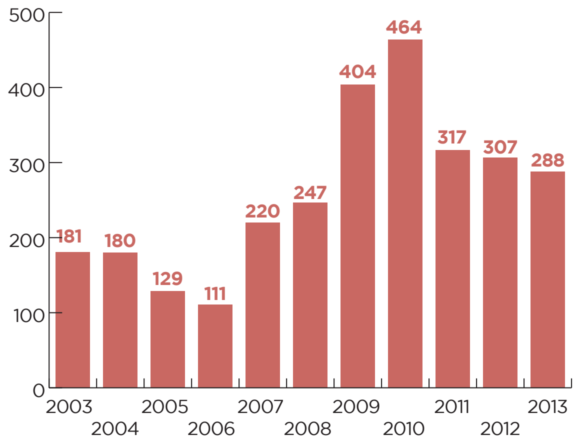
CUSTOMER PROTECTION

ONLY 3% OF THE TOTAL NUMBER OF CUSTOMER COMPLAINTS FILED WITH THE BANKS WAS FORWARDED TO THE FCMC, WHICH IS A POSITIVE EVALUATION FOR BANK COOPERATION WITH CUSTOMERS.

One of the basic objectives of the FCMC is safeguarding the interests of the investors, depositors and insured persons, therefore the protection of rights of the customers of market participants remained a key factor of supervision in 2013 as well.

In 2013, the FCMC received and reviewed 288 applications about the behaviour of the participants of the financial and capital market, *inter alia*, 172 bank customer complaints, 47 complaints of the customers of insurance companies and branches of the EEA countries insurers, three complaints regarding insurance intermediaries, 20 applications about financial instruments market participants, nine applications regarding credit unions, nine applications regarding investment management companies, two applications on the State funded pension scheme participants, two complaints on electronic money institutions, and 24 applications regarding various issues related to the financial market.

Image 22.
Number of complaints received by years



In all cases the FCMC asked market participants to provide explanations, after the assessment whereof the customers received answers or consultations in terms of essence within the scope of FCMC competence. The FCMC also checked whether there were any violations of laws and regulations observed in the activities of market participants.

Of the 172 complaints by customers of credit institutions, in 13 cases the FCMC uncovered weaknesses in the activities of the market participants and in 11 cases the contents of the customer complaints was used for supervisory needs. After the FCMC was involved in the solution of particular cases, the weaknesses were eliminated.

Credit institution ustomer complaints were mostly about the provided lending services, deposits, account management and failure to commence cooperation or termination of cooperation.

In the FCMCš opinion the fact that in 2012 market participants received 6,054 customer complaints, but in 2013 the number of such complaints comprised 4,851 and only 3.5% of these customers complained about the activities of the credit institutions to the FCMC, would be assessed as a positive sign of cooperation of credit institutions with customers.

IN 2013, A POSITIVE TURNING POINT WAS ACHIEVED – BOTH THE TRUST IN THE FCMC AND THE LEVEL OF PUBLIC AWARENESS ABOUT THE ACTIVITIES OF THE AUTHORITY GRADUALLY INCREASED.

In respect to payment of the guaranteed compensation to the depositors of the JSC "Latvijas Krājbanka" (in liquidation) in 2013 and with a view to ensure the effective solution of customer related matters, the FCMC separately processed and analysed applications related to the payment of the guarantee deposit in the amount of up to 100,000 euros from DGF. 27 applications to this effect were received and processed in 2013.

Even though by the end of 2013, the customers of the liquidated JSC "Latvijas Krājbanka" had withdrawn 98% of the sum total of the guaranteed compensation, there were still about 100 thousand customers remaining, who had not applied for the receipt of guaranteed compensation. Therefore the FCMC distributed the remainder to those customers, who for more than two years after the winding up of the banking activities had not withdrawn the State guaranteed compensation in the sum total of over 5.75 million lats, to receive them in the bank Citadele.

By urging the population to abstain from cooperation with non-licensed financial service providers, the FCMC posted on its website and published in mass media a warning regarding particular enterprises. In 2013, such customer warnings were distributed twice – on the provider of illegal investment services SIA "Life Capital" and the services of the website www.dargums.lv which might be used for bad faith transactions.

COMMUNICATION WITH THE GENERAL PUBLIC. EDUCATING CUSTOMERS

The objectives and direction of the Communications Division of the FCMC last year was determined by the communication strategy for 2012–2015, specifying an open and proactive approach to providing information to the general public about the FCMC's activities, functions and role. A significant task was to explain financial education issues in order to gradually increase the level of public financial awareness.

According to the SKDS (marketing and public opinion research centre) survey about the population of Latvia trusting in financial institutions, in 2013, a positive turning point was reached – both the trust in the FCMC and the level of public awareness about the activities of the authority gradually increased. In 2013, the highest public awareness level was achieved, if compared to those observed during the course of research starting from 2002, except for January of 2012, which, due to the events with the liquidated JSC "Latvijas Krājbanka" created a short-term increase in identification of the FCMC.

In order to provide complete information to the general public about topical trends in the financial and capital market, in 2013, the FCMC posted on its website and disseminated 141 statements (in 2012 – 116) to mass media, as well as held three media events about topical issues. Last year, FCMC management gave more than 50 interviews to both local and international media. As of January 2012, the FCMC has also been communicating in the social network "Twitter.com" account @FKTK_LV, and last year it also started using the possibilities offered by "YouTube" and "Slideshare" for informing the target audience. According to the information aggregated by the Communication Division, the name of the FCMC during the period of 2013 had been mentioned 3,763 times in Latvian media, which was ~20% more than in 2012.

In 2013, the most significant topics in respect to the financial and capital market, for the explanation whereof the Communications Division had comparatively spent the most resources, were as follows:

- the amount of non-resident deposits attracted by Latvian banks, their impact on the Latvian financial system and the additional supervisory measures introduced by the FCMC for the mitigation of possible risks;
- the introduction of the euro in Latvia and the readiness of the financial and capital market for the new currency;
- single supervisory mechanism and its impact on the existing model of the supervision of Latvian banks, allocating the functions among the ECB and FCMC, which has to start fully operating on 4 November 2014;
- new procedure for the disclosure of information about sanctions imposed by the FCMC on the banks, which, along with the changes in the *Credit Institution Law*, will come into effect in 2014.

To strengthen the image of the FCMC as an open and modern authority and enhance the public awareness of its operation and functions, for the first time the FCMC took part in the campaign "Back to School", participating in lectures in Latvian schools, as well as in the Open Door Day, when the public institutions are open to any interested party and offer the possibility to meet the officials.

In 2013, the improvement of the crisis communication process was continued, organising the first training, crisis communication simulation, for the employees of the involved public administration communication divisions, in line with the Crisis Communication Plan developed in 2012, which states the circle of decision-makers and communication mechanism.

Development of financial literacy direction

In the reporting year, the FCMC ensured the implementation of its strategic priority – raising financial education and understanding levels, and continued the activities commenced in the previous years, as well as launched several new financial education promotion projects.

On 26 March 2013, in the learning centre of the Bank of Latvia "Money World" the FCMC information stand was opened to ensure permanent representation in this exhibition. The video presentation prepared for the stand reflects the operation of the FCMC, the Latvian financial sector, the customer protection system in Latvia and offers to take a quiz for checking the acquired knowledge. The video presentation during the reporting year has also been a significant informative support in other public education measures implemented by the FCMC.

Pursuant to the planned transformation of the educational portal of the FCMC CUSTOMER SCHOOL (KLIENTU SKOLA), in 2013 the development of the design of the new concept was ensured and the structure of the three-tier content of the new educational additional section CUSTOMER ABC (KLIENTU ABC) was approved. Work on the new version of the CUSTOMER SCHOOL will continue in 2014. In 2013, via the CUSTOMER SCHOOL, 81 e-consultations were provided to the financial sector customers (in 2012 - 79).

By signing the letter of understanding, on 28 January 2013 the FCMC became a partner of the organisation *Child and Youth Finance International* and its national coordinator in organising further financial education activities in respect to the annual international event *Global Money Week*. The first financial education week in Latvia was already held this year (March 18 – 22). During this week the list of financial education internet activities offered by the cooperation partners – study materials and quizzes, by creating a special design for it, was sent to Latvian schools, the results of three studies were presented, internet activities in total involved more than 5,000 interested parties, and on-site activities were carried out as well – 40 guest lectures in schools and two seminars for teachers.

To fix the financial literacy level of Latvian society and the most significant problems thereof, as well as to define the future activities in this field in more detail, in the reporting year the FCMC ensured regular public opinion polls regarding financial literacy topics and also communicated the results to the general public. (in February – on the lack of financial knowledge, - in June – on the attitude towards the formation of savings, in November – on the planning of a personal budget).

Pertaining to the invitation to become a member state of the Organisation for economic Cooperation and Development or OECD extended to Latvia, in 2013 the FCMC commenced negotiations with the financial literacy expert tool of the said organisation – INFE (*International Network on Financial Education*), received an invitation to become a full member in this financial literacy expert structure and on 18 April 2013 was registered as the national coordinator of OECD INFE in Latvia, also undertaking the coverage of the annual full membership fee in the amount of 3,000 euros.

To establish a uniform strategic approach to the gradual increase of the financial literacy level of the population, defining the purposes to be achieved, main directions and tasks of the activities, as well as the necessary resources and the involved institutions for implementing these activities, in the reporting year the FCMC invited the financial education activities' partners in Latvia to develop the national financial education strategy and on 23 July 2013 set up an intra-institutional working group. Following the OECD INFE recommendations and by involvement of the aid partners (Ministry of Education and Science, National Centre for Education, Consumer Rights Protection Centre, BA School of Business and Finance, as well as professional associations of financial service providers – the Association of Commercial Banks of Latvia and Latvian Insurers Association), the FCMC ensured the development of the document "National Strategy for Financial Literacy in Latvia 2014 – 2020" (Strategy).

On 24 February 2014 the strategic partners signed the memorandum of cooperation regarding the introduction of the Strategy to promote the gradual raising the financial literacy level of the population. The Strategy defines the necessary directions of activities (seven directions in total), stating in each, the tasks to be accomplished and the corresponding activities of each involved institution. Both the strategic partners and also other cooperation partners, who confirmed their readiness to be involved in joint activities or provide the necessary support for the promotion of financial literacy, would take part in the implementation of the purposes of the Strategy. During the reporting year, the FCMC established the partnership with the Ministry of Finance and the State Revenue Service, the Ministry of Economics, the Ministry of Welfare, the Bank of Latvia, Central Statistical Bureau, professional associations of market participants and the Latvian Association of Local Governments, as well as with the higher education institutions – the University of Latvia, Latvia University of Agriculture and Riga Technical University to promote cooperation in ensuring activities and research within the process of implementation of the Strategy. According to the Strategy the FCMC, as the national coordinator in promoting financial literacy, has been planning to develop a new measurement system and the methodology for the aggregation of the results thereof – financial literacy index of the Latvian population (Index). A new intra-institutional working group was set up in 2013 for the establishment and expertise of the Index, which would ensure the development thereof in the first half of 2014.

During the reporting year, the FCMC also ensured a constant information flow related to the financial literacy topics on the website and the FCMC "Twitter" account, as well as in communication with media, and indirect educational activities – guest lectures of FCMC management and experts in the educational institutions for various target audiences, *inter alia*, in reply to invitations of non-governmental organisations to be involved in several public education campaigns.

GOVERNANCE AND STRUCTURE OF FCMC

Personnel policy

Personnel is the most important resource of the FCMC that ensure achieving FCMC's goals and further development of the institution. In 2013, the FCMC continued the commenced projects - assessment of the distribution of workload and responsibilities in support structures and defining and assessing the individual goals to be achieved by employees.

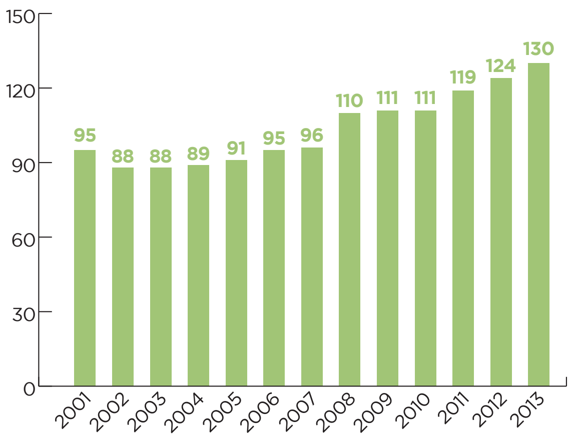
Numerical composition and changes in the personnel

In the reporting year, the number of persons employed by the FCMC increased to 130 positions. All six of the newly recruited employees are performing core functions (supervision and methodology experts and financial market analysts).

In 2013, the structure of the FCMC changed – to optimise the use of resources and management processes, the position of the Advisor to the Chairman was closed and two support structural units were united – Financial Division and General Service Division, forming the Financial and Service Division. The structural unit is directly accountable to the FCMC Deputy Chairman.

Image 23.

Dynamics of the number of employees (2001–2013)



The average number of employees, including employees that had been absent for a long time, was 129 in 2013, of which:

- 102 (79%) were performing core activities and 27 (21%) were performing support functions;
- 89 (70%) were public officials and 40 (30%) were employees;
- all employees were performing intellectual work.

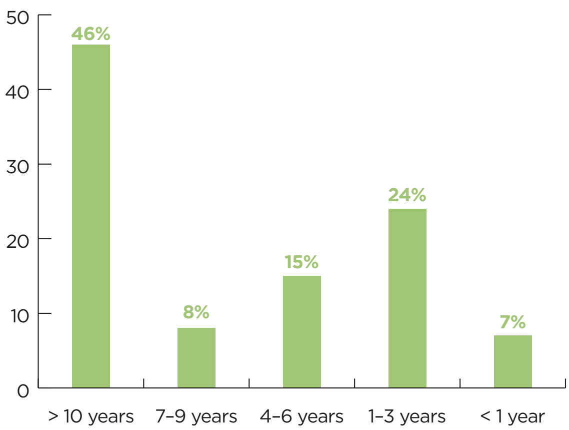
In the reporting year, 56 (43%) were assigned for 261 business trips, *inter alia*:

- 46 employees were involved, on a regular basis, in the work of the European Union bodies and working groups established by the European financial supervisory authorities (European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority);
- five employees took part in the working groups established by the European Central Bank in respect to the establishment of a single bank supervisory mechanism;
- Chairman and Deputy Chairman of the FCMC, as the representatives of the Republic of Latvia, participated in the Spring and Autumn meetings of the International Monetary Fund and the World Bank, and the Chairman of the FCMC also met with the representatives of the Central Bank of the Russian Federation.

In 2013, 93% (121) employees had worked in the FCMC for more than one year, 46% (59) employees had been employed with the FCMC for 12 years, i.e. as of its establishment (2001), and 7% (9) employees had worked in the FCMC for less than a year.

Image 24.

Breakdown of personnel by job duration in the FCMC (%)

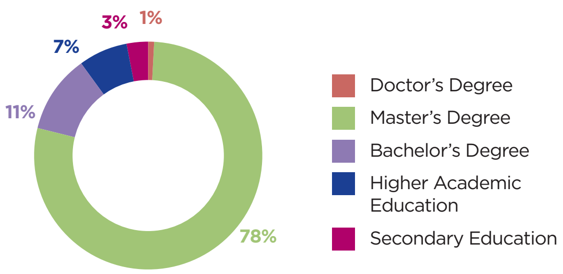


The staff turnover rate in 2013 was 2.3%. In the reporting year, 11 employees started working in the FCMC, of which one employee had an employment contract with the FCMC concluded for the extended absence of an employee (child care leave). After the probation period, in accordance with the established adaptation period plan all 11 employees received a positive assessment and continued their employment with the FCMC. The FCMC terminated its employment relationship with three employees, of which two had decided to make a career in the private sector, but one had passed the selection competition and continues her career in the European Banking Authority in Great Britain.

Staff qualification

Educated and professional employees are of high value to the FCMC. In the reporting year, 97% (126) of FCMC employees had higher (university) education (of which 78% had a Master's Degree), but 3% (4) employees had general secondary or professional secondary education (see Image 25).

Image 25.
Breakdown of FCMC personnel by education level (%)

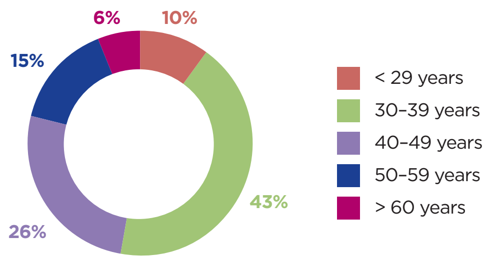


Demographic breakdown and age characteristics of personnel

In 2013, 73% (95) of all FCMC employees were women and 27% (35) were men. In the reporting year, the age profile of the personnel is characterised by the following indicators: 10% (13) of employees were up to 29 years old, 43% (56) – from 30 to 39 years old, 26% (33) – from 40 to 49 years old and 21% (28) were more than 50 years old.

The average age of FCMC employees in 2013, as compared to the previous year, slightly grew – 41 year.

Image 26.
Breakdown of FCMC personnel by age groups (%)



Performance management assessment

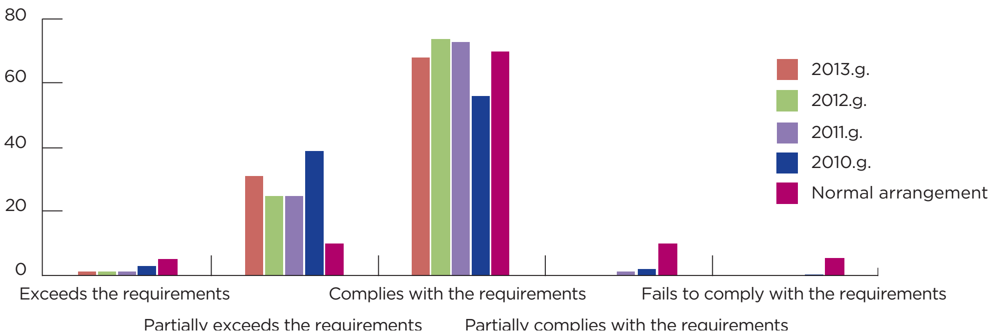
The year 2013 is the fourth year since the FCMC has started to carry out Performance Management Assessment (PMA) of the employees. In 2013, under the procedure set forth by the FCMC, 120 employees participated in the Performance Management Assessment, of which 22 were heads of structural units (incl., three Board members) and 98 were experts.

Four criteria were assessed within the performance management: attaining the established goals, fulfilment of professional duties, compliance with the requirements of professional qualification (incl., the level of education, professional experience, professional knowledge and skills, language proficiency and computer skills) and the required job-related competencies.

The overall assessment of all criteria "Complies with the requirements" was received by 68% employees, "Partially exceeds the requirements" - 31% of employees, but the assessment "Exceeds the requirements"' – 1% of the employees. In 2013 no employee received the overall assessment of all criteria "Partially complies with the requirements" and "Fails to comply with the requirements".

Image 27.

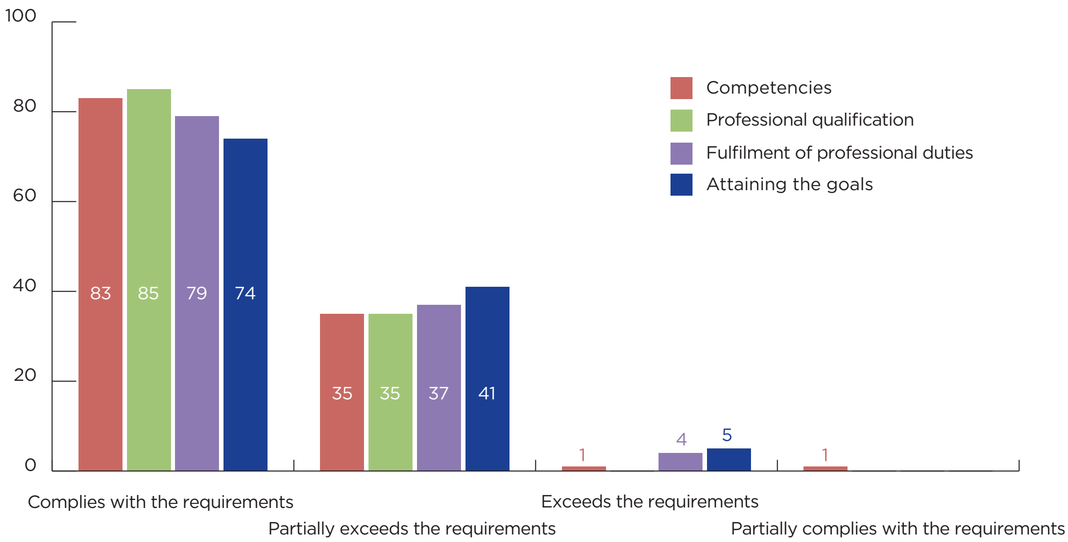
Overall assessment under PMA by criteria (number)



The majority of employees received the assessment "Complies with the requirements" also for each criterion separately – for attaining the established goals - 62% (74) employees, for the fulfilment of professional duties – 66% (79) employees, for compliance with the requirements of professional qualification – 71% (85) employees and for the required job-related competencies – 69% (83) employees.

Image 28.

Overall assessment under PMA by criteria (number)

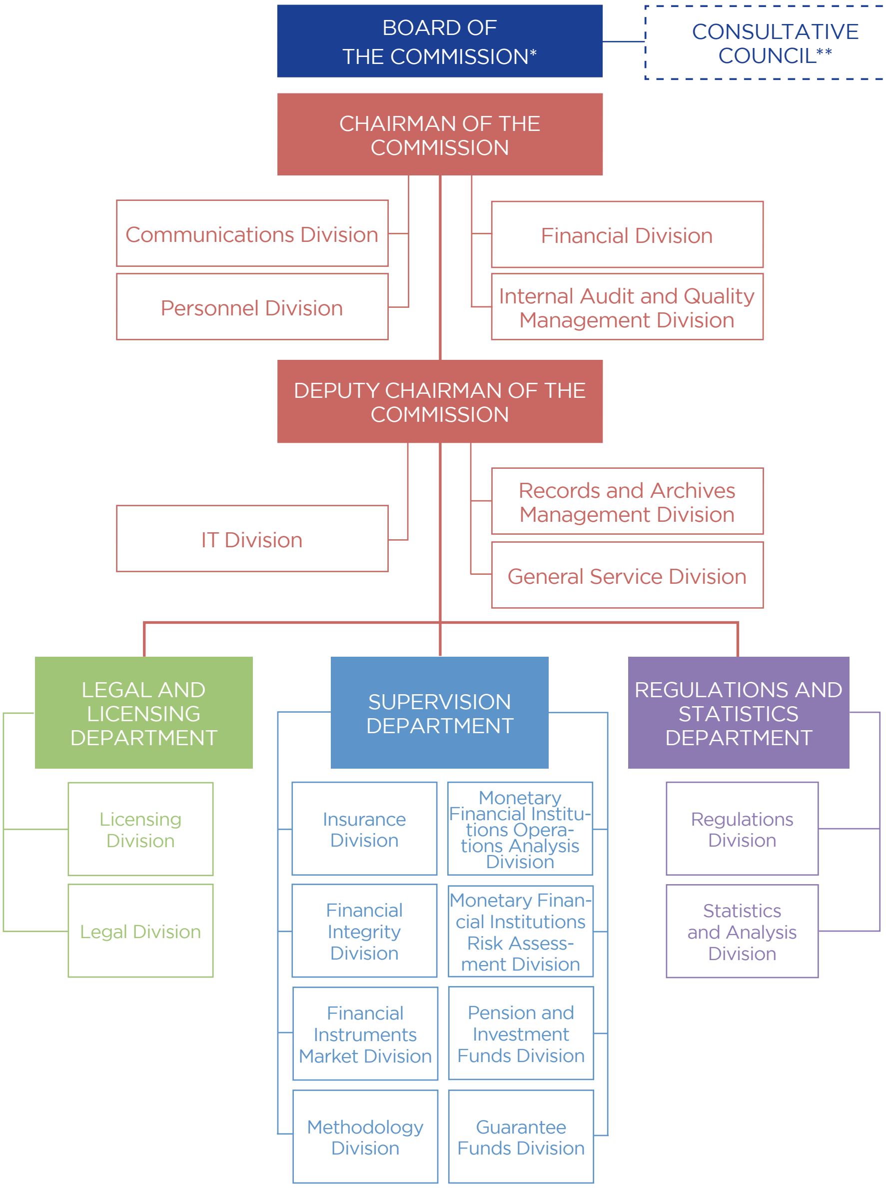


Improving staff qualifications

In order to, in line with the FCMC's strategy, constantly improve the FCMC's activity processes, increase the efficiency and productivity of performance, as well as to perform the supervision of the financial sector, especially the banking sector, 90 (69%) of CMC employees improved their qualification by attending training related to the fulfilment of their official duties both in Latvia and other countries. In Latvia, they attended seminars related to the improvement of knowledge in the area of administration and application of laws and regulations, on the issues of skills of financial analysis, risk management, electronic payments, procurement management, record keeping, information technologies and management skills. 18 (14%) of FCMC employees improved their English language skills to take active part in the work of the working groups established by the European Union bodies and the European financial supervisory authorities.

To supplement the knowledge in the area of banking risk management, stress testing methodology and practice, assessment of the anti-money laundering system, capital requirement of the insurance sector *Solvency II*, bank capital requirement or *Basel Capital Accord III* and in other issues related to financial supervision, 47 (36%) of FCMC employees attended seminars abroad.

FCMC structure



*The Board consists of five Board members: Chairman of the Commission, his Deputy and three Board members, who concurrently hold the positions of Directors of the Commission Departments.

**The Consultative Council on the parity principle is comprised of the Commission representatives and the head of public organisations (professional associations) of the financial and capital market participant

Financing of the FCMC's activities

In the reporting year, FCMC activities were fully financed from the payments by the participants of the financial and capital market. The FCMC, within the scope of its budget, in 2013 also managed the Deposit Guarantee Fund and the Fund for the Protection of the Insured, as well as administered the financial stability fee. Assets accrued in DGF and FPI are used for the purposes of funds only and the funds thereof are not used for the benefit of the FCMC for carrying out the administration tasks. The FCMC does not receive any payment from the state for administering the financial stability fee. The financial stability fee is credited to the State budget. Table 6 shows the budget approved for ensuring the FCMC's activities and the execution thereof.

Table 6.
Financing of FCMC's activities (2012–2013)

		IN 2013			
	Actual result in 2012[16], in lats	Actual result[16], in lats	Reporting year budget[16], in lats	Reporting year budget result, %	Share of actual result, %
REVENUES (+)	**4 224 632**	**4 462 910**	**4 454 645**	**100.2**	**100**
PAYMENTS BY PARTICIPANTS OF THE FINANCIAL AND CAPITAL MARKET	**4 208 517**	**4 449 978**	**4 447 620**	**100**	**100**
REVENUES RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	**2 767 040**	**3 181 520**	**3 258 545**	**98**	**72**
Payments by credit institutions	2 744 589	3 157 344	3 233 915		
Payments by credit unions	17 809	19 437	19 730		
Payments by payment institutions	3 323	3 547	3 500		
Payments by electronic money institutions	1 319	1 392	1 400		
REVENUES RELATED TO THE SUPERVISION OF INSURANCE	**1 102 646**	**862 846**	**862 845**	**100**	**19**
Payments by life insurance companies	161 337	146 621	117 550		
Payments by other insurance companies	941 309	716 225	745 295		
REVENUES RELATED TO THE SUPERVISION OF FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	**338 831**	**405 612**	**326 230**	**124**	**9**
Payments by participants of the financial instruments market	253 935	299 403	260 560		
Payments by private pension funds	84 896	106 209	65 670		
OTHER REVENUES	**16 115**	**12 932**	**5 300**	**184**	
EXPENSES (-)	**4 085 538**	**4 420 215**	**4 936 600**	**88.94**	**100**
REMUNERATION	**3 056 369**	**3 285 616**	**3 423 915**	**96**	**74**
Work remuneration, other payments to employees, mandatory State Social insurance contributions[17]	3 039 762	3 266 632	3 404 415	95	
Insurance of employees	16 607	18 984	19 500	97	
IMPROVING PROFESSIONAL QUALIFICATION OF THE STAFF AND BUSINESS TRIPS	**243 216**	**253 614**	**333 815**	**76**	**6**
SERVICES AND GOODS TO ENSURE ACTIVITIES	**534 022**	**557 429**	**754 400**	**74**	**12**
Telecommunications, liaison and information	126 419	107 021	122 355	87	
Information to the general public, internal and external communication	10 906	19 935	24 440	82	
Maintenance and maintenance-related expenses	310 261	387 455	396 360	98	
Professional services	86 436	43 018	211 245	20	
PARTICIPATION FEES IN INTERNATIONAL ORGANISATIONS	**183 599**	**250 678**	**341 470**	**73**	**6**
AMORTISATION/DEPRECIATION OF CAPITAL INVESTMENT	**68 332**	**72 878**	**83 000**	**88**	**2**

[16] The calculated amount of the advance payment of the Financial Stability for 2014 that is not included in the budget.

[17] Payments comparable to the work salary include lump sum benefits in the case of a birth of a child, in the case of death of a family member (200 lats) or benefits upon retirement, and compensation of medicinal optical eye-sight correction means (spectacles) (100 lats) for the emplyees specified by the occupational doctor. These payments also included the supplement for the replacement of employees during a long-term absence thereof or for the fulfilment of duties under increased work intensity circumstances.

To ensure the expenses of FCMC's activities, the increase whereof in 2013, as compared to 2012, comprised 7.9%, it was planned that the payment by financial and capital market participants would cover 90% of the FCMC budget, but the remaining 10% the FCMC would cover from the accrued funds for the previous reporting years. If any of the financial and capital market sectors exceeds the scope of financing allotted to it, the respective surcharge shall be accounted in the advance payments of the market participant for the financing of FCMC's activities for the next period. In 2013, out of all sectors, the excess only formed in the amount of 2.3%. In turn, in view of considerable savings in separate expenses items, the FCMC was able to close 2013 with income exceeding the expenses, thus the use of the planned 10% of the accrued funds of the FCMC for the previous reporting year was not implemented.

The amount of payments by the financial and capital market participants into the revenue budget of the FCMC is directly proportional depending upon the payment rates stated for them for financing the FCMC and changes in the financial market performance indicators (increase or decrease), as well as from the amount of expenses necessary for ensuring the activities of FCMC.

Table 7.

Changes in the actual financing of the FCMC (2007–2013, %)

	2013/2012	2012/2011	2011/2010	2010/2009	2009/2008	2008/2007
Payment by participants of the financial and capital market	**6%**	**4%**	**2%**	**-22%**	**45%**	**4%**
Income related to the supervision of monetary financial institutions	15%	-3%	1%	-25%	58%	3%
Income related to the supervision of insurance	-22%	18%	-1%	-11%	21%	0%
Income related to the supervision of financial instruments market and private pension funds	20%	26%	29%	-17%	20%	36%

The dynamics of the financing of the FCMC is also related to the share of the costs for supervising the respective sector and the sector's ability to ensure the necessary amount of financing. Over the years the financing of the FCMC from market participants has been proportionally shared, taking into account the scope of supervision of each sector and the costs related thereto. In 2013, in view of the increase of the indicators of the financial instruments market, this sector had also increased its ability to cover the costs of its supervision, and in 2013 they reached 9% of the total financing structure of the FCMC. In view of the decrease of the costs of supervision of the insurance sector, the share of financing of this sector also decreased in the total income budget of the FCMC. The share of financing increased for monetary financial institutions, but it should be noted that since 2011 the circle of monetary financial institutions has been supplemented by payment institutions and electronic money institutions.

Image 29.

Structure of FCMC financing (2007–2013, share %)

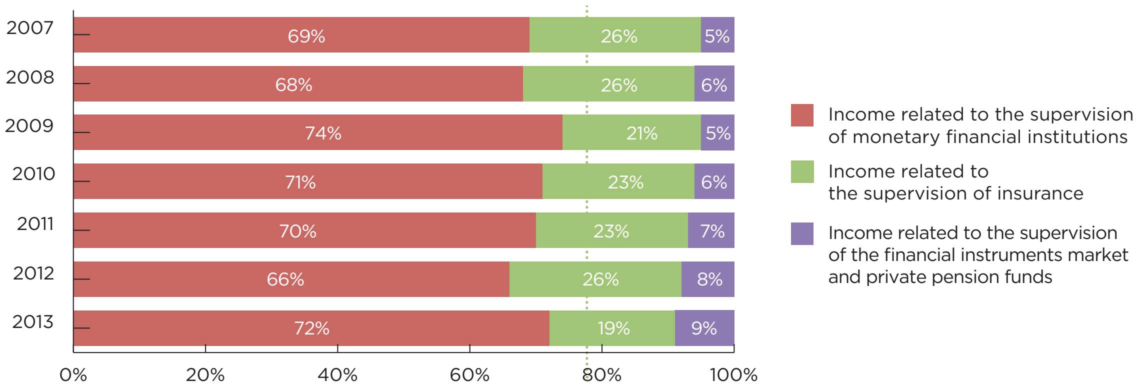
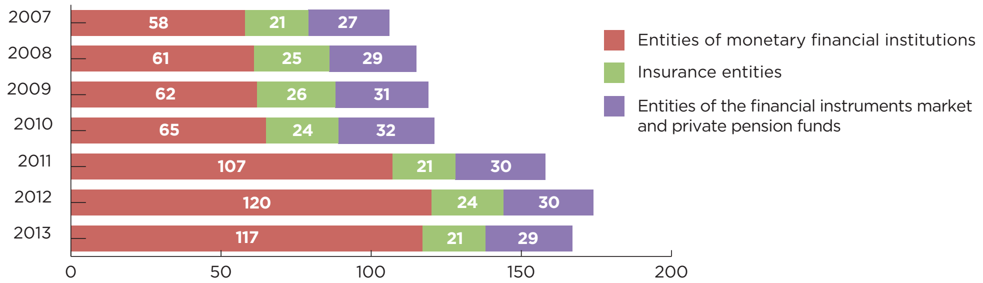


Image 30.

The number of financing providers to the FCMC and of the entities of the financial and capital market subject to supervision, excluding the entities that do not provide financing to the FCMC (2007–2013)



In 2013, staff remuneration costs formed the largest part (74%) of expenses for ensuring the activities of the FCMC, which, in terms of volume, have changed according to the number of job positions in the FCMC and changes in remuneration in the financial sector, which the FCMC is guided by in determining the salaries of employees and observing the restrictions in the field of work remuneration and social guarantees set for the employees of public administration institutions. As of 1 March 2011, the monthly remuneration of FCMC's officials and employees has been determined according to the *Law on Remuneration of Officials and Employees of the State and Local Government Authorities*, taking into account the importance of the position (the level of responsibility and complexity), assessment of individual qualifications and competencies of the respective official or employee, as well as the remuneration of the employees in the financial sector. Remuneration of the FCMC Chairman may not exceed the average monthly salary disclosed by the Central Statistical Bureau in its Statement about employees of the financial and insurance sector in the year before the previous year, i.e. 2011, and applying a ratio of 4.95 thereto. The FCMC demonstrated its solidarity with other public administration bodies and, as of 2008, the remuneration system has been reviewed. The remuneration to FCMC Board members has not been changed since 2011. Table 8 shows the remuneration structure of FCMC employees in 2013.

Table 8.

The remuneration structure of FCMC employees in 2013

TYPE OF REMUNERATION	AMOUNT, IN LATS	SHARE, %
Salary	**2 193 315**	**66.76**
Supplement	8 693	0.26
Payment for absence related to temporary inability	21 803	0.66
Leaves of absence (annual, supplementary, leave compensation)	264 940	8.06
Study leaves	3 211	0.10
Paid day off[18], retaining the salary	9 771	0.30
Material benefits or rewards (child birth, death of a relative, notable personal event)	8 603	0.26
Compensation for medically optical correction means	3 734	0.11
Leave benefits[19]	86 520	2.63
Payment for the meeting of Consultative Council[20]	4 305	0.13
Contracts for work performance	565	0.02
Provisions for bonuses	30 000	0.91
Mandatory State Social Insurance contributions	**631 172**	**19.21**
Health insurance of employees	**18 984**	**0.58**
TOTAL	**3 285 616**	**100**

[18] In cases stated by the Labour Law and FCMC.

[19] If an employee has worked with the FCMC for more than 5 years – the amount of leave benefit comprises 50% of his / her salary, but if he / she has worked for less than five years, but not less than for a year – 25%.

[20] In 2013 eight meetings were held, including payment for the meeting in December of 2012.

Table 9.

Breakdown of work remuneration and other payments to employees by structural units in 2013

STRUCTURAL SEGMENT	NUMBER OF THE EMPLOYED	SHARE OF THE EMPLOYED %	AMOUNT[21] IN LATS	SHARE OF COSTS %
FCMC Board	5	3.73	240 926	9.26
Personnel Division	3	2.24	48 605	1.87
Financial and Service Division	6	4.48	101 744	3.91
Information Technologies Division	9	6.72	181 794	6.99
Internal Audit and Quality Management Division	2	1.49	36 440	1.4
External Communications Division	3	2.24	45 423	1.75
Communications Division	4	2.99	59 715	2.30
Records and Archives Management Division	7	5.22	82 643	3.18
Supervision Department	61	45.51	1 117 427	42.97
Legal and Licensing Department	17	12.69	311 294	11.97
Regulations and Statistics Department	17	12.69	374 579	14.40
Total	**134**	**100**	**2 600 590**	**100**
Consultative Council (6) and contract for work performance (1)	4[22]	-	4 870	

As of its establishment, the FCMC had invested notable funds in information technologies in order to optimise supervisory processes and the FCMC's organisational management processes, including the flow of electronic record keeping documents, and to more efficiently process the financial information of the entities of the financial and capital market for supervisory purposes. The FCMC actively applies the alternative types of document execution and electronically signed documents, and the documents are mainly signed by an electronically secure signature. By maintaining an electronically secure signing in the FCMC, the costs thereof in 2013 comprised the amount of 1,265 lats. The book value of information technologies at the end of 2013 comprised 67% of the total long-term investments (see Table 10).

Table 10.

Dynamics of the FCMC's long-term investments, 2007–2013 (at the end of the year)

	2013	2012	2011	2010	2009	2008	2008
Total long-term investments in the book value in lats	**233 998**	**211 528**	**212 436**	**196 970**	**193 126**	**182 898**	**88 948**
Total units	**4 103**	**3 949**	**3 859**	**3 710**	**3 564**	**3 363**	**2 966**
incl., software and information systems in book value, in lats	87 700	95 091	90 529	75 925	65 044	53 443	47 853
number of units	2 508	2 386	2 344	2 246	2 166	2 002	1 759
t.sk. informācijas tehnoloģiju iekārtas bilances vērtībā, latos	69 855	62 473	68 100	68 521	72 321	66 542	23 021
number of units	430	384	360	382	367	374	307

[21] Without provisions for bonuses.

[22] The meetings of Consultative Council are attended, on a regular basis, by four members of the Consultative Council.

Investments in information technologies include the regular replacement of computers to ensure their optimum performance for processing supervisory information systems and more advanced use of equipment in its work, and the development and improvement of information systems, as well as the use of licensed software. For the FCMC to ensure the flow of statistical, supervisory and recordkeeping documents, several information systems have been developed and adapted for the FCMC's needs with the aim to minimise the flow of paper format documents and manual processes, ensuring swift action, data quality and a comfortable cooperation environment for market participants (see Table 11).

Table 11.

Dynamics of changes of the FCMC's capital investments, 2008–2013

	Changes in 2013[23]	Changes in 2012[23]	Changes in 2011[23]	Changes in 2010[23]	Changes in 2009[23]	Changes in 2008[23]	Changes in 2007[23]
Total capital investments, in lats	**31 291**	**47 559**	**3 199**	**56 291**	**38 236**	**99 222**	**32 156**
Total units	**161**	**90**	**133**	**146**	**196**	**388**	**307**
incl., software and information systems, in lats	25 907	34 684	32 435	33 105	35 074	32 394	30 798
number of units	122	42	77	87	156	229	265
incl., improvements of existing units	4	3	22	7	11	7	9
incl., information technology equipment, in lats	7 578	9 776	-37 886	19 660	10 547	51 712	3 094
number of units	46	19	-22	21	-7	67	7
incl., improvements of existing units	3	4	1	6	1	2	1

The financial statements of the FCMC for 2013, as well as the financial statements of 2013 of DGF and FPI under the possession of the FCMC and independent auditors' statements thereon are available on the FCMC website at www.fktk.lv.

[23] Acquired during the year, deducting the excluded ones (in the amount of the initial value).

INTERNAL AUDIT AND QUALITY MANAGEMENT

In 2013, the Internal Audit and Quality Management Division, objectively verifying the functions and processes of the FCMC, provided FCMC management with an opinion about:

- the efficiency of the established internal control system and its suitability for achieving the set objectives;
- compliance of the activities of structural units with laws and regulations, established functions and approved work plans;
- improving overall governance process by providing information on risks and control in the relevant areas.

Internal audits are planned and carried out on the basis of risk assessment, paying the main attention to the core activity processes of the FCMC. The outcomes of each internal audit are reported to the FCMC Board, by submitting the corresponding report.

In the reporting year, two internal audit inspections planned for the reporting year were accomplished and two – commenced. The performed internal audit inspections covered the following audited areas: supervision of activities of private pension funds and investment management companies, supervision and control of the provision of investment services, trading in financial instruments and disclosure of information, corruption and conflict of interests risk management, and, on the basis of the customer's application, an official inspection was also carried out regarding the facts mentioned in the application.

As a result of the performed internal audit inspections, it was detected that in the audited areas the internal control system has been established and was well-functioning in all material aspects, yet separate improvements were still needed, and the assessed control procedures, in general, were adequate, sufficient and efficient, providing sufficient confidence that FCMNC risks have been managed and the institution had reached its objectives.

For the improvement of the functioning of the internal control system and the mitigation of potential risks and adverse effects, the auditors, during the reporting year, having carried out the internal audit inspections, made 14 recommendations directed towards the improvement and streamlining of the internal control system of the FCMC, of which five or 36% were assigned high priority, eight or 57% were assigned average priority, one or 7% was assigned low priority. The provided audit recommendations ensure the elimination of detected weaknesses and improve the existing control system to contribute to an orderly and efficient performance of the FCMC. By the end of the reporting year, the management had implemented 85% of the approved recommendations to be introduced during the reporting year and the work on the implementation of other recommendations has been continued.

AUDIT RECOMMENDATIONS ENSURE THE ELIMINATION OF UNCOVERED WEAKNESSES – BY THE END OF THE REPORTING YEAR 85% OF THE APPROVED RECOMMENDATIONS WERE INTRODUCED.

To improve and streamline the functioning of the internal control system of the FCMC, in the reporting year, the FCMC, by implementing the recommendations provided in the internal audit reports, started working on streamlining the risk management process, took several measures to strengthen the process of the supervision of activities of private pension funds and investment management companies, supervision and control of the provision of investment services, trading in financial instruments and disclosure of information, continued working on streamlining the functioning of the deposit guarantee scheme, streamlining the supervisory processes in the field of the prevention of money laundering and terrorist financing.

In the reporting year, SIA "PricewaterhouseCoopers" carried out the conformity assessment of the FCMC internal audit function to "Internal Audit Definition", "Code of Ethics", "International Standards of

Professional practice of Internal Audit" issued by the Institute of Internal Auditors and coming into effect on 1 January 2013, Practice Advisories of Internal Audit, containing the guidance notes for the application of Standards, in the updated version on 1 December 2013, as well as the best practice in the internal audit. As a result of the conformity assessment, several recommendations were received, through the implementation whereof the FCMC would increase the efficiency of the internal audit function.

To ensure the conformity of the services provided by the FCMC to the interests of the State and population, as well as the customer interests and requirements set forth by laws and regulations by means of streamlining opportunities and available resources, a quality management system was established in the FCMC in line with the requirements of EN ISO EN ISO 9001:2008 standard (activity scope "Regulations and Monitoring of the Financial and Capital Market and the Activities of its Participants"), subject to constant improvement, in view of the best practice examples and experience of the financial sector supervisory authorities. On the basis of the FCMC management decision, the quality management system has been maintained without certification as of 8 May 2012. According to the outcomes of internal audits, the FCMC continues working on the constant improvement and increase of efficiency of the quality management system.

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