FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

ANNUAL REPORT AND ACTIVITY REPORT OF THE FINANCIAL AND CAPITAL MARKET COMMISSION FOR 2014

OUR MISSION

To regulate and supervise the activities of the financial and capital market and of the participants thereof, promote the protection of the interests of investors, depositors, and insured persons, as well as the development and stability of the financial and capital market.

OUR VISION

A sound Latvian financial market integrated in the European Union common market, associated with professional, rigorous and fair supervision.

OUR VALUES

Accountability — we are aware of the impact of our activities on the performance of individual market participants and on the financial system as a whole, we are responsible for the protection of the interests of investors, depositors, and insured persons, as well as for the development and stability of the financial and capital market.

Openness — we are open to a dialogue before making decisions, available and cooperative, as well as we are able to professionally make use of our knowledge finding solutions to a wide spectrum of challenges.

Transparency — we explain our decisions to the public in an explicit manner, complying with regulatory restrictions on the disclosure of information.

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INTRODUCTION

CHAIRMAN'S FOREWORD

The past year was a challenging one, however, in spite of some uncertainty in the geopolitical situation and economic growth, Latvian economy continued to move in the direction undertaken in the previous years — towards development, which had a favourable impact on the growth of the Latvian financial sector.

The signs of stable growth were observed in all participating segments of the financial market. In the banking sector, the capitalisation and liquidity levels remained high, the earning capacity and the quality of the loan portfolio improved, deposits continued to increase and the rate of reduction in the bank loan portfolio slightly slowed down. In 2014, total gross premiums written by insurance companies exceeded the pre-crisis level, and their profitability indicators improved. Last year was also a successful year for state-funded and private pension funds. In 2014, the accumulated pension capital of the second-pillar investment plans was slightly above 2 billion EUR, while private pension plans experienced the sharpest increase in terms of the number of the participants over the last five years.

Developments in 2014

On 1 January, the euro replaced lats in our purses and wallets. Having lived more than a year in the Eurozone, all debates, expert forecasts and speculations one could observe in the beginning of the year, have long been forgotten. It was the introduction of the euro that was one of the greatest challenges of the year to Latvian financial market participants, which made them improve, as well as seek appropriate solutions to successfully adapt to the new circumstances of operation.

In the spring of 2014, there was a tense public focus on the events occurring in the neighbouring countries, which also had an impact on the developments in the financial sector. Having regard to the European Union (EU) agreement on the application of international sanctions on certain Ukrainian and Russian persons, all Member States, including Latvia, complied with the requirements of the EU Council regulation on freezing financial funds. The Financial and Capital Market Commission (FCMC) monitored compliance with the requirements laid down in the Regulation by all institutions, paying particular attention to the impact of the financial sanctions on Latvian banks. The conclusion drawn was that the sanctions had not had a significant impact on the ability of banks to comply with the regulatory requirements. Neither have the sanctions had a direct impact on the total amount of deposits in the banking sector or on other financial performance. Of course, the attention of the supervisors was also focused on the indirect impact of the sanctions, because the sanctions lead to the worsening of the overall economic situation in Russia resulting in the increase of the general government deficit. Generally, taking into account also the indirect impact of the sanctions, no significant consequences thereof were observed in the Latvian financial system.

Speaking of developments in supervision during the last year, the activities related to the stability of the banking sector as well as the overall financial stability of the system as a whole must be noted.

In November 2014, we successfully introduced the Single Supervisory Mechanism (SSM) of banks. It was the first step towards the building of the European banking union to restore confidence in the banking sector and expand the monitoring thereof under uniform standards. Before the European Central Bank (ECB) took over the supervisory duties within the scope of the SSM, the Comprehensive Assessment of banks was carried out for almost a year. The FCMC experts were also involved in this extensive review of the financial standing of banks ensuring, in cooperation with the ECB, a uniform approach to the assessment as well as other necessary support. The three largest (in terms of their assets) Latvian banks (*Swedbank, SEB Bank and ABLV Bank)* participated in this assessment, and all three have passed it (the implementation of the new supervisory system of the European banks is detailed in the section *The implementation of the Single Supervisory Mechanism* of the report).

From the perspective of the stability of the financial system as a whole, macro-prudential supervision is being implemented in Latvia, which provides for appropriate measures to promote the resilience of the system. In the future, should cyclical (e.g. excessive increase of crediting) or structural (e.g. related to systemically significant (too big to fail) credit institutions) systemic risks increase, the FCMC will be able to apply appropriate instruments — introduce the capital buffer requirements, raise the minimum capital and liquidity requirements, impose tighter restrictions on large exposures, etc.

The reform entailing the publishing of supervisory decisions was another development in 2014. We started the publication of information about all sanctions (fines, warnings, etc.) applied by the FCMC to banks as required under the European Parliament Capital Requirements Regulation and Directive (CRR/CRD IV or Basel III). In providing greater transparency on the decisions passed by the supervisor, we have not derogated from the minimum disclosure requirement. The FCMC has opted to publish information on the type of the applied sanction, as well as disclosing the name of the market participant. Previously, under the effective Latvian laws and regulations all information obtained in the course of the supervisory process along with the decisions passed qualified as restricted access information that could only be disclosed in a summarised form so that the specific market participant could not be identified. It should be noted that this has been just the first step. We started with the largest and major participants of the financial and capital market — banks. However, we expect that the publishing of the information on the applied sanctions will also be gradually extended to other market participants: insurance companies, pension funds, etc. According to a worldwide trend, the financial supervision moves towards a greater disclosure of information to the general public, seeking to strike the balance between transparency and market stability. Such an approach encourages market participants to keep a closer focus at how they comply with laws and regulations.

Ever since we undertook the strategic management of financial literacy, 2014 was a particularly full year in terms of new activities. Last year, the *National Strategy for Financial Literacy in Latvia 2014–2020* was developed, the first survey of the financial literacy of Latvian population was carried out and a new measurement tool (Financial Literacy Index) was built to be used to gauge the level of knowledge of Latvian population in terms of seven literacy topics, which will be used in the future years to assess the financial literacy level of Latvian population for the current year. In the future, the FCMC will continue to actively work at promoting the public knowledge and understanding of the correct action in making financial decisions, which is an important condition for the overall financial system stability.

Challenges for 2015

Although not having had a significantly impact on the banking sector as a whole, the events in the neighbouring countries and the international financial sanctions applied by the EU have contributed to the building of a fairly prudent view of the future development and growth opportunities. To that end, in 2014, the supervisor as well as market participants had a focus on the appropriate management of risks and the ability to maintain strong performance indicators. This goal will also be pursued in 2015.

The increase in crediting and the availability of loans to various segment groups is one of the questions unlikely to lose its topicality, just like as the question of the access to financial services in regions. In the debate between commercial banks and politicians aimed at finding a compromise, an agreement has been reached on further action to tackle these matters.

The implementation of the SSM is a goal already achieved; however, the cooperation with the ECB will continue to evolve, as this year will pass under the sign of integration. Furthermore, this year, the next steps will be taken to create the banking union — a harmonised deposit-guarantee scheme, which in the case of Latvia has already been largely brought in line with the EU requirements, as well as implementing the Single Resolution Mechanism (SRM).

Taking responsibility for the use of a number of new macro-prudential instruments, macro-prudential supervision has become one of the strategic areas, which the FCMC will continue to consolidate this year. From 2015 onwards, the FCMC will determine, on a quarterly basis, and publish the requirement of the countercyclical capital buffer (CCB) in transactions with Latvian residents, which will apply 12 months after determining the CCB requirement specific to a particular credit institution. The CCB aims to ensure that credit institutions accumulate a sufficient capital base during an economic upturn to absorb losses during a downturn. It will serve as a kind of a safety cushion to credit institutions, so that they are able to continue crediting when difficult times set in.

With a view to effectively implementing its functions, promoting the development and stability of the financial and capital market, as well as protecting the interests of investors, depositors and insured persons, during the past year, the FCMC developed (and approved in 2015) *the Capital Markets Authority Strategic Plan for 2013-2017*, laying down six strategic priorities, which will attract a special focus of the FCMC in the forthcoming three years.

The highlighted priority areas are: the improvement of the regulatory framework of the Latvian financial sector within the context of the EU single market, building of efficient macro prudential supervisory mechanisms in cooperation with the Bank of Latvia and the Ministry of Finance, the development and optimisation of supervisory methods and practices, promoting the implementation of such operational business models of market participants that are adequate for Latvian circumstances, sustainable and secure for consumers, the implementation of efficiently functioning resolution mechanisms, as well as providing information to the general public and raising the level of its financial literacy.

Using this opportunity, I would like to thank my colleagues — all FCMC staff — for their responsible attitude and professional work in fulfilling our tasks in 2014, about which everyone has the opportunity to familiarise themselves in this annual report.

Yours sincerely

Kristaps Zakulis
Chairman of the FCMC

REPORT OF THE BOARD

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

The activities of the FCMC are managed by the Board, consisting of five members of the Board: Chairman of the FCMC, his deputy and three members of the Board, who concurrently are the directors of the FCMC department. The composition of the Board has remained unchanged compared to the previous year.

Kristaps Zakulis — Chairman of the FCMC

Pēters Putniņš — Deputy Chairman of the FCMC

Gvido Romeiko — Member of the Board and Director of the Legal and Licensing Department

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

Once a week, the Chairman of the FCMC convenes and chairs the meetings of the Board for the review of important issues and adoption of decisions. In 2014, 46 meetings of the FCMC Board were held, during which 307 decisions were adopted (in 2013 — 50 meetings and 297 decisions, respectively).

To promote the efficiency of the monitoring of the financial and capital market and facilitate the safety, stability and development of this market, the meetings of the Consultative Council are also convened on a regular basis. In 2014, nine such meetings were held during which 39 draft laws and regulations binding on the financial and capital market were reviewed (in 2013 — 50 draft laws, respectively).

As the core function of the FCMC is to ensure the supervision of market participants, last year, the FCMC continued to consolidate the framework of intensive supervision the purpose of which is to enable the carrying out of risk-based and result-oriented supervisory measures. For more information on the measures taken refer to section Supervision. Last year, the SSM became operational; therefore significant supervisory measures were also carried out in cooperation with the ECB, including the transfer of the direct supervision of the largest Latvian banks to the ECB within the scope of the Comprehensive Assessment.

The on-going supervision of market participants was based on related methods — the off-site monitoring of their performance and on-site inspections. Overall, in 2014, the FCMC carried out 78 on-site inspections of market participants, of which 23 inspections were carried out in banks, one — in an insurance company, six on-site dawn raids of insurance and reinsurance brokers (legal entities), 21 — in credit unions, four — in payment institutions, one on-site inspection in an electronic money institution, two — in investment management companies and in total 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 one — in an investment brokerage company. Last year, to assess the compliance of the activities of financial and capital market participants with the requirements of the *Law on the Prevention of Laundering the Proceeds from Criminal*

Activity (Money Laundering) and of Terrorist Financing, the FCMC carried out eight on-site inspections in banks, three inspections related to the supervision of payment institutions, as well as one inspection in an investment brokerage firm.

Overall in 2014, with a view to improving the principles of supervision of the providers of financial services and caring about the protection of customer interests, the FCMC also carried out four mystery shopping visits, to ascertain that the financial and capital market participants complied with the requirements of laws and regulations in the field of the provision of investment services. Within the scope of the inspections, the FCMC also performed eight on-site information system security audits.

In 2014, the FCMC experts continued to improve the regulatory framework governing the activities of the financial and capital market participants. Based on the guidelines issued by EU institutions, best international practices and considering the specific nature of the Latvian financial sector, amendments to several FCMC Regulations were developed and approved, the most important of which are summarized in section *Development of laws and regulations*.

In order to effectively fulfil its mission and objectives, the FCMC continued to actively cooperate with other state institutions, such as the relevant parliamentary committees, the Bank of Latvia, the Ministry of Finance, the Latvian Central Depository, the Consumer Rights Protection Centre, etc. In terms of international cooperation, the priority of the FCMC was participating in events in the European region. The FCMC was involved in debating laws and regulations at the EU Council and the committees of the European Commission, as well in the work of the European financial supervisory authorities. In 2014, participation in the SSM emerged as a new direction of activity. Continuing bilateral cooperation with the supervisory authorities in those countries which have engaged in cross-border cooperation with Latvia was equally as important. In 2014, on the grounds that Latvia has started the negotiation process for joining the *Organisation for Economic Co-operation and Development (OECD)*, the FCMC was actively involved in the preparation and examining of Latvian reports at the OECD financial market, insurance and pension, investment and corporate governance committees.

STRATEGY OF THE FCMC ACTIVITIES

In 2012, when reviewing the strategy of its activities for 2012-2014, the FCMC identified three key priorities aimed at carrying out the functions of a supervisory institution as efficiently as possible. The following three strategic priorities were identified by the end of 2014:

- improving the regulatory framework of the financial sector,
- consolidating the supervisory framework,
- raising of the level of financial education and awareness.

The targeted effort of the FCMC directed to the mentioned areas has brought about obvious progress, enabling a conclusion that the strategic priorities set for the medium term have been partially or fully implemented.

Improving the regulatory framework of the financial sector provided for the activities of the FCMC in the institutions of the European financial supervision and the implementation of the EU legislation in the banking and insurance sector, ensuring a solution that is the most appropriate for the Latvian market. Extensive and comprehensive information on the performance of the FCMC in these areas has been summarised in sections *Development of laws and regulations and Cooperation* of the present report.

The FCMC also took part in the process aimed at the building of the EU Single Framework for Managing Crisis to ensure the representation of the national position in developing the framework for the recovery and resolution of investment brokerage firms, which is being continued and will be completed in 2015.

The FCMC played had an important role in planning and implementing the adoption of the euro to ensure that the Latvian financial market is ready for the changeover to the new currency. The working group of the Financial System of the Euro Project, which was led by the FCMC representative, developed and implemented measures for the adoption of the euro in the money and capital market, financial instruments market and the public debt denomination areas as well as for adapting of the securities system to carrying out transactions in the euro.

To ensure a smooth transition to the euro, the FCMC, as the financial supervisory authority, was closely monitoring how market participants prepared for the adoption of the euro, i.e. whether all market participants had developed action plans or guidelines for the adoption of the euro, designated the person responsible for ensuring the changeover to the euro, assessed potential operational and information technology risks and activities aimed at mitigating the impact thereof, how they intended to provide a dual display of prices in lats and the euro during the period specified in the euro legislation, and what their plans were for ensuring the availability of cash in euros at ATMs and cash offices. The FCMC also monitored the changes to the commission charges of banks during the transition period. Considering the coordinated planning process, as well as enhanced supervision in the last month before the changeover to another currency, the introduction of the euro went smoothly without any major incidents, as evidenced by the absence of any significant complaints about violations by market participants during the introduction of the euro.

In implementing measures aimed at **consolidating the supervisory framework**, the FCMC in cooperation with the Bank of Latvia worked on the consolidation of the macro-prudential supervision to ensure a timely identification of systemic risks and take measures to prevent or mitigate them. The Chairman of the FCMC also attended the meetings of the European Systemic Risk Board (*ESRB*), to which macro-prudential powers have been conferred and whose task is to evaluate the potential hazards to financial stability as well as ensuring a timely warning of emerging systemic risks. The issues related to the ensuring of macro-prudential supervision will remain topical also in future periods.

With a view to strengthening supervision, over the last three years, the supervisory methods of on-site inspections and off-site monitoring were improved, carrying out risk-based supervision. For more detailed information, refer to sections *Methods of supervision* and *Measures of supervision* of the present report. The FCMC also assessed the performance, risk level, and the quality of managing thereof on a quarterly basis. The results of the monitoring of these risks were used by the FCMC to plan the required supervisory measures, including on-site inspections. In carrying out the supervision of banks, the FCMC applied sanctions provided for under the *Credit Institution Law*.

Considering that financial knowledge is a necessity of a modern society, **raising the level of financial literacy and awareness** was identified as the third key priority. Since 2012, with a view to promoting the understanding of the financial sector and the ability to make informed decisions in choosing each financial service, the FCMC has been making available extensive information on the activities of the FCMC, as well as those of the financial and capital markets. In 2012, the Communications Division was re-established within the FCMC and the *Communication Strategy for 2012–2015* was developed, providing for an open and proactive approach to informing the general public through traditional as well as social media. In 2012, the FCMC approved the *Crisis communication plan*, which provides for coordinated communication and cooperation between the FCMC, the Bank of Latvia, the Ministry of Finance and the Prime Minister's office in the event of crisis, involving, if necessary, market participants as well as the professional associations thereof. A number of crisis communication simulations have been held, and the training was delivered to the staff of public administration institutions.

With a view to promoting the awareness of the customers of the sector on the services and the key risks thereof, the FCMC has been maintaining an educational portal *CUSTOMER SCHOOL*, offering continuing education for individuals who do not have the possibility to return back to school.

In 2012, responding to the call by the general public to provide summarised information to enable customers to evaluate a bank before becoming the customers thereof, the FCMC experts built an interactive tool *BANKING COMPASS* to be used by anyone interested to familiarise themselves with the most important banking indicators. *BANKING COMPASS* provides information on the quarterly banking performance indicators, as well as the explanations of the key indicators.

In 2013, expanding the international dimension, the FCMC became the partner and national coordinator of *Child and Youth Finance International*, coordinating the annual *Global Money Week* among other things. The first Financial Training Week in Latvia was held in March 2013, growing into a tradition in 2014 as well as in 2015.

During this period, the FCMC also participated in school support campaigns *Back to School, Open Door Day* and *Shadow Day,* delivering guest lectures at schools and universities, as well as conducting opinion polls on the topics of financial literacy and informing the general public about the results thereof.

With a view to establishing a uniform strategic approach to gradual raising of the level of the financial literacy of the population, when defining its objectives to be achieved, the main directions and tasks, as well as the necessary resources and institutions involved, the FCMC in cooperation with the partners also developed the *National Strategy for Financial Literacy in Latvia 2014–2020*. The FCMC has taken the next step to promote financial literacy. For the measurement thereof in Latvia it has developed a new measurement system and result aggregation methodology, i.e. it has developed the Financial Literacy Index of Latvian population. More information on the successes of 2014 are provided in the section *Communication with the General Public. Educating customers*.

In 2014, the FCMC developed the **Regulation and Supervision Strategy for the Financial and Capital Markets**: 2015–2017, which was approved in 2015[1], setting out six strategic priorities attracting a special focus in the forthcoming three years:

- To improve the regulatory environment of the Latvian financial sector in the context of the EU single market.
  Improving of the regulation of the financial sector provides for the improvement of the regulatory environment that is appropriate and commensurable for the Latvian financial sector and for the supervisory objectives in the context of the EU single market.
- To create an effectively functioning macro-prudential mechanism, in cooperation with the Bank of Latvia and the Ministry of Finance.
  Significant strengthening of macro supervision is one of the key tasks in the process of the consolidation of the supervisory framework to enable the timely identification of systemic risks and to take the measures aimed at preventing or mitigating these risks, employing appropriate instruments.
- To develop and make more efficient the supervisory methods, tools and practices employed in supervising the financial and capital market.
  Upon joining the Eurozone, Latvia automatically joined the SSM. Considering the new challenges, within the next three years, the FCMC plans to ensure that its supervisory methods, tools and practices conform to the principles applied by the ECB, continuing active and mutually productive cooperation with the ECB, taking into account also the nature of the Latvian financial sector.

1 FCMC strategic priorities for 2015–2017 are: http://www.fktk.lv/texts_files/STR_2015_2017-FKTK.pdf

- To promote the implementation of such business models of the activities of market participants that are adequate to Latvian circumstances, sustainable, responsible, and secure for the consumers of financial services.
  Given the changes in the global and Latvian financial market, which also impact the business decisions and activities of market participants, there are plans to have a closer focus on the changes and trends in the strategies of the market participants through maintaining a continuous and open dialogue with them to enable a more accurate assessment of risks and taking the necessary measures early to promote market development.
- To implement a resolution mechanism that is integrated with the EU system, appropriate for the Latvian financial sector and effectively functioning, among other things, improving the instruments for the prevention of crisis.
  In order to ensure the fulfilment of the tasks of the FCMC as the national competent authority (the functions of the resolution institution), one of its priorities is the implementation of a resolution mechanism that is integrated with the EU system, appropriate for the Latvian financial sector and functioning effectively to consolidate the supervision of market participants and improve the instruments for the prevention of crisis, protect the interests of the general public during the resolution process and preserve financial stability in the country.
- To proactively inform the general public and raise the level of its financial literacy.
  Considering that financial knowledge is a necessity of a modern society, raising of the level of financial literacy has been identified as one of the priorities. It provides for raising the awareness of customers of financial services and the risks associated thereto, as well as of the nature of the financial sector, to enable customers to make informed decisions when choosing a particular financial service. In the future, the FCMC will continue to ensure access to extensive information on the activities of the supervisor as well as on the latest developments in the financial sector, and engage in explaining the topical matters on the agenda of the general public and media.

FCMC ACTIVITIES IN 2014

SUPERVISION

Supervisory principles

The FCMC regulates and supervises the financial and capital market pursuant to the provisions laid down in the *Financial and Capital Market Commission Law*, best international practices of supervising credit institutions, and its principal operational principles. The FCMC has an on-going focus on improving the methods applied in the supervision of market participants.

The FCMC carries out regular and comprehensive supervision of market participants by:

- carrying out the off-site analysis of the indicators characterising the activities of market participants, continuously focusing on the qualitative and quantitative changes of the financial indicators as well as compliance with the regulatory requirements;
- carrying out on-site inspections.

Last year, the Single Supervisory Mechanism (SSM) of banks became operational, bringing about changes to the previous supervisory model of Latvian credit institutions. In the future, the ECB in cooperation with the national supervisory institutions of the involved EU Member States, including the FCMC, will be responsible for the effective and coordinated functioning of the SSM in achieving the following key goals:

- to ensure the security and stability of the European banking system;
- to increase financial integration and stability;
- to ensure coordinated supervision.

In 2014, to facilitate the achieving of the above goals, as well as ensuring the implementation of the supervisory principles laid down by the SSM, the FCMC reviewed and improved its supervisory methods. In 2015, in the light of the relatively short period of time of the existence of the SSM and due to the continuous improvement of supervisory practices, the FCMC will continue to be actively engaged in implementing the supervisory principles laid down by the SSM as well as establishing an appropriate framework that meets the principles of best international practices of supervising credit institutions as well as the operational requirements.

Implementation of the SSM

On 4 November 2014, the SSM implemented by the ECB[2] became effective. Its main purpose is to ensure the security and resilience of the European banking system and promote financial integration and stability in Europe. Within the scope of the SSM the ECB has assumed new supervisory duties over banks.

Upon joining the Eurozone, Latvia automatically joined the SSM. Generally, the ECB has about 130 credit institutions under its direct supervision, which represent nearly 82% of the total assets of the Eurozone banks.

Under the SSM, the ECB will supervise major Eurozone credit institutions in the future, closely cooperating with national supervisory institutions. This cooperation will benefit from the ECB expertise in the areas of macro-economics and financial stability, as well as from the knowledge and expertise of the supervision of credit institutions gained by national supervisory institutions in their jurisdiction, having regard to the peculiarities of the financial sector of the respective country. The national supervisory institutions will continue to supervise less significant credit institutions, although the ECB will be able to prescribe uniform key principles and guidelines for supervising this category of credit institutions.

In Latvia, the ECB has taken over the supervision of the three largest banks (in terms of their assets) — *Swedbank, SEB banka* and *ABLV Bank*. These banks are supervised in close cooperation with the FCMC.

Considering the above, 2014 was marked by carrying out preparatory works for establishing the SSM at the ECB as well as national level.

All bodies required for decision-making have been established within the ECB: the Supervisory Board, the Steering Committee, the Administrative Board of Review, and the Mediation Panel of ECB's Governing Council.

Due to the Chairman of the FCMC being a member of the Supervisory Board, the FCMC was also involved in the process of approving the necessary framework for the functioning of the SSM.

2 The annual report on the supervisory activity of the ECB for 2014 (in Latvian) is available here: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmar2014.lv.pdf?87431e2fed07dab9c78db0b2fe52d93d.

Last year, the joint supervisory teams, which form the basis of the supervision of credit institutions on a daily basis, became operational.

Before the ECB took over the supervision of the significant credit institutions in the Eurozone, it carried out a due diligence review — the comprehensive assessment of the financial standing of these credit institutions (see the section *ECB Comprehensive Assessment*).

In 2014, significant work was carried out at processing the data of the credit institutions. With a view to identifying the information for supervisory needs at the disposal of credit institutions and the national competent authorities in various jurisdictions, as well as the possible lack of data, testing the data flow model for transferring to the SSM and considering the need to assess the risk within the process of supervisory inspections and assessments, several data submission pilot projects were carried out, with the FCMC and Latvian credit institutions participating.

During the reporting year, gradual amendments were made to the Credit Institution Law and the internal procedures of the FCMC to adapt the requirements laid down therein to the situation where the ECB has been granted the powers to carry out the licensing of credit institutions, the assessment of their officials and the acquisition of significant holdings, as well as supervision.

Banking sector

General information

At the end of 2014, 17 banks and nine branches of EU Member States were operating in the Republic of Latvia. The improved banking regulation, as well as capital requirements have contributed to the banking sector becoming stronger and better capitalised than before the crisis. However, in 2014, banks were exposed to a number of factors that had an impact on the external and internal financial environment in which they operated.

Foreign capital accounts for a significant part in the shareholding structure of Latvian banks. At the end of December 2014, the share of foreign capital in the paid-up share capital of banks amounted to 80.5%, with Scandinavian capital prevailing. In turn, due to only one bank remaining under control of the government, the government's share fell to 5.6% (was 18.1% at the end of 2013).

Latvia's economy continued to grow, showing the first signs of recovery which was driven by the successful changeover to the euro, as well as the stabilisation of the situation in the EU Member States. In 2014, banks continued to keep their focus on development. The earning capacity of the banking sector improved same as the quality of the loan portfolio, deposits continued to grow, while the rate of decline in the loan portfolio of banks slightly slowed down. At the same time, the rate at which new loans were issued remained slow, due to certain cautiousness prevailing in the supply as well as demand of loans. In addition, the geopolitical tension in Russia and the Ukraine brought about uncertainty and the possibility of the credit risk arising, especially taking into account the fragile solvency position of borrowers, still a high debt burden and the amount of restructured loans.

The external macro-financial environment continued to remain a source of uncertainty for the future economic development. However, the start of the new EU fund financing absorption period might have a positive impact on the development of crediting. In turn, the growth in real wages has contributed to the improvement of the purchasing power of the population. Therefore private consumption could be one of the drivers of economic growth in 2015, producing a positive impact on banks and their performance.

In 2014, despite some uncertainty in the geopolitical situation and economic growth, the key indicators of the banking sector continued to stabilise, the shock tolerance level was high, especially due to the high level of capitalisation and liquidity of the banking sector.

Banking sector performance indicators

The level of the capitalisation the banking sector remained high. At the end of 2014, the capital adequacy ratio of the banking sector was 20.8%, whereas the Common Equity Tier 1 capital (hereinafter referred to as CET1) was 18%. All banks complied with the minimum capital requirement (8%), minimum CET1 (6%), as well as minimum CET1 capital requirement (4.5%). The quality of the capital of banking sector is ensured by the key element of the own funds of banks, i.e. CET1 capital, which represents the top quality capital. It equals CET1 in the case of Latvian banks.

Bank liquidity

During the reporting year, on-demand deposits continued to grow, however, as liquid assets increased, the liquidity risk remained limited. At the end of 2014, the liquidity indicator was 63.1% (the minimum requirement being 30%), having declining by 1.1 percentage points during the year.

Profit and loss

The banking sector had a stable performance resulting in profits. In 2014, the unaudited profit amounted to 311 million EUR (in 2013 — 246.2 million EUR). Among the banks, 13 Latvian banks and three branches of foreign banks, the assets whereof comprised almost 80% of the assets of the banking sector, had an aggregate profit of 339.7 million EUR in 2014. During 2014, the earning capacity of banks improved, and the return on equity (ROE) indicator of the banking sector was 11.1% (at the end of 2013 — 8.6%). The income and cost structure of banks has stabilised. In 2014, the increase of bank profits was mainly due to cost reduction (net costs of provisions for doubtful debts decreased by 40.3%, whereas administrative expenses fell by 6.8%, and the net income from commission charges increased by 8.3%.

Deposits

In 2014, the amount of deposits attracted in the banking sector overall significantly increased (by 2.7 billion EUR or 13.8%) totalling 22 billion EUR at the end of the year.

Resident deposits increased by 446 million EUR or 4.3% and totalled 10.7 billion EUR. The introduction of the euro contributed to a high level of household deposits at the end of 2013. In 2014, however, they continued to increase — by 335 million EUR or 7.1%. The deposits of government and financial institutions also increased — by 136 million EUR or 12% and by 79 million EUR or 11.4%, respectively. In contrast, the deposits of governmental non-financial companies and private non-financial companies decreased by 145 million EUR or 25% and by 11 million EUR or 0.4%, respectively.

A considerable increase of non-resident deposits (by 2.2 billion EUR or 24.3%) was significantly affected by the steep appreciation of the USD (non-resident deposits increased by 14.4% due to the adjustments to take account of the changes in the USD value).

Figure 1.
Bank capital adequacy ratio (%)

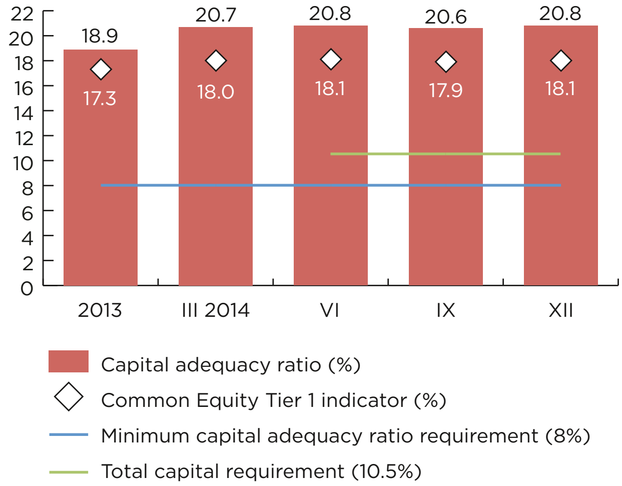


Figure 2.
Dynamics of the return on equity indicator (ROE) of banks (%)

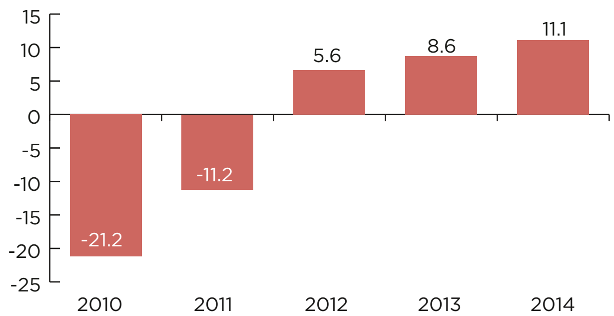
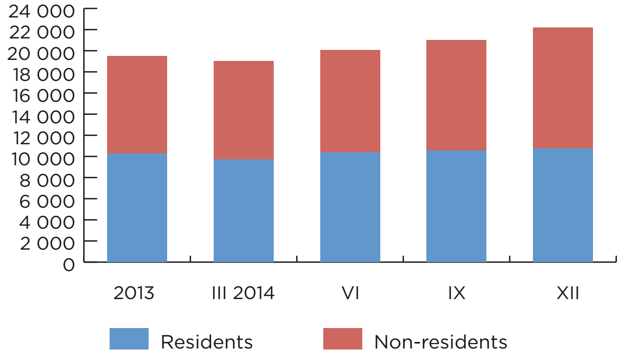


Figure 3.
Dynamics of deposits with banks (in million EUR)



Financing attracted by banks

In 2014, the financing attracted from monetary financial institutions (MFIs) continued to decrease, which was mainly due to the reduction of the loan portfolio as well as due to the refinancing of this financing with customer deposits. In 2014, the financing attracted from the MFIs fell to 976 million EUR (21.8%) mainly due to the decrease in the financing attracted by the subsidiaries and branches of foreign banks from their parent banks.

In order to balance off the term structure of financing, banks with a high share of on-demand deposits in total deposits have been continuing to issue long-term bonds. Even though the share of the issued debt securities increased by 180 million EUR (54%) during the year and totalled 513 million EUR, it still represented an immaterial share of bank financing.

Loan portfolio

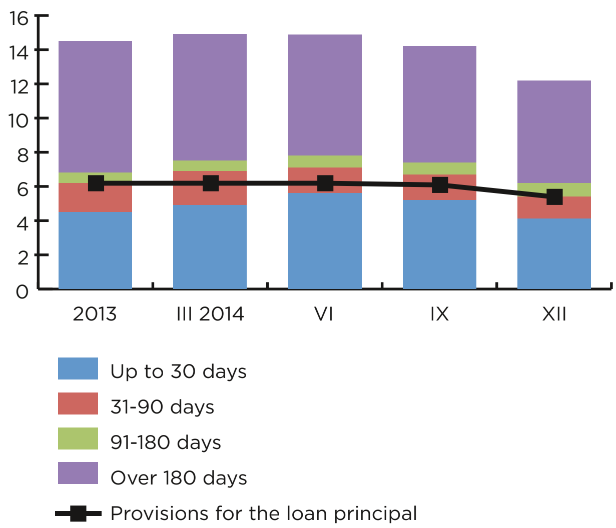
In 2014, the loan portfolio decreased by 6.1% (resident companies — down by 6.9%; resident households — down by 7.5%). In 2014, the new loans issued by banks to resident non-financial companies and households totalled 1.7 billion EUR (in 2013 — 2.3 billion EUR). The decline was observed in most sectors, particularly in real estate, construction and trade sectors, while manufacturing and some service sectors showed a slight increase in the new crediting compared with the previous year. Loans issued to households for purchasing, reconstruction and/or repairing of housing exceeded 280 million EUR (up by 6.3% from the previous year).

Overdue loans

The share of loans overdue for over 90 days continued to decline in the total loan portfolio of the banking sector. At the end of December 2014, they totalled 6.9% (at the end of 2013 — 8.3%). The share of such loans in the household loan portfolio was 9.5%, whereas in the portfolio of resident non-financial companies — 5.4%. The share of overdue loans in the loan portfolio of the banking sector decreased from 14.6% to 12.3% during the year. At the end of 2014, the balance of bank provisions for doubtful loans fell to 779 million EUR (5.3% of the total loan portfolio of banks) (at the end of 2013 — 6.1%), while the provisions/loans overdue for over 90 days ratio remained high — 77.2%.

Figure 4.

Overdue loans and provisions, % of the loan portfolio



Bank supervisory measures

Last year, the FCMC continued to consolidate the intensive supervisory framework, the purpose of which is to take risk-based and result-orientated supervisory measures and enable the FCMC to timely get involved in the activities of the banks and take the necessary measures to resolve potential and existing problems or reduce losses.

During the reporting year, the priority areas in supervising banks were as follows:

- assessing the adequacy of the capital base of Latvian banks;
- assessing the liquidity maintenance, administration adequacy and quality, taking into account the business model selected by the bank;
- assessing the adequacy of the quality of banking activities with regard to problem loans, and of the recognition of loan impairment losses in the financial statements of banks;
- assessing the potential impact of the operating strategies of banks on the structure and size of risks;
- assessing the recovery plans of banks, maintaining a dialogue with banks regarding the necessary improvements;

Significant supervisory measures were also carried out in cooperation the ECB within the scope of building and starting-up of the SSM:

- cooperating with the ECB within the scope of the SSM Comprehensive Assessment of major banks;

- transferring of the supervisory duties over the largest Latvian banks to the ECB, including an active engaging of the FCMC staff in the start-off and implementation of the activities of the joint supervisory teams of the SSM;
- gradually familiarising the ECB with less significant sector of Latvian banks;
- participating in a number of the working groups of the SSM set up by the ECB with a view to identifying and assimilating the best supervisory practices, equalising the supervisory approach, including the ensuring of the application of the proportionality principle.

In 2014, supervision of banks was based on related methods — off-site monitoring of the performance of banks using their financial statements and carrying out the analysis of other operational information at the disposal of the FCMC, and on-site inspections.

ECB Comprehensive Assessment

In 2014, the FCMC took part in the comprehensive assessment of banks initiated and led by the ECB. The purpose of the assessment was to promote a greater transparency of the balance sheets of banks, ensuring a better access to information on the financial standing of banks with a view to increasing trust to the financial sector. The local supervisors of each Eurozone country and the European Banking Authority (*EBA*) were involved in this review.

The Comprehensive Assessment (CA) consisted of the due diligence of the financial standing of the largest banks of the Eurozone countries, which was carried out before the ECB took over the supervisory duties of the banks of the Eurozone on 4 November 2014. The assets of 130 assessed banks totalled 22 trillion EUR, representing 82% of the total assets of the banking sector of the Eurozone. Three largest Latvian banks (in terms of assets) — *Swedbank, SEB banka* and *ABLV Bank* participated in the assessment.

The Comprehensive Assessment consisted of the following stages:

- An Asset Quality Review, which included the assessment of the appropriateness of the assessment of assets and collaterals, which was carried out to improve the transparency of bank risk exposures;
- A stress test that was carried out to test the financial tolerance of banks under the circumstances of stress scenarios.

The results of the Asset Quality Review and stress tests were integrated within the scope of the ECB CA, which enabled a more accurate assessment of the financial standing of the banks, as well as of credit risk and other risks related to bank portfolios.

The CA was carried out ensuring a high level of transparency, consistency and equal treatment.

According to the findings of the CA, the Latvian banks that were involved in this CA were overall well-capitalised. They also have sufficient capital to be used under a potentially unfavourable market scenario, as demonstrated by the results of the stress test.

Commenting on the results of the CA of the Latvian banks, Chairman of the FCMC Kristaps Zukulis pointed out: "I think we can be satisfied with the results of the Latvian banks in this extensive financial "health" check of banks. All three Latvian banks included in the comprehensive assessment have performed well in it, and have passed it."

In turn, Daniele Nouy, Chairwoman of the Supervisory Board of the ECB, said: "This exercise is an excellent start in the right direction. It required extraordinary efforts and substantial resources by all parties involved, including the euro area countries' national authorities and the ECB. It bolstered transparency in the banking sector and exposed the areas in the individual banks, as well as in the whole system, that needed improvement [...] The comprehensive assessment enabled us to compare various business models of banks of different countries, and the findings thereof will help us gain an insight and draw conclusions for future supervisory work."

Off-site monitoring of the bank performance

In 2014, the FCMC carried out an active off-site monitoring of banking activities, which was based on the analysis of the regular reports submitted by banks, as well as the analysis of the following additional operative statements, information and reports:

- daily reports about the dynamics of deposits;
- reports about liabilities to related financial institutions;
- minutes of the meetings of bank credit committees, management board and supervisory board as well as internal audit reports of the bank on performed reviews;
- credit risk, liquidity and market risk reports and the results of stress tests.

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

In 2014, the FCMC retained focus on the balances of the correspondent accounts of banks and the availability thereof during on-site, as well as off-site inspections in banks. The FCMC experts also assessed the quality of the cooperation of banks with corresponding banks and encouraged them to diversify correspondent relations.

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, and the results of these tests were used to determine the likely losses in the loan portfolio under different scenarios and assumptions about the economic development, as well as to assess the capacity of the banks to absorb the said losses. Stress tests in respect of liquidity risk were also carried out. Within the scope of these stress tests, several customer behaviour patterns were analysed along with the ability of banks to ensure the timely performance of lawful claims by customers.

With the geopolitical events in Russia and the Ukraine accelerating, the FCMC held meetings with banks to discuss the impact of these events on the operation of Latvian banks. At the same time, to carry out as full as possible an analysis of the impact of these events on the performance indicators of Latvian banks, the FCMC developed a stress test covering all banks and carried it out several times during the year.

Consistently with the results of the performed stress tests, where necessary, the FCMC maintained a dialogue with banks about their plans to ensure appropriate capital adequacy ratio and liquidity in emergency situations as well as the need to reduce the exposure of banks to particular countries.

Risk-based supervision is one of the key principles of supervision. Under this principle and on the basis of reports and other information at its disposal, the FCMC assessed, on a quarterly basis, the performance of banks, the level of risks and the quality of their management. Risk monitoring tests were used in planning the necessary supervision, including on-site inspections.

For several years now, based on the results of the analysis of the bank performance and the results of performed inspections, the FCMC has been assessing the risks of banks by rating 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 (i.e. to assess the risk profile) and to assess the quality, adequacy and appropriateness of the risk management methods applied by them in view of the volume and complexity of their operations.

The key objectives of the rating system are:

- to assess the risks inherent to the activities of the institutions subject to supervision, as well as their risk management systems;
- to establish a standardised supervisory approach to identify, analyse and assess risks;
- to summarise the results of the assessment in a concise and comparable manner (i.e., assigning a rating to each institution subject to supervision);
- to ensure an efficient and targeted planning of supervision;
- to ensure continuity and transparency of the supervisory process;
- to promote the establishment of a more advanced approach to risk management in institutions subject to supervision;
- to promote communication and a dialogue with supervised institutions.

As a result of the rating assignment process, each institution subject to supervision is assigned, for supervisory purposes, a rating from 1.0 to 4.0, where 1.0 is the highest, whereas 4.0 is the lowest score. The planning of the supervision of an institution is performed based on the rating assigned to it — the required supervisory measures applied to an institution that has been assigned the highest rating (the institution's activities have a low inherent risk and its risk management is sufficient) are minimal, whereas an institution with the lowest rating (the institution's activities have a high inherent risk and its risk management is weak) attracts continuous and enhanced supervisory control.

In 2014, on the basis of the results of the inspections carried out by the FCMC, as well as those of the off-site analysis of banking operations, the ratings of five banks were reviewed. Overall, at the end of the reporting year, the following ratings were assigned to banks

RATING SCALE	1–2	2.1–3	3.1–4
Number of banks	4	9	4

In 2014, the key risks of banking operations were credit risk, liquidity risk, reputation risk, strategy risk, and business risk. Particular attention was paid to the operational strategies and earning capacity of banks.

Sanctions and corrective measures

In 2014, carrying out the supervisory activities of banks, the FCMC applied sanctions provided for under the *Credit Institution Law*, including:

- giving a warning to one bank about the violation of the requirements of the *Credit Institution Law*;
- giving a warning to one bank about the violations of the requirements laid down in the FCMC Regulations;
- giving a warning to one bank for the deficiencies in the bank's internal control system for the prevention of money laundering;
- imposing a fine of 70,000 EUR on one bank for violations in the area of preventing money laundering.

The FCMC also took corrective measures, laying down additional requirements for all the three banks in the credit risk area.

Group supervision

In 2014, the FCMC cooperated with the supervisory authorities of the credit institutions of the Member States, which pursuant to laws and regulations implement the supervision of groups of credit institutions. In 2014, the FCMC staff took part in the work of the colleges of supervisors of five EU Member States, their duties including the chairing of one board of supervisory authorities in the capacity of responsible supervisory authority. Commencing the work in the SSM of the ECB, the FCMC transferred its membership status in the boards of supervisory institutions in respect of the two major Latvian banks to the SSM of the ECB, while itself assuming the observer status in the mentioned boards, enabling the FCMC to participate in the work of the colleges of supervisors and ensuring access to the information necessary for the FCMC to carry out supervisory work.

In 2014, the most topical issues on the agenda of the boards were related to the coordination of supervisory measures, assessment of the processes and the risk profile of internal capital and liquidity adequacy assessment of banks at group level, as well as the assessment of the recovery plans developed by banks.

On-site inspections in credit institutions

During the reporting year, the FCMC carried out 23 on-site inspections in banks, paying particular attention to assessing capital adequacy ratio, the crediting process as well as risk management functions — management of credit risk, operational risk, liquidity risk, strategy, and business risk, as well as the control function over operational compliance. The identified deficiencies and discrepancies were discussed with the bank management and action plans were coordinated to implement improvements.

Follow-up monitoring was carried out within the scope of off-site supervision by controlling the course of the implementation of the deficiencies of the action plan.

Capital adequacy

Throughout 2014, the capitalisation level of the banking sector remained high owing to the key component of equity —Common Equity Tier 1 (CET1).

At present, the CET1 (which represents the top quality capital) of Latvian banks is equal to Tier 1 capital and totals 18.1% (the average CET1 in the EU is 11.8%)

During the year, several banks used the opportunity to consolidate their capital base, including therein the audited (interim) profit for the current operating year. The increase in the capitalisation level was also driven by the gradual improvement of the quality of the bank loan portfolio and relatively slow credit growth rates. In 2014, four banks increased their paid-up share capital by 74 million EUR in total.

The FCMC stringently assessed the adequacy of provisions made for expected losses. A positive difference between the volume of expected losses and the provisions made under the requirements of the accounting standards was taken into account when assessing the capital adequacy ratio of banks. In 2014, the capital adequacy ratio calculations of eight banks were adjusted.

In addition to the minimum capital adequacy ratio requirements, banks also assessed their internal capital adequacy ratio to ascertain that the capital of the bank, in terms of the amount, elements and the breakdown thereof, is adequate for covering the risks inherent to the current and planned activities of the bank, as well as for covering potential risks. As a result of the capital adequacy ratio assessment, all banks ascertained 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 circumstances affecting their operations.

During 2014, within the scope of the supervisory inspection and assessment process, the capital adequacy ratio assessment process performed by the banks was assessed in all banks, as well as the conformity of the assessment process of the banks' internal capital adequacy ratio to the requirements of laws and regulations. Some areas for improvements were identified during the FCMC inspections (such as the procedure for the determination of the size of capital necessary for the covering of material risks inherent to the current and planned activities of the bank, methods applied in the stress testing and the analysis of the results thereof). The FCMC engaged in a further dialogue with several banks about their strategies and capital planning process.

During the assessment of bank capital adequacy ratio, the FCMC paid particular attention to whether the capital adequacy ratio was consistent with the future operational strategy of the bank and the size of the risks inherent to the bank's planned operations, as well as to the methods employed for managing these risks. In 2014, upon identifying an unduly high risk, the FCMC, according to the rights vested to it under the *Credit Institution Law*, imposed an obligation on 14 banks to maintain their own funds above the minimum capital requirement.

Credit risk

In carrying out its supervisory work, the FCMC has set as a priority ensuring of the maintaining of a sufficient capital base by Latvian banks to ensure efficient debt restructuring. In 2014, the FCMC continued to base its supervisory methods upon the risk assessment of the activities of market participants, using related techniques such as the monitoring of the operational performance of banks, based on the analysis of financial statements, and on-site inspections.

Considering the large share of problem loans in the loan portfolio, during inspections closer attention was paid to the handling by banks of overdue and problem loans, i.e. justification and efficiency of loan restructuring. After the inspections, the FCMC required the banks to additionally recognise loan impairment losses, making provisions or capital corrections. Additional impairment was identified mainly in respect of the loans that depended on collaterals. Considering the increase in the volume of new loans issued to non-residents and additional risks associated with the crediting to non-residents, the crediting practices to non-residents were reviewed during the inspections, i.e. the criteria for issuing a loan, monitoring of the loan quality, and the quality of issued loans.

Six of the on-site inspections of banks carried out in 2014 aimed at assessing the quality of loan portfolios of banks and credit risk management. These inspections covered 60.6% (9.4 billion EUR) of the total loan portfolio of the banking sector. Particular attention was paid to the timely recognition of loan impairment losses (the adequacy of the provisions made) or volume of the capital correction made where the expected losses exceeded the volume of the provisions made. The quality of the monitoring of the real estate pledged on behalf of banks, the results of which directly affect the timely recognition of loan impairment losses, was assessed.

Operational risk

In keeping pace with contemporary banking practices, Latvian banks have been increasingly focusing on customer service using remote channels, which in turn requires greater investments in the information technology infrastructure to ensure the security of providing such services and protection against cyber attacks. At the same time, to improve their earning capacity indicators, banks work at the optimisation of their costs and processes. These and other factors arising from the business model of each bank affect the level of operational risk in the bank. To ensure an on-going control, the FCMC continuously receives and analyses reports on operational risk events, assesses the stress tests carried out by banks, as well as the results and assumptions thereof.

Liquidity risk

Although the overall liquidity risk level in the banking sector declined and liquidity indicators remained consistently high, due to uncertainty in the macro financial environment in relation to the geopolitical tension in Russia and the Ukraine, in 2014, the FCMC continued to pay close attention to the liquidity of banks.

In 2014, with a view to controlling the cash flows of banks, the FCMC continued to require banks to provide daily operative information about the dynamics of deposits, as well as increasingly focused on the quality of the group liquidity management of the subsidiaries of foreign banks, monitoring such inter-group transactions, under which money was placed in the parent bank as well as such in which the bank primarily relied on the resources assigned by the parent bank. The results of liquidity stress-tests carried out by the FCMC in cooperation with the Bank of Latvia were used in the supervisory process. Thus, the FCMC supervised the liquidity risk in the banking system as a whole and, if necessary, required banks to take preventive measures aimed at improving their liquidity risk management.

In 2014, upon identifying an unduly high risk, the FCMC, according to the rights vested to it under the *Credit Institution Law*, imposed an obligation on 14 banks to maintain their liquidity above the amount of the minimum liquidity requirement.

Market risk

In 2014, compared to the banks of other countries, Latvian banks did not make any significant investments in financial instruments, although the share of these investments had an upward trend (overall, equity shares and debt securities did not exceed 15.5% of bank assets (in 2013 — 10.6% of bank assets). Even though in general market risk is not significant in the banking system, as securities portfolios of banks increase, the level of this risk tends to gradually increase. Considering the above and such factors as the prevailing fragile state of the Eurozone economy, geopolitical tension in Russia and the Ukraine, as well as the changing sentiment among investors, which could potentially have an impact on the banking system, in 2014, the FCMC continued to perform a focused assessment of the portfolios of the financial instruments of banks and considered them in carrying out stress tests to ensure that the approach applied by banks — increasing their investments in financial instruments, was sufficiently prudent and investments in financial instruments were gradual. The FCMC engaged in monitoring whether the financial instruments are presented prudently in financial statements, as well as assessed the liquidity of securities.

In four banks that were subject to on-site inspections in 2014, particular attention was paid to the inspection of items exposed to market risk. Of the total equity shares and debt securities portfolio of the banking sector, 56.4% (a portfolio of 2.7 billion EUR) were inspected. The key focus of these inspections was on the methods applied by banks to manage market risk and the assessment of the efficiency of the risk management system. Inspections also covered the assessment of the liquidity of the securities in bank portfolios and the reasonableness of the principles and assumptions applied in determining the carrying value thereof.

Risk management function

In providing financial services, banks need to ensure not only the efficiency of every business unit or activity type but also establish and efficiently implement the overall risk management function which is important for banking activities. In 2014, carrying out the inspections of banking activities, the FCMC continued to focus closely on the quality of managing of each key risk, considering the size of the particular risk and the effect of changes on the bank's overall operations, as well as the effectiveness of the internal control system and of the efficiency of the activities of the bank management in identifying, measuring and managing each relevant risk. Particular attention was paid to establishing whether, in managing key risks, banks were using tools such as stress tests and scenario analysis. Furthermore, the quality of those stress tests and selected scenarios, as well as their appropriateness for the nature of each bank were assessed. If necessary, the FCMC requested the carrying out of improvements in banking activities.

Bank recovery plans

Considering the European Banking Authority's regulation regarding the development of recovery plans of the groups of banks, aimed at stabilising the financial standing of the groups of banks as a whole, or, alternately, significant institutions of the bank, each separately, which, in turn would ensure the financial stability in the financial sector in general, already in 2013, the FCMC invited banks to develop a single set of documents — *The Bank Group Recovery Plan*. Conversely, in 2014, the FCMC engaged in a dialogue with banks to ensure that they had reviewed and improved their recovery plans pursuant to the FCMC guidelines on the identified deficiencies. The mentioned dialogue will be carried on with particular banks in 2015.

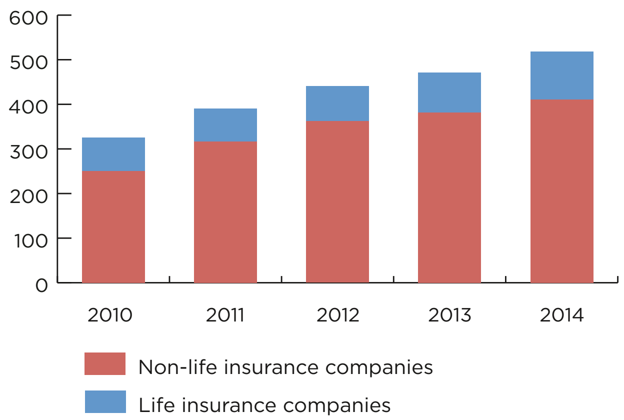
Publication of supervisory decisions

In 2014, with a view to promoting greater transparency on the decisions passed in the supervisory process, the FCMC began publication of the passed decisions on all sanctions applied to credit institutions as provided for amendments to the *Credit Institution Law*, which arise from the EU's financial sector regulatory reform (Capital Requirements Regulations and Directives (CRDIV/CRR or Basel III)).

A sanction applied to a bank can take the form of a warning issued by the FCMC, a fine, a temporary prohibition for the employee who is responsible for the violation to perform certain duties, revocation of the license or other additional sanctions, such as those applied for serious violations in the area of money laundering and terrorist financing, etc.

The FCMC publishes information on the applied sanctions on its website, disclosing the name of the credit institution, the type and nature of the violation, the applied sanction, information on the appeal status and on the outcome thereof, as well as information on additional obligations imposed on the bank: http://www.fktk.lv/lv/tirgus-dalibnieki/kreditiestades/2014-10-22-fktk-piemerotas-sankcijas.html.

Figure 5.
Dynamics of the premiums written by life and non-life insurance companies (in million EUR)



Insurance sector

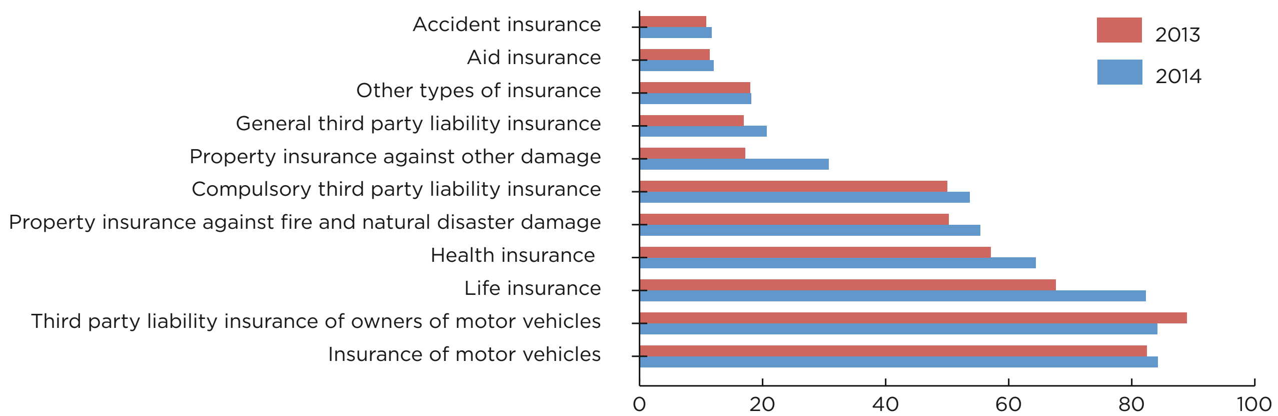
Performance indicators of insurance companies

At the end of 2014, seven insurance companies were operating in Latvia (two life insurance and five non-life insurance companies), as well as 14 branches of EU Member State insurance companies (five life insurance and nine non-life insurance company branches).

During the reporting year the insurance sector retained moderate growth. At the end of the year, the total volume of gross written premiums of the insurers (insurance companies and branches of foreign insurance companies) increased by 9.9% to 517 million EUR (including the gross written premiums of the branches of foreign insurance companies, which had grown by 21% to 146 million EUR, representing 28% of the total premiums written), whereas the volume of disbursed gross indemnities grew by 8% to 283 million EUR.

In 2014, gross premiums written in Latvia had the steepest growth in the post-crisis period (by about 11%), amounting to 349 million EUR, whereas the amount of services provided by insurance companies in the EU Member States (Estonia, France, Germany, Italy, Lithuania, Poland, and Spain) increased by 6.7% to 33% of the total gross premiums written in the insurance market (in 2013 — 10.6% and 35%, respectively).

Figure 6.
Gross written premiums by type of insurance (in million EUR)



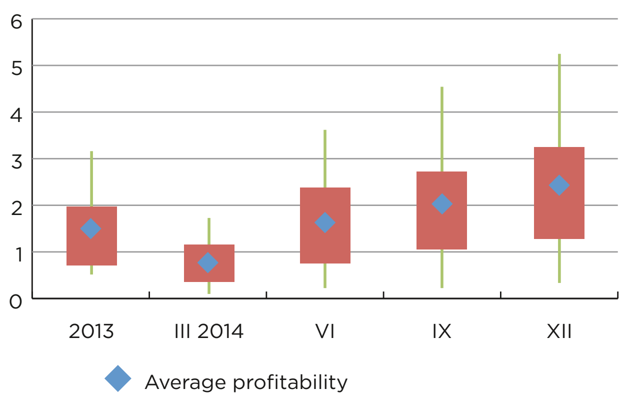
During the reporting year, gross premiums written continued to grow almost in all major types of insurance, except the third party liability insurance of owners of motor vehicles (down by 5.4%). Property-related written premiums (up by 27.7%) and life insurance (up by 21.5%) had the fastest growth, but that did not have a material impact on the breakdown of the premiums written in the insurance market.

In terms of the share of premiums written in the insurance market, motor insurance, third party liability insurance of owners of motor vehicles, as well as life and health insurance (16.3%, 16.2%, 15.9% and 12.4%, respectively) continued to prevail.

Overall, in 2014, insurance companies had fairly good returns on investments (the annual average profitability ranged from 0.5% to 5.2%). Life insurance companies demonstrated better performance as they were engaged in the handling of higher risk investments (29% of investments in stocks), and their average profitability was 4.9%, whereas the average profitability of non-life insurance companies was 2.6%.

Figure 7.

Average annual profitability (%)



Overall, in 2014, the profits of insurance companies totalled 9.8 million EUR, i.e. up by 19.5% compared to the previous year (in 2013 — 8.3 million EUR). Besides, the profit of non-life insurance companies was 6.4 million EUR, whereas that of life insurance companies was 3.4 million EUR. The profit of insurance companies was mainly due to the revaluation of investments.

During the reporting year, the sources of profit of insurance companies were mainly the general third-party liability insurance of the owners of motor vehicles (5.6 million EUR), and property insurance against fire and natural disaster damage (3.7 million EUR).

Conversely, losses were caused mainly by motor vehicle insurance (3.8 million EUR), compulsory third-party liability insurance (2.8 million EUR), property insurance against other losses and health insurance (1.3 million EUR and 0.6 million EUR, respectively).

Supervisory measures applied to insurance companies

In 2014, the FCMC carried out a full-scale on-site inspection of the activities of one insurance company.

The FCMC monitors, on a regular basis, the compliance with the requirements for the solvency margin and the cover for technical provisions prescribed by the *Law on Insurance Companies and Supervision Thereof*.

In 2014, no material violations of the laws and regulations were identified, which would attract sanctions provided for in the *Law on Insurance Companies and the Supervision Thereof*.

In 2014, the FCMC cooperated with the supervisory authorities of insurance and reinsurance companies of the countries of the European Economic Area (EEA), which carried out the supervision of the insurance groups and reinsurance groups whose members were insurance companies licensed in Latvia. During 2014, the FCMC staff participated in the work of three colleges of supervisors supervising the insurance and reinsurance companies of the EEA countries. The topical issue in the work of these boards was the assessment of the financial standing of an insurance and reinsurance group, 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 2014, the FCMC also cooperated with Estonian and Lithuanian insurance supervisory authorities, participating in jointly organised discussions on topical issues and ensuring, on a quarterly basis, the provision of information to them, in line with the cooperation agreements concluded in 2013 on the cross-border supervision of insurance companies.

In 2014, 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 assessments *Peer Review on Joint On-sites* and *Peer Review on Freedom to Provide Services*, ensuring participation in the stress test of insurance companies organised by the EIOPA, by providing, on a quarterly basis, information for the needs of the preparation of *Risk Dashboard*, providing information for the needs of the *Spring Report* and *Autumn Report*, as well as providing answers to other information requests.

In order to implement the requirements laid down in the *Management System Guidelines* and *Towards Own Risk Assessment Guidelines* (based on the own risk and solvency assessment principles), the FCMC drafted the recommendations No. 296 *Recommendations for Establishing the Management System*, which were approved at its Council meeting on 10 December 2014. To implement the requirements laid down in the *Guidelines for the Review of Complaints in Insurance Companies*, the FCMC drafted the Regulations No. 195 *Regulations on the Procedure for Reviewing, Registration and Reporting of Complaints Received by Insurance Companies and the Branches of Non-Member State Insurance Companies*, which were approved at its Council meeting on 24 September 2014. To implement the requirements laid down in the *Opinion of the Protection of Beneficiaries in Life Insurance*, it drafted recommendations No. 194 *Recommendations for Measures to Be Taken to Protect the Interests of the Beneficiaries in Life Insurance.*

Guarantee fund of the compulsory third-party liability insurance of the owners of motor vehicles

Under Section 51 of the Compulsory Civil Liability Insurance of Owners of Motor Vehicles Law and Paragraph 19 of the Cabinet Regulation No. 195 *On the Procedure for Establishing the Guarantee Fund of the Compulsory Third-Party Liability Insurance of the Owners of Motor Vehicles, for Accruing Assets in the Fund and Managing the Fund* of 22 March 2005, in 2014, the FCMC carried out the compliance inspection of the establishment, accrual and administration procedures of the guarantee fund of the compulsory third-party liability of the owners of motor vehicles administered by the society *Motor Insurers' Bureau of Latvia* and notified the Ministry of Finance and the society *Motor Insurers' Bureau of Latvia* of the findings of the inspection.

Insurance and reinsurance intermediaries

In 2014, the FCMC carried out two off-site inspections of all insurance and reinsurance intermediaries (legal entities) registered in the Register of insurance and reinsurance intermediaries maintained by the FCMC, to assess their compliance with the requirements laid down in the *Activities of Insurance and Reinsurance Intermediaries Law* concerning the keeping of the register of employees and insurance intermediary assistants directly involved in the insurance and reinsurance intermediation and concerning keeping the funds acquired from insurance and reinsurance intermediation distinct from the funds of the market participant itself.

In 2014, the FCMC also carried out six on-site dawn-raids of insurance and reinsurance intermediaries (legal entities) registered in the Register of insurance and reinsurance intermediaries maintained by the FCMC, assessing the compliance of their activities to the requirements prescribed by the *Activities of Insurance and Reinsurance Intermediaries Law*.

In addition, in 2014, the FCMC carried out off-site inspections of insurance and reinsurance intermediaries (legal entities) registered in the Register of insurance and reinsurance intermediaries maintained by the FCMC. The activities of randomly selected 53 insurance agents (out of 219 insurance agents registered in the Register maintained by the FCMC upon the start of the inspection) were inspected in terms of their compliance with the requirements prescribed by the above Law on keeping the funds obtained from insurance mediation distinct from the funds of the insurance intermediary.

During the inspections, violations of the requirements of laws and regulations were identified, for which in 2014, an administrative case was initiated by the FCMC against one insurance and reinsurance intermediary for the violation of the requirements laid down in the *Activities of Insurance and Reinsurance Intermediaries Law*.

Cooperative credit unions

Performance indicators of cooperative credit unions

At the end of 2014, 32 cooperative credit unions were operating in Latvia. At the end of the year, their total assets were 22.7 million EUR (i.e., 0.1% of the total assets of the financial and capital market).

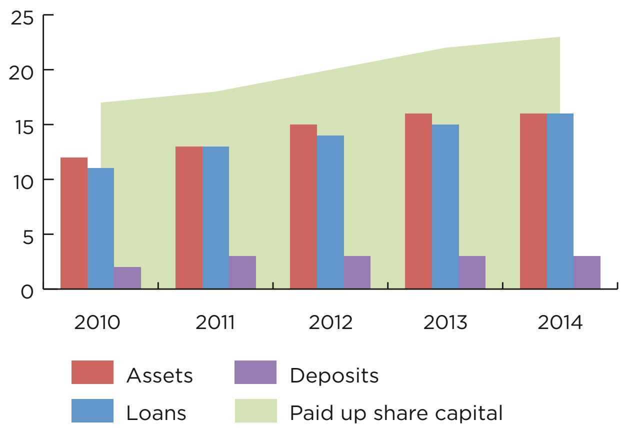
The equity of cooperative credit unions/the sum total of the assets and off-balance items ratio, i.e. capital adequacy remained high in 2014, amounting to

20.63% at the end of December 2014 (at the end of 2013 — 21.3%). The minimum own capital adequacy requirements is 10%.

In 2014, the profits of credit unions totalled 340 thousand EUR, which was down by 4% compared to the previous year when profits amounted to 354 thousand EUR. During the reporting period, the performance of 15 credit unions was a profit of 387 thousand EUR, whereas the total losses of the remaining 17 credit unions amounted to 47 thousand EUR.

The main source of income of credit unions was interest income on the loans issued to the members of credit unions (67.2%), whereas the most considerable expense items of the associations, i.e. administrative expenses, expenses for provisions for doubtful debts and interest expense on deposits were 43%, 33.1% and 16.6%, respectively, of the total expenses of the unions at the end of December.

Figure 8.
Assets, loans, deposits and paid-up share capital of credit unions (in million EUR)



The main type of activity of credit unions is granting loans to their own members. In 2014, the balance of loans issued to the members continued to rise, i.e., up by 301 thousand EUR or 1.9% (in 2013 — 1.2 million EUR or 8.7%, respectively), totalling 16.2 million EUR at the end of the year.

During the year slight changes occurred to the quality of the loan portfolio. At the end of December, 60.2% of the loan portfolio of credit unions was assessed as standard, 34% qualified as subject to supervision, and 5.8% were non-performing loans (at the end of 2013 — 62.4%, 31.5% and 6.1%, respectively).

At the end of December, special provisions for doubtful debts amounted to 7.9% of the total loan portfolio of credit unions (at the end of 2013 — 7.7%).

In terms of the financing structure of the unions, 99.1% represented the deposits of members — their balance increased during the reporting year by 8.1% or 1.2 million EUR, reaching 16.5 million EUR at the end of December.

Supervisory measures applied to cooperative credit unions

In 2014, the supervision of cooperative credit unions was carried out by monitoring their performance based on the analysis of financial statements, with a special focus on the sufficiency of the provisions for doubtful debts made by companies, as well as carrying out on-site inspections.

During the reporting year, the FCMC experts carried out 21 on-site inspections (in 2013 — ten) aimed at assessing the financial standing of the cooperative credit unions, management performance, quality of assets, income and cost structure, as well as the compliance of their activities to the requirements of laws and regulations, especially those of the *Credit Union Law*.

Sanctions and corrective measures

Carrying out the supervision of the activities of credit unions, in 2014, the FCMC cancelled the licences of three credit unions. Prohibition to issue new loans was a sanction applied to one credit institution, to which also a warning was issued regarding the inability of its management board to ensure the activities of the union in compliance with the laws and regulations. One union was subject to a minimum fine for the violation of the requirements laid down in Paragraphs nine and ten, Section 20 of the *Credit Union Law*.

Payment institutions and electronic money institutions

Performance indicators of payment institutions and electronic money institutions

At the end of the reporting year, 26 registered payment institutions and ten registered electronic money institutions were operating in Latvia, including four electronic money institutions eligible to provide payment services (in total there were 32 payment institutions and 12 electronic money institutions registered). In 2014, two electronic money institutions were assigned the status of licensed electronic payment institutions with the right to provide payment services.

In 2014, the total amount of payments performed by the payment institutions declined by 54.4% to 54.4 million EUR, while the total amount of payments performed by electronic money institutions increased by 80.8% to 63.1 million EUR, whereas the average amount of electronic money in the circulation of these institutions increased by 58% to 2.8 million EUR.

Supervisory measures applied to payment institutions and electronic money institutions

Supervision of payment institutions and electronic money institutions in 2014 was carried out mainly by monitoring the performance thereof based on the analysis of the financial statements, with a special focus on the total amount of payments made by payment institutions and electronic money institutions and the average volumes of electronic money in circulation. Registered payment institutions and electronic money institutions are required to submit a report on customer funds, in which they present information about transactions which were commenced and completed by the institution, specifying the mean average value of the payments performed within the previous 12 months. Conversely, electronic money institutions present the average volume of electronic money in circulation for the last six months, as well as information on the amount of repurchased electronic money. During the reporting year, on-site inspections were carried out in four payment institutions and one electronic money institution. These inspections were aimed at assessing the compliance of the operational model and the performance of the management of payment institutions and electronic money institutions to the requirements of laws and regulations, especially those laid down in 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*.

Sanctions and corrective measures

Carrying out the supervision of the activities of payment institutions and electronic money institutions, in 2014, the FCMC initiated five administrative cases and applied the following sanctions:

- two payment institutions were removed from the Register of payment institutions and electronic money institutions maintained by the FCMC.
- restrictions to provide payment services were applied to one payment institution.

Investment management companies and managers of alternative investment funds

Performance indicators of the investment management companies and investment funds

At the end of 2014, 12 investment management companies were operating in Latvia (whereof three held licences for the managing of alternative investment funds) and six managers of alternative investment funds. At the end of 2014, investment management companies managed 2.6 billion EUR, whereof 2 billion EUR were made up of the second-pillar pension investment plans, 283 million EUR — third-pillar pension plans, 228 million EUR — investment funds registered in Latvia (incl. 210.8 million EUR — open-end investment funds), 22.7 million EUR — investment funds registered in other Member States, and 9.8 million EUR — alternative investment funds. Conversely, at the end of the year, the amount of funds managed by the managers of alternative investment funds totalled 39.8 million EUR.

The aggregate total assets of alternative investment funds amounted to 50 million EUR, whereof securities represented the major share (25 million EUR, including stocks and other variable-yield securities — 23.5 million EUR) and long-term loans (14 million EUR).

Performance indicators of investment funds

At the end of the year, the assets of open-end investment funds totalled 210.8 million EUR, remaining at the previous year's level. At the end of the year, the assets of bond and money market fund totalled 178 million EUR, those of mixed funds and stock funds — 2.9 million EUR and 30 million EUR, respectively.

Bond and money market funds accounted for the major share of the investment fund sector, therefore debt securities accounted for the major share in the aggregate securities portfolio of investment funds (83%), followed by investment fund investment certificates (12%), as well as stocks and other variable-yield securities (4%). The greatest share of investments in debt securities and stocks (55% and 51%, respectively) was accounted for by investments in the securities of the issuers of the EEA countries, while the greatest share of investments into fund investment certificates were made in the US-registered investment fund certificates (60%), mostly representing the funds traded on the exchange (ETF; source: Bloomberg).

Figure 9.
Securities portfolio of open-end investment funds by type of financial instruments and by group of countries (by the country of registration of the issuer) at 31.12.2014

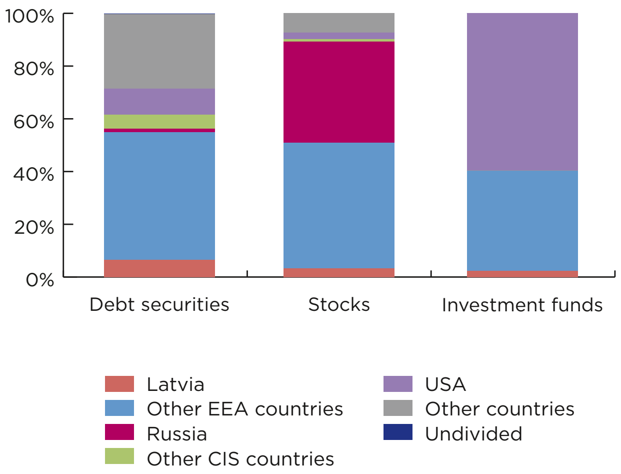


Figure 10.
Annual return of open-end investment funds by type of fund at 31.12.2014 (%)

The majority of investment funds had a positive return in 2014, while the performance of some investment funds was negatively affected by the escalation of the geopolitical tension due to the events occurring in the Ukraine and Russia, as well as the deterioration of the value of the Russian rouble.

At the end of 2014, the annual return earned by bond and money market fund ranged from -44.1% to +15.5% (four funds had a negative return). However, if the data of the fund with the highest negative return were excluded from the data, the lowest return in this fund group was -8.6% .

The annual return of open-end mixed funds ranged from -0.4% to + 9.5%, while that of open-end bond funds ranged from -43.4% to + 20.2%. It was negative in three of the nine funds. However, if the data of one fund with the highest negative margin were excluded from the data, the lowest margin of this fund group would be -9.6%.

Supervisory measures applied to 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, quality of assets, income and expense structure and compliance of their activities with the requirements of the laws of the Republic of Latvia, the FCMC regulations and guidelines, as well as other laws and regulations.

The supervisors had a focus towards the conformity assessment of key information aimed at investors, as well as assessing whether the synthetic indicators of particular investment funds of investment management funds corresponded to the fluctuation of profitability of the funds.

Closer attention was paid to off-site analysis of the internal control system and internal audit of investment management companies, as well as the assessment of the key risks to companies, their strategic objectives, changes in the management information system, the assessment of risks related to outsourced services, as well as the planned changes in the area of investment management.

The FCMC carried out the large exposure profile assessment of investment management companies and investment funds.

During the reporting year, the FCMC also carried out two on-site inspections of investment management companies. The inspections were aimed at assessing the key areas of the operations of those companies, their compliance with the requirements of the laws of the Republic of Latvia, the 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 rules. 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 deficiencies and inconsistencies identified during the inspections were discussed with company management and action plans for necessary corrections were agreed to ensure the successful functioning of the companies.

Follow-up monitoring was carried out within the scope of off-site supervision by controlling the implementation of the action plan and, where necessary, recommending the necessary adjustments.

Managers of alternative investment funds and alternative investment funds

During the financial year, managers of alternative investment funds launched their activities actively, managing alternative investment funds. During the reporting year, the FCMC carried out off-site supervision of managers of alternative investment funds to assess their financial standing, quality of assets, income and expense structure and compliance of their activities with the requirements of the laws of the Republic of Latvia, the FCMC regulations and guidelines, as well as other laws and regulations. The assessment of the business model of alternative investment funds was started.

State-funded pension scheme

Performance indicators of the state-funded pension scheme

Although in 2014, there was an increase of geopolitical and macro economic risks, asset managers were able to ensure very good performance of the state-funded pension scheme (second-pillar investment plans).

In 2014 the number of participants grew by 24,303. At the end of the year 1,249,440 participants had joined the second-pillar of the state-funded pension scheme, among them 61% had joined mandatory. The pension capital accrued in the investment plans, i.e. net assets of investment plans grew by 19.5% in 2014, to slightly more than 2 billion EUR. Over the year, the number of investment plans offered by managers of assets of the state-funded pension scheme declined from 23 to 20, because two fund managers merged their investment plans with a similar investment strategy to optimise costs and reach better profitability indicators.

In 2014 all investment plans posted a positive return. For conservative investment plans, which mainly focus on investments in debt securities, it ranged from 2.6% to 5.6%, for balanced funds — from 3.2% to 6.4%, while for active funds, which invest a significant share of funds in stocks or the funds thereof, it ranged from 2.3% to 7.9%.

At the end of 2014, debt securities accounted for the greatest share in the total investment portfolio of investment plans (48%), whereas investment fund investment certificates had the second largest share (37%). The major part of investment funds had a focus on investments in stocks or the indices thereof (56%). Due to low interest rates, the share of term deposits continued to gradually decline, accounting for merely 4.6% at the end of the year.

Investments in Latvia grew by 11.7% compared to the end of 2013. At the end of 2014, they accounted for 43% of total investments or 876.2 million EUR (including investments of 547.9 million EUR in the securities issued or guaranteed by the government, 40.9 million EUR — in debt securities issued by commercial companies, 2.2 million EUR — in stocks, 7.4 million EUR — in investment funds, 3 million EUR — in Latvian venture capital market, and 274.8 million EUR were placed with credit institutions). Conversely, investments in securities of the issuers of other EEA Member States accounted for 96% of all the securities of foreign issuers.

Figure 11.
Investments of the second-pillar pension plans by type of plan (in million EUR)

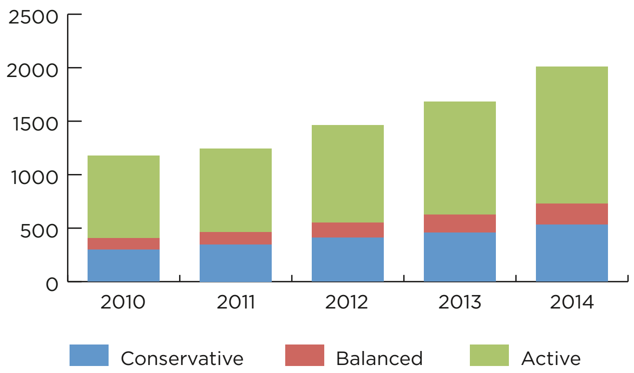
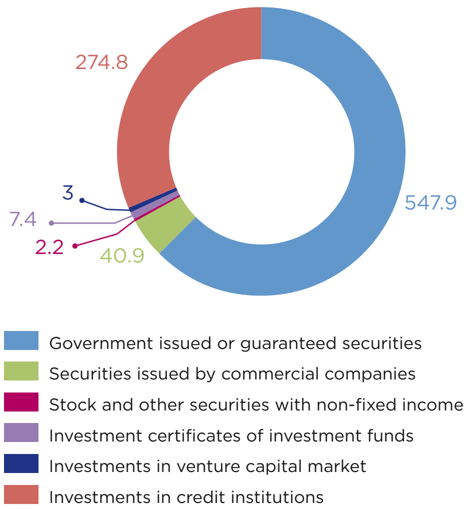


Figure 12.
Weighted average (by net assets) annual return of investment funds (%)

Figure 13.
Investments of investment plans in Latvia at 31.12.2014 (in million EUR)



Supervisory measures of managers of the assets of the state-funded pension scheme and investment plans

During the reporting year, the FCMC carried out off-site supervision of state-funded pension scheme (*SFPS*) to assess their financial standing, quality of assets, income and expense structure, and compliance of their activities with the requirements of the laws of the Republic of Latvia, the FCMC regulations and guidelines, as well as other laws and regulations.

During the reporting year, the FCMC also carried out two on-site inspections of the managers of the funds of the SFPS. During the inspection, particular attention was paid to assessing the internal control system of the manager of assets, compliance of the division 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 rules and the established reporting system. The FCMC paid particular attention to the selection 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.

The deficiencies and inconsistencies identified during the inspections were discussed with the management of the SFPS and action plans for necessary corrections were agreed upon to ensure the improvements for the successful carrying out of the functions. Follow-up monitoring was carried out within the scope of off-site supervision by controlling the implementation of the action plan and, where necessary, recommending the necessary adjustments.

During the reporting year, within the scope of off-site supervision, the FCMC also assessed the critical situation analysis submitted by asset managers of the SFPS for the investment portfolio of each investment plan. The specified risk factors, assessed scenarios and anticipated activities to be carried out in the event of adverse scenarios setting were assessed.

While carrying out off-site supervision, the internal audit function of asset managers was assessed by evaluating internal audit plans and prepared opinions. Also, meetings were held with the management of asset managers to monitor the key 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.

Taking into account the changes in the principles used to calculate the commissions of asset managers, as well as changes in restrictions applicable to investing and notifying of the members of the SFPS, the FCMC developed Regulations No. 295 *Regulations on the Preparation of the Key Information to the Members of the State-Funded Pension Scheme*, which were approved at by the Council of the FCMC on 10 December 2014.

Private pension funds

Performance indicators of private pension funds

2014 was a very successful year for private pension funds. Trends such as the steepest increase in the number of participants over the last five years, a new historical maximum in terms of the contributions made by participants during the year, as well as increasing returns were observed.

At the end of 2014, five open-end pension funds and one closed-end pension fund were operating in Latvia.

In 2014, 51.6 million EUR were paid into third-pillar pension plans, which was an increase by 25% compared with 2013. During the year, employee contributions rose by almost a third, while the employer contributions remained at the previous year's level. At the end of 2014, the capital accumulated by pension plans amounted to 280.8 million EUR, having increased by 19.1% during the year.

During the year, 17.4 million EUR were disbursed from the pension plans capital, which was by one third more than in the respective period last year. 98% were disbursed due to the participants of the plans reaching the retirement age.

The average return of pension plans in 2014 was 5.2% (in 2013 — 2.8%), for individual plans it ranged from 0.1% to 11.8%. For some individual plans an increase in profitability was due to the significant rise in the value of the US dollar against the euro.

At the end of the year, almost half of the portfolio of pension plans consisted of investment fund certificates (47.4%), of which 52% had a focus on stocks or the indices thereof, while 44.5% had a focus on investments in fixed income instruments. Investments in debt securities and other fixed-income securities (38.2%) accounted for the second largest share in the total portfolio, of which the major share (71%) consisted of state-issued or guaranteed securities. Just like for the total investments of the second-pillar, the share of investments in the term deposits in the portfolios of private pension funds declined from 9.8% to 3.5% during the year.

In 2014, investments made in Latvia increased by 17% to 105.5 million EUR at the end of the year (37% of total investments). Conversely, investments in securities of the issuers of other EEA Member States accounted for 98% of all the securities of foreign issuers.

Figure 14.
Contributions into third-pillar pension plans (in million EUR)

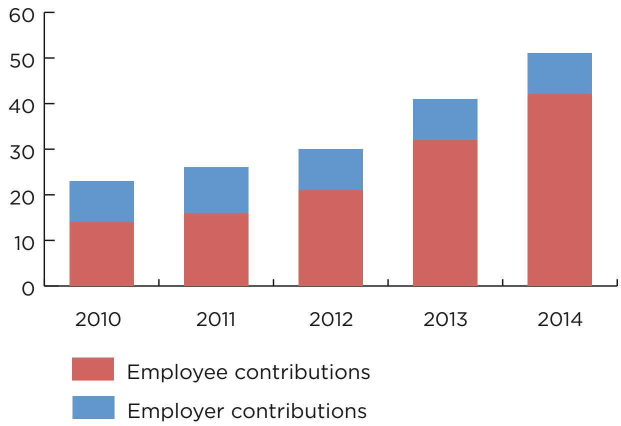


Figure 15.
Weighted average (by net assets) annual return of pension plans (%)

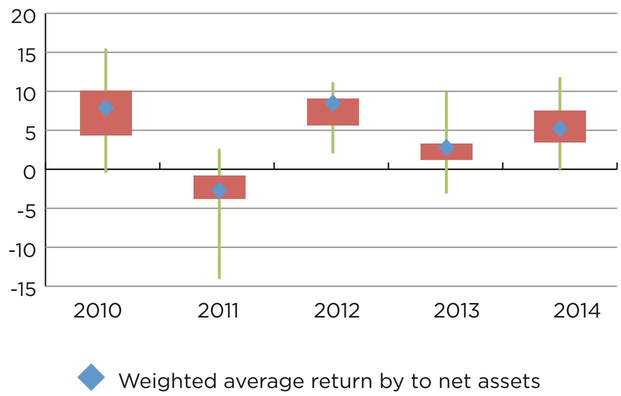
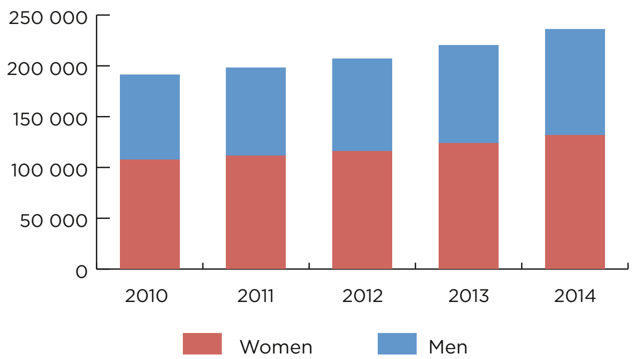


Figure 16.
Number of participants of the third-pillar pension plans



In 2014, the total number of participants who joined private pension plans increased by 15,400 (i.e. by 7%), representing the steepest increase in the number of participants over the last five years, reaching 236,087 or 24% of economically active Latvian residents at the end of the year.

Supervisory measures of private pension funds and pension plans

During the reporting year, the FCMC carried out off-site supervision of private pension funds (hereinafter referred to as pension funds) to assess their financial standing, quality of assets, income and expense structure, and compliance of their activities with the requirements of the laws of the Republic of Latvia, the FCMC regulations and guidelines, as well as other laws and regulations.

In the reporting year, one on-site inspection of private pension funds was carried out to assess the activities of the pension fund when carrying out the functions specified in the *Law on Private Pension Funds*. During the inspection, 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. Segregation of functions and appropriateness to 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. The FCMC paid particular attention to the selection and use of outsourced services, assessing the control systems established by the pension fund to assess the outsourced services. The activities of asset managers and asset holders were also assessed. During the inspection, the FCMC also assessed the risk trends of the products offered by the pension funds.

The deficiencies and inconsistencies identified during the inspection were discussed with the management of the pension fund and action plans for necessary adjustments were agreed upon to ensure the successful functioning of the pension fund. Follow-up monitoring was carried out within the scope of off-site supervision by controlling the implementation of the action plan and, where necessary, recommending the necessary adjustments.

Off-site supervision also covered the assessment of the critical situation analysis for the investment portfolio of each pension plan. The specified risk factors, assessed scenarios and anticipated activities to be carried out in the event of adverse scenarios setting 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, evaluating the internal audit plans and prepared opinions.

During the reporting year, one "mystery shopping" inspection was carried out, applying the mystery shopping technique to ascertain that the information required under the *Law on Private Pension Funds* is appropriately explained to potential participants.

In 2014, an extensive assessment of the risk profile of private pension funds was carried out.

Also, meetings were held with the management of private pension funds to monitor the key events in the activities of market participants and the fulfilment of business strategies in between on-site inspections.

During the reporting year, active work was carried out in the area of pension fund supervision in committees at 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 European level. One FCMC staff member led the work entailing the development of the study of the OPC SG *Costs and Charges applicable to IORPs* (https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-266-Final_report_on_costs_and_charges_of_IORPs.pdf). The FMCM also took an active part in the EIOPA *Task Force on Personal Pensions* and *Review Panel.*

During the reporting year, the following internal regulations were approved to consolidate the supervisory framework. *Manual of on-site supervision and inspections of private pension funds and investment management companies, including the asset managers of state-funded pension scheme and Policy for the timely application of corrective measures and sanctions to private pension funds, investment management companies, asset managers of the state-funded pension scheme and persons carrying out the function of a custodian bank.*

During the reporting year, the FCMC representatives participated in discussions with representatives of the OECD concerning Latvia's joining the OECD within the scope of the OECD negotiations, as well as in the preparatory works aimed at ensuring the events within the scope of the Latvian Presidency of the EU Council.

Investment service providers

Performance indicators of investment service providers

In 2014, of the five investment brokerage firms operating in Latvia, four firms operated at a profit of 3.5 million EUR in total. Income from commission fees and other similar income for the services rendered to customers accounted for nearly 95% of all income of investment brokerage firms, whereas administrative expenses was the highest expense item (64%).

In 2014, two investment brokerage firms continued to be engaged in the holding of financial instruments of the customers, under the licences issued to them for the performance of non-core investment services, while of the two firms holding licences for the individual management of the financial instruments of investors, customer assets were transferred for being managed only to one firm.

During the reporting year, the amount of cash of customers, which was held by brokerage firms for the performance of transactions in financial instruments, increased by 27% to 6.5 million EUR.

At the end of 2014, the capital adequacy ratio of investment brokerage firms was 25.5% (at the end of 2013 — 23.3%) (the minimum capital adequacy ratio requirement was 8%).

Supervisory measures applied to investment service providers

At the end of the reporting period, five investment brokerage firms licensed in Latvia had the right to provide investment services in Latvia (one new licence was issued in 2014), 17 banks registered in Latvia, which had obtained the respective permit, 11 investment management companies registered in Latvia and holding the relevant licence. Also two branches of foreign investment brokerage firms, six branches of foreign banks, as well as over 1,600 investment service providers from the EEA countries entitled to provide investment services according to the principle of freedom to provide services.

In 2014, in the field of the provision of investment services the FCMC carried out four on-site inspections in banks (three planned and one targeted inspections) and one inspection in investment brokerage firm. Targeted inspections are mainly carried out in response to customer complaints or responding to other information on possible irregularities in the activities of the providers of investment services, and also to ensure that the obligations set by the FCMC are 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 the risks pertaining thereto, ensuring the customers with the best outcome, the determination of the suitability and appropriateness of an investment service to the customer in terms of his knowledge, experience, investment objective and financial ability to assume a particular risk. The FCMC experts also assessed the topicality of internal processes and documents of investment service providers and their compliance with the requirements of laws and regulations.

By improving the supervisory principles of the providers of financial services and caring about the protection of customer interests, overall in 2014 the FCMC also carried out three mystery shopping visits, to ascertain that the financial and capital market participants complied with the requirements of laws and regulations in the field of the provision of investment services. These inspections were mainly focussed on how and what kind of information had been provided to customers regarding investing in financial instruments, among other things — information about risks and costs.

In 2014, the FCMC reviewed 11 customer complaints about investment services provided to them and prepared opinions on the compliance of the action of the market participants with the requirements of the law.

Continuing the commenced tradition, the FCMC, upon the invitation of the Association of Latvian Commercial Banks arranged a seminar on internal audit in the area of providing investment services. In 2014, the FCMC also organised a public consultation on guidelines on the application of particular requirements of the *Financial Instrument Market Law* (hereinafter — the FIML), which govern the provision of investment services.

Sanctions and corrective measures

Carrying out the supervision of the activities of the providers of investment services, in 2014, for violations and deficiencies in the area of providing investment services administrative agreements were entered into with two participants of the financial and capital market under which the latter undertook to eliminate the identified violations and deficiencies within a specified term, as well as pay the total fine of 65,000 EUR under the administrative agreement.

The FCMC applied corrective measures of another kind to two more participants of the financial and capital market, thereby ensuring that the deficiencies are eliminated.

Financial instruments market

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

At the end of the reporting year, *AS NASDAQ OMX Riga* (hereinafter also referred to as — Stock Exchange) was operating in Latvia as the only regulated market.

In 2014, the shares of AS *Latvijas zoovetapgāde* were excluded from the Stock Exchange. At the end of the year, shares of 29 issuers were listed on the Stock Exchange. The bonds of five new issuers were including in the securities listing in 2014, as well as of 12 issuers, totalling 52 issued of various debt securities, whereof 19 were Latvian government debt securities and 33 were corporate debt securities.

The FCMC continuously monitored whether the issuers disclosed information in a timely manner and in compliance with requirements of the *Financial Instrument Market Law (FIML)*. In 2014, having considered the nature of the identified violations, in eight cases the FCMC required that issuers to take measures to eliminate the deficiencies in disclosing mandatory information in the future, and passed decisions in six administrative cases for violations in disclosing mandatory information. Accordingly, administrative provisions were issued — in two cases a warning to the issuer, and in two cases — a fine of 3,550 EUR and 4,000 EUR, respectively. In one case, it was identified that the issuer's financial statements did not meet the requirements of the FIML, and in the other case, the FCMC decided on delisting the issuer from the stock exchange for continuous violations of the FIML.

In 2014, to promote the compliance with the provisions of law, which are key to the shareholders of various issuers, the FCMC sent to the issuers several letters interpreting law. In cooperation with the Ministry of Justice and the AS *Latvijas Centrālais depozitārijs* (Latvian Central Depository) the FCMC developed recommendations for the denomination of the share capital from lats to the euro for the joint stock companies whose shares were listed on the regulated market.

In 2014, the FCMC completed inspections in two administrative cases on concerted practices of persons and the duty to express the compulsory share redemption proposal. In the former case, the FCMC applied a fine of 14,200 EUR to each of the two persons. In the latter administrative case, the FCMC also applied a fine of 14,200 EUR and 10,650 EUR to two persons, respectively, as well as imposed a duty thereon to express the compulsory share redemption proposal to other shareholders.

Trading in financial instruments

In 2014, the stock trading activity on Latvian regulated market *AS NASDAQ OMX Riga* was low. In 2014, compared to 2013, the total number of transactions in the stock market declined by 19%, the number of traded shares dropped by 47%, whereas the total turnover in the share market was 17.2 million EUR, which is by 20.3% lower than in 2013. At the end of 2014, the stock market capitalisation of *AS NASDAQ OMX Riga*, compared to the end of 2013, had also declined by 9% to 860 million EUR.

Conversely, the shares of only one company were traded on the Baltic alternative market *First North* in 2014, and the trading activity was very low, with the total turnover amounting to 20.3 thousand EUR for 2014.

To promote the sound operation of the financial instruments market, the FCMC continuously monitored the trading in financial instruments by following and analysing the orders submitted to the stock exchange and the transactions carried out therein to identify and prevent market manipulation and insider dealing. Upon identifying the features of market manipulation or insider dealing, due diligence was carried out. The FCMC warned four investors and requested them to cease the action that might mislead other investors regarding stock price, demand and supply.

In 2014, inspecting whether the persons listed as the holders of insider information had complied with the requirement of the FIML on submitting a notification to the FCMC on performed transactions, as well as whether the persons, according to the requirements of the FIML had notified the FCMC of the acquisition or disposal of a qualifying holding, the FCMC passed the decision in five cases. In four cases a warning was issued, and in one case a fine of 500 EUR was applied. Identifying instances of minor deficiencies or inaccuracies, the FCMC did not initiate administrative processes but rather reprimanded the persons, requesting to eliminate the deficiencies or inaccuracies in the future.

Security of financial services and information systems

In 2014, the FCMC carried out eight on-site information system security audits and six inspections related to the supervision of payment institutions.

Overall in the reporting year, particular attention was paid to the secure use of remote services as well as ensuring control over the activities of users with extended rights.

The amendments to the regulations on the security of the information system were also aimed at gradually increasing the security level of the authentication and monitoring of remote services, and of on-line payment security.

In 2015, the FCMC intends to endorse the guidelines for the security of on-line payments endorsed by the European Banking Authority.

The FCMC maintained close cooperation with the authority for the prevention of security incidents of information technologies CERT.LV, carrying out a joint communication training for the events entailing cyber-attacks.

In 2014, the FCMC also carried out preparatory works for participation in the SSM in respect of the supervision of the security of banking information.

Preventing money laundering

The year 2014 was a special year, mainly due to geopolitical reasons which led to imposing financial sanctions determined by the US competent authorities and the EU on Russian and Ukrainian officials. At the end of the first quarter of 2014, the FCMC as the authority responsible for the implementation of sanctions in Latvia, encountered peculiarities of incoherent application of the sanction regime between the two continents.

At the same time, the FCMC continued the work aimed at the implementation of the revised international anti-money laundering and terrorist financing standard (40 recommendations of the *Financial Action Task Force (on Money Laundering) (FATF)* by taking measures aimed at the implementation of further risk-based approach in the financial sector.

In 2014, to assess the compliance 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*, the FCMC carried out eight on-site inspections in banks and three inspections of payment institutions, as well as one inspection of an investment brokerage firm. In 2014, the FCMC carried out 20 off-site inspections (including the assessment of the submitted procedures) in credit institutions and 45 inspections (including the assessment of procedures) in financial institutions: five inspections of electronic money institutions, 20 inspections of payment institutions, two inspections of investment brokerage firms, five inspections of insurance intermediaries rendering life insurance services, five inspections of credit union companies, seven inspections of insurance intermediaries rendering life insurance services, and one inspection of an alternative investment fund.

Carrying out the inspections in 2014, the FCMC had an on-going focus on the assessment of the effectiveness of the functioning of the established internal control systems of the institution subject to inspection, as it is considered one of the key preconditions for preventing risks related to money laundering and for fulfilment of the requirements of the existing laws and regulations.

In carrying out inspections, the FCMC identified several cases when the credit institutions and financial institutions failed to comply with the requirements of the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing*. In such cases, making decision on the applicable sanction, the FCMC considered the nature as well as materiality of the violation. Therefore, the FCMC imposed a fine for the failure to observe the requirements of the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing* on one credit institution and one payment institution, as well as suspended the licence to provide payment services of one payment institution, and deleted the entry of one payment institution in the register of payment institutions. Conversely, in one case, considering the nature of the violation and observing the principle of proportionality, instead of imposing a sanction for the violation, a warning was issued to one credit institution for failure to comply with the requirements of the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing.*

In agreement with previously adopted decisions of the FCMC, the responsible member of the management board of the bank was replaced, transferring the performance of his duties related to the area of anti-money laundering and terrorist financing to another member of the management board.

With a view to exchanging the information for supervisory purposes in connection with anti-money laundering, in 2014, the FCMC received eight requests for information from foreign financial and capital market supervisory authorities, including three from Russia, four from the USA and one from Germany. Conversely, the FCMC sent one request for information to the Russian supervisory authority.

In 2014, pursuant to its competence and in accordance with the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) recommendations and the FATF recommendations, the FCMC prepared and the Parliament of the Republic of Latvia (*Saeima*) approved significant amendments to the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing* (effective from 16 September 2014). The amendments comprised the refining of the definition of a politically exposed person, supplementing the list of the subjects of the Law (credit unions, reinsurance companies and managers of alternative investment funds), as well as refining the regulatory framework for identifying the beneficiary owner, segregating the obtaining of information from the examination thereof, as well as refining the regulatory framework in respect of the off-site identification of customers, providing for additional measures that need to be taken under a risk-based approach.

Furthermore, in 2014, the FCMC developed a number of methodological materials for credit institutions in the area of anti-money laundering and terrorist financing, which refine the measures to be taken to identify the origin of a customer's money and welfare, and for customer off-site identification, as well as in the area of correspondent relations to mitigate money laundering and terrorist financing risk.

In regard to the matters concerning anti-money laundering, in 2014, the FCMC representatives continued to participate in the work carried out by the European Committee on the Prevention of Money Laundering and Terrorist Financing, as well as of the joint committee of three EU supervisory authorities (the European Banking Authority, the European Securities and Markets Authority, the European Insurance and Occupational Pensions Authority) on the matters concerning anti-money laundering and prevention of terrorist financing (the *Anti-Money Laundering Committee*). In 2014, FCMC representatives participated in the work carried out by the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL).

In 2014, in accordance with the FCMC register of unusual and suspicious financial transactions, the FCMC forwarded four reports to the Office for the Prevention of the Laundering of Proceeds Derived from Criminal Activity.

LICENSING

In 2014, minor changes could be observed in all financial market segments, except management of alternative investment funds, under the *Law on Alternative Investment Funds and the Managers Thereof,* which became effective in 2013, market participants carried out their core activities in compliance with the law providing for the registration or obtaining a licence from the FCMC.

Changes in the number of banks were affected by the decisions of FCMC passed in 2013, when based on the request of market participants, the licences of AS *UniCredit Bank* and VAS *Latvijas Hipotēku un Zemes Banka* were withdrawn as of 1 January 2014. The waiver of the license was provided for in the strategy of the shareholders of AS *UniCredit Bank*, and currently, after ceasing the operations of a credit institution, the company has a focus on providing leasing services, following the merger with SIA *UniCredit Leasing*. Conversely, VAS *Latvijas Hipotēku un Zemes Bank*a was reorganised into a development finance institution.

In the beginning of 2014, the Latvian branch of *Nordea Bank AB* (Sweden) started its operations in Latvia, thus implementing the decision of the Nordea group under which in the future it will be represented in Latvia by the Swedish *Nordea Bank AB*. This decision is based on the objective of building as simple and centralised a structure of the *Nordea group* as possible. In March 2014, the FCMC passed the decision authorising the transfer of the Latvian branch of *Nordea Bank Finland Plc* (Finland) into the ownership of *Nordea Bank AB* (Sweden). The Latvian branch of *Nordea Bank Finland Plc* is expected to be wound up in 2015.

Thus, in 2014, 17 banks and nine branches of the EU Member State banks were operating in Latvia.

In terms of banking supervision, including licensing, 2014 proceeded under the sign of the SSM, with the ECB taking over from national banking supervisory authorities the decision-making in the areas such as issuing of licenses for new credit institutions, withdrawing of the licences of credit institutions, issuing the permit related to a qualifying holding, making decisions concerning the opening of branches of significant credit institutions in other EU Member States, and approving bank officers to their positions in these significant credit institutions. The FCMC has been actively involved in this process, and it is still responsible for the examining of the submitted documents and preparation of draft decisions, which are subsequently submitted to the ECB for a final decision. Starting from 4 November 2014 when the SSM became operational, the ECB has adopted one decision submitted to it by the FCMC approving the appointment of officers to their positions.

In 2014, the number of cooperative credit unions dropped by three. Their violations of laws and regulations served as the basis for the withdrawal of their licences.

2014 was a relatively calm year for insurance companies, payment institutions, investment management companies and investment firms, where there were minor changes in the number of participants.

A significant number of new market entrants was registered and licensed by the FCMC in the area of alternative investment fund manager segment (all in all, three licensed and seven registered managers, one of the registered managers changed its status to a licensed manager status).

The changes that occurred in the number of licensed market participants in 2014 are summarized in Table 1.

Table 1.
Changes in the number of licensed market participants

	AT THE BEGINNING OF 2014	AT THE END OF 2014	NEW MARKET ENTRANTS IN 2014
Banks	19	17 (-2)	-2[3]
Branches of the EU Member State banks	9	9	0
Cooperative credit unions	35	32 (-3)	0[4]
Providers of banking services from the EEA	301	309 (-4 companies)	+12
Insurance companies	7	7	0
Branches of the EU Member State insurance companies	13	14	+1[5]
Providers of insurance services from the EEA	491	501 (-10 companies)	+20
Investment management companies	12	12	0[6]
Providers of investment management services from EEA	22	23	+1
Investment brokerage firms	4	5	+1[7]
Branches of investment brokerage firms of the EU Member States	1	2	+1[8]
Providers of investment brokerage services from the EEA	1808	1828 (-121 companies)	+141
Tied agents of providers of investment services from the EEA	19	23 (-1)	+5
Private pension funds	7	6	-1[9]
Insurance brokerage firms	88	88 (-4 companies)	+4[10]

3 Banks. On 12 December 2013, the FCMC passed the decision on withdrawing the licence issued to AS *UniCredit Bank* for engaging in the activities of a credit institution with effect from 1 January 2014. On 19 December 2013, the FCMC passed the decision on withdrawing the licence issued to VAS *Latvijas Hipotēku un Zemes Banka* for engaging in the activities of a credit institution with effect from 1 January 2014.

4 Cooperative credit unions The licence of *Vecumnieki Cooperative Credit Union* has been withdrawn under the 2 July 2014 decision of the FCMC Board. The licence of the cooperative credit union of *Latvian Agricultural Chamber KRĀJKASE* has been withdrawn under the 19 June 2014 decision of the FCMC Board. The licence of *Metallurgist cooperative credit* union has been withdrawn under the 5 March 2014 decision of the FCMC Board. On 27 March 2014, the Court of Liepāja declared the company's insolvency procedure.

5 Branches of the EU Member State insurance companies. On 27 January 2014, the FCMC received a letter from the Swedish insurance company supervisory authority dated 23.01.2014, ref. No. FI Dnr 13-14706 regarding the wish of *If P&C Insurance Ltd (Publ)* to open a branch in Latvia. On 27 March 2014, the Latvian branch of *If P&C Insurance Ltd (Publ)* was registered in the Commercial Register under No. 40103774146.

6 Investment management companies. On 12 March 2014, the FCMC withdrew the licence of IPS GE Money Asset Management. Conversely, on 17 April 2014, it issued the licence to joint stock company *Rietumu Asset Management ieguldījumu pārvaldes sabiedrība*.

7 Investment brokerage firms. On 12 February 2014, the FCMC issued a licence to the joint stock company *Amenda Wealth Management*.

8 Branches of investment brokerage firms of the EU Member States. On 3 April 2014, Latvian branch of *MeritKapital Ltd* started its operations in Latvia.

9 Private pension funds. On 13 August 2014, the licence of joint stock company *GE Money atklātais pensiju fonds* was withdrawn.

10 Insurance agents in 2014, the following insurance brokerage firms were registered in the Register of insurance and reinsurance intermediaries: SIA *PrivatBrokers* — on 11 March 2014; SIA *Savour* — on 11 March 2014; SIA *Skandi Apdrošināšanas Brokeri* — on 19 June 2014; SIA *Ziemeļu Apdrošināšanas Brokeri* — on 10 September 2014.

	AT THE BEGINNING OF 2014	AT THE END OF 2014	NEW MARKET ENTRANTS IN 2014
Insurance agents	533	544 (-116)	+127
Providers of payment services from the EEA	189	234 (-1 company)	+46
Payment institutions (registered)	36	34 (provision of services suspended to 2 payment institutions) (5 deleted entries in the register)	+5[11]
Electronic money institutions (registered)	14	12 (1 deleted entry in the register)	+1[12]
Electronic money institutions (licensed)	0	2	+2[12]
Electronic money institutions from the EEA.	40	50	+10
Licensed managers of alternative investment funds	0	3	+3[13]
Registered managers of alternative investment funds	0	6 (-1)	-1[14]

11 Payment institutions. In 2014, the following payment institutions were registered: SIA *AlfaPay* — on 05 March 2014; SIA WoT — on 05 March 2014; SIA *PAYTECH* — on 29 April 2014; SIA *Sollo LV* — on 13 June 2014; SIA *Digital Retail* — on 13 August 2014. The FCMC deleted the entries related to the following payment institutions from the Register of payment institutions: SIA *Nextpay* — on 23 January 2014; SIA *ONLINE SERVICES* — 12 February 2014; SIA *Post Service* — on 12 March 2014; SIA *DNOVO* — 21 May 2014; AS *Preses Apvienība* — 09 July 2014. The provision of services was suspended by: SIA *RFM TRANSFER LATVIA* — 21 February 2014 at 12 a.m.; SIA *DIXIPAY* — on 30 August 2014 at 12 a.m.

12 Electronic money institutions. In 2014, licences were issued for the operations of the following electronic money institutions: SIA *Transact Pro* — on 20 June 2014; SIA *Qiwi Wallet Europe* — on 12 November 2014. On 2 July 2014, the FCM registered the electronic money institution SIA *QR Pay*, which was initially registered in the Register of payment institutions on 11 September 2013. On 20 August 2014, the FCMC deleted the entry on SIA *Money Group* from the Register of electronic money institutions.

13 Licensed managers of alternative investment funds. On 10 January 2014, a licence to carry out the activities of the manager of alternative investment funds was issued to joint stock investment management company *CBL Asset Management*. On 19 November 2014, a licence to carry out the activities of the manager of alternative investment funds was issued to joint stock investment company *Finasta Asset Management*'. On 15 October 2014, a licence to carry out the activities of the manager of alternative investment funds was issued to joint stock investment management company *Hipo Fondi aktīvu pārvalde*.

14 Registered managers of alternative investment funds. On 12 March 2014, joint stock investment management company *Hipo Fondi aktīvu pārvalde* was registered as the manager of alternative investment funds (the registration was cancelled on 15 October 2014, when the company acquired the status of a licensed manager of alternative investment funds). On 09 April 2014, SIA *EuVECA Livonia Partners* was registered as the manager of alternative investment funds. On 13 August 2014, SIA *BaltCap AIFP* was registered as the manager of alternative investment funds. On 20 August 2014, SIA *AIFP Imprimatur Capital Fund Management* was registered as the manager of alternative investment funds. On 27 August 2014, SIA *ZGI CAPITAL* was registered as the manager of alternative investment funds. On 24 September 2014, SIA *FlyCap AIFP* was registered as the manager of alternative investment funds. On 08 October 2014, SIA *Expansion Capital AIFP* was registered as the manager of alternative investment funds.

DEVELOPMENT OF LAWS AND REGULATIONS

National legislation

In 2014, the FCMC continued to improve the regulatory framework governing the activities of the financial and capital market participants. Based on the guidelines issued by the EU institutions, best international practices and considering the specific nature of the Latvian financial sector, amendments to several FCMC Regulations were developed and approved. The key amendments were made to the following laws and regulations:

Regulation on Procedure for Calculating the Maximum Distributable Amount, which transposes the requirements of Directive 2013/36/EU[15] into Latvian laws and regulations and lays down the procedure for calculating the maximum distributable amount (profit), i.e. the amount that an institution that is not subject to the total capital reserve requirement laid down in the *Credit Institution Law*, may distribute.

Amendments to *Regulation on Credit Risk Management*, in assessing credit risk, institutions may not mechanically rely on the credit ratings provided by external credit rating institutions (rating agencies), or use them as the only criterion for assessing credit risk, but should rather take into account all available external and internal information related to credit risk. Furthermore, the need to respect the diversification principle in forming a loan portfolio is emphasised.

Amendments to *Regulations on the Issue of Credit Institution and Credit Union Operating Licences, Obtaining Permits Regulating the Operation of Credit Institutions and Credit Unions, Settlement of Documents and Provision of Information* lay down the procedure under which credit institutions notify the FCMC of their intent to disburse dividends (including extraordinary dividends), and refine the procedure for issuing the authorisation for the disbursement of dividends (including extraordinary dividends), if the report of a certified auditor is qualified.

15 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.

Regulations on Registration of Retail Payment Systems were developed considering the amendments in the *Payment Services and Electronic Money Law* that delegates the supervision of retail payment systems to the FCMC. As previously such retail payment systems were not registered in the FCMC register, these Regulations provide for the procedure for the future registration of the new market participants and for deleting of the entry, as well as for the procedure under which the system operator will be obliged to inform the FCMC on the changes to the submitted documents and information.

Amendments to *Regulations on the Issue of Payment Institution and Electronic Money Institution Licences, Procedure for Payment Institution and Electronic Money Institution Registration, Documents to be Submitted and Provisions of Information* specify in more detail what documents need to be submitted by licensed institutions and such institutions which are not required to obtain a licence under Sections 5 and 5.1 of the *Payment Services and Electronic Money Law*, including what information needs to be specified in the business plan of an institution, what procedures need to be complied with to ensure the establishment and effective functioning of the money laundering and terrorist financing prevention system, and what information needs to be submitted on the officials of the institution, etc.

Regulations on the Regulatory Requirements for Payment Institutions and Electronic Money Institutions and the Preparation of Reports were developed having regard to the amendments made to the *Payment Services and Electronic Money Law*, and they lay down a new procedure for the calculation of capital adequacy ratio. Under the Regulations, the calculation of own funds needs to be performed in accordance with the requirements laid down in Regulation No. 575/2013, and the capital adequacy ratio is calculated having regard to the amendments to the *Payment Services and Electronic Money Law*. To that end, Annex 3 has been developed for the mentioned calculation, which is binding on payment institutions as well as electronic money institutions. The content of information to be disclosed in annexes has been enhanced.

Solvency II

The draft law *Insurance and Reinsurance Law* was developed to transpose the provisions 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*) into Latvian laws and regulations. The draft law amendments to the existing solvency and supervisory regime for the insurance and reinsurance sector, lay down a new procedure for the calculation of capital requirements based on risk assessment, as well as incorporates the requirements of the current *Law On Insurance Companies and Supervision Thereof* and *the Reinsurance Law*, which remain applicable.

Currently in Latvia, the solvency and prudential requirements for the insurance sector are laid down by *the Solvency I* rules under the existing EU directives. The existing regulatory framework provides for a capital requirement calculation which is based on the amount of premiums or claims. Thus, not all risks are taken into account when determining capital requirements, e.g. market risk, credit risk and operational risk, to which an insurance company or a reinsurance company is exposed. After implementing the new solvency and supervisory regime *Solvency II,* the protection of the interests of policyholders will significantly improve.

The requirements of the draft law will take effect gradually, the full application of the requirement is planned to become effective from 1 January 2016.

Amendments to the *Payment Services and Electronic Money Law* were developed considering the previous practice of payment institutions and electronic money institutions and the deficiencies identified during the supervisory process. The amendments are aimed at improving and enhancing the supervisory requirements, as well as transposing the requirements for the calculation of own funds arising from the Directive of the European Parliament and of the Council 2007/64/EC.

The amendments were aimed at improving the supervisory process of institutions and reducing the risks applicable to their operations, supervisory requirements have been improved, and the limit for payments and money in circulation upon exceeding which the FCMC licence should be obtained, has been lowered. In addition, several technical changes were made.

At the same time, the range of persons who have the right to provide payment services was extended to include credit unions, thus ensuring that the credit institutions authorised to provide payment services also qualify as payment service providers in the meaning of the Law. The own funds capital requirement calculation was changed on the basis of the Method B laid down in Article 8 of Directive 2007/64/EC, thereby improving the supervision of licensed payment institutions and ensuring reasonable requirements for the required amount of own funds, considering the amount and type of payment services actually provided by the payment institution.

Amendments were made in connection with the institution's initial capital and own funds and the procedure for calculating thereof to ensure the fulfilment of the requirements laid down in Directive No. 575/2013.

Considering that the FCMC has been identified as the competent authority which supervises the retail payment systems and compliance of their operation with the European Parliament and Council Regulation No. 260/2012, the amendments provide for the registration of retail payment systems. Furthermore, the amendments make the FCMC eligible to request the necessary information and carry out inspections of payment systems. The amendments also provide for the fee for the supervision thereof.

In 2014, work was started on the implementation of the new ***Law on Recovery and Resolution of Credit Institutions and Investment Firms***, which also provides for the amendments to:

- the Financial and Capital Market Commission Law, complementing the list of the FCMC functions providing for the FCMC to comply with the provisions of the *Law on Recovery and Resolution of Credit Institutions and Investment Firms*;
- the *Credit Institution Law*, mainly providing for the amendments related to the provisions of the *Law on Recovery and Resolution of Credit Institutions and Investment Firms and Settlement*; such as concerning a proxy appointed by the FCMC. The law will be complemented with a new category of creditor claims to which specified amounts will be payable upon liquidation or insolvency of the credit institution;

- the *Financial Instrument Market Law*, laying down a special procedure for settling creditor claims in the event of the liquidation or insolvency of the brokerage firm, providing for disbursements to be made firstly to investors, which under the provisions of the *Investor Protection Law* are eligible for compensation, and, secondly, disbursements to natural persons and micro enterprises, as well as small and medium-sized enterprises.

In addition, amendments have been made to the *Credit Institution Law* to ensure the right of the FCMC pursuant to its competence to exchange restricted information with the ECB, maintaining restricted access status for the provided information under Regulation No. 1024/2013, conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, as well as to lay down the reference to the rights and obligations of the FCMC within the scope of the SSM.

In 2014, the draft law **Amendments to the Activities of Insurance and Reinsurance Intermediaries Law** was developed aimed at improving the supervision of insurance and reinsurance intermediaries, making it more efficient, as well as identifying the procedure for handling complaints received from customers, enhancing the protection of customer interests and eliminating practical deficiencies identified in the current regulatory framework. The amendments refine the existing employment relationship between the insurance broker and the employees directly involved in insurance or reinsurance intermediary activities, provide for the right of insurance companies and the branches of non EU insurance companies to submit documents for registration on behalf of an insurance agent, as well as to make a request to cancel the entry in the register of insurance and reinsurance intermediaries. The latest amendments also complement the list of applicable sanctions, providing for the right of the FCMC to set reasonable restrictions on the activities of the insurance and reinsurance intermediaries. The amendments also provide for an additional kind of third-party liability insurance for insurance and reinsurance intermediaries — an equivalent to a guarantee issued by a credit institution. The latest amendments also provide for an annual fee for supervision applicable to insurance brokers and the branches of other EU Member State insurance and reinsurance intermediaries, as well as to confer rights on the FCMC to prescribe the procedure for its calculation and payment.

Implementation of the reporting prescribed by the EU legislation

In 2014, a number of European Commission Regulations and Implementing Regulations were adopted, which are directly applicable legislative enactments. The number of reports to be submitted by credit institutions and the amount of information to be included therein for supervisory needs increased significantly. Under the requirements of the European Parliament and Council Implementing Regulation (EU) No. 680/2014[16] applicable to credit institutions, starting with 31 March 2014, a number of new reports need to be prepared (including reports on own funds and own fund requirements, leverage indicator, fulfilment of the large exposure restrictions, liquidity indicators, and financial information). Throughout 2014, the FCMC staff was actively engaged in providing advice to market participants, helping them to prepare and submit the mentioned reports.

To obtain the data, which under Regulation No. 231/2013[17] need to be exchanged with the supervisory institutions of other EU Member States, the European Securities and Markets Authority (ESMA) and the European Systemic Risk Board, the FCMC developed **Regulations on Provision of Information by Managers of Alternative Investment Funds**. These Regulations prescribe the procedure under which managers of alternative investment funds that are licensed and registered in Latvia prepare and provide information on the alternative investment funds managed by them.

16 The European Parliament and Council Implementing Regulation (EU) No. 680/2014 laying down the implementing technical standards with regard to the monitoring reports provided by the authorities under the European Parliament and Council Regulation (EU) No. 575/2013.

17 The Commission delegated regulation (EU) No. 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

EU directives and regulations adopted in 2014

Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing **a framework for the recovery and resolution of credit institutions and investment firms** and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council

The Directive provides for the implementation of a minimum set of resolution instruments for credit institutions and investment brokerage firms in all EU Member States, significantly increasing the likelihood of an institution to achieve a successful and efficient resolution, thereby preserving the continuity of financial services and the stability of the financial system as a whole. It provides for a mechanism which enables a partial write-off of debts or a partial conversion thereof into own funds (equity) (a debt write-off instrument). The new piece of legislation aims to minimise the involvement of taxpayers' money in saving of distressed credit institutions and investment brokerage firms, preserving financial stability and confidence in the financial sector.

The requirements of the Directive had to be transposed into national law by 31 December 2014, and the provisions of the regulatory enactment are applicable from 1 January 2015, on certain matters — from 1 January 2016.

Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of the **Single Resolution Mechanism** and the **Single Resolution Fund** and amending Regulation (EU) No. 1093/2010

The Regulation provides for establishing the single resolution mechanism in the countries participating in the SSM (currently the Eurozone countries), in applying the recovery and resolution mechanisms provided for in the Directive. The principal objective of this Regulation is to minimise the losses of depositors, governments and taxpayers, ensuring an adequate recovery and resolution of large and systemically important credit institutions, through a single resolution mechanism, which is based on a central decision-making authority. Similarly, the Regulation provides for establishing a common resolution fund of credit institutions, which from the contributions of the credit institutions established in the countries participating in the mechanism will be able to accumulate a greater amount of resources than the national state funds and thus would better protect taxpayers while ensuring a level playing field in terms of the circumstances of competition for all credit institutions in the participating Member States.

The requirements of the Regulation are applicable from 1 January 2016.

Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on **deposit guarantee schemes**

The Directive provides for the harmonisation of the concept of guaranteed deposits, maintaining the amount of the guaranteed compensation amount up to 100,000 EUR, ensuring a faster disbursement of the guaranteed amount (seven working days), as well as improving depositors' awareness of the operation of the security and guarantee system, using easy to understand standard forms and account statements. At the same time, the Directive seeks to ensure the settling of the issues concerning the financing of deposit guarantee systems.

The Directive entered into force on 2 July 2014, and the Member States are obliged to comply with a number of its requirement from 4 July 2015.

Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on **the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features**

The requirements of the Directive focus on improving the information on the transparency and comparability of payment account tariffs, facilitation of the change of payment accounts, preventing discrimination and precluding such instances of a refusal to open a payment account, which are based on the consumer's nationality or domicile, if different from the country in which the service provider is located. The directive also aims to ensure consumer access to payment accounts with basic functions in any Member State, irrespective of their permanent place of residence.

The Directive entered into force on 19 September 2014, and the Member States are required to adopt laws and regulations and administrative provisions necessary to comply with the provisions of this Directive by 18 September 2016.

> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on **credit agreements for consumers relating to residential immovable property** and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010

The Directive lays down the key requirements for certain aspects of the credit agreements concluded with consumers on residential real estate, and provides for the amount of information that needs to be provided by the credit institution and credit intermediary before entering into the contract as well as during the contract term to the borrower, imposed a duty on the creditor to assess the borrower's creditworthiness, as well as the borrower's obligation to provide information to the creditor, the procedure for licensing and monitoring of credit intermediaries, etc.

The Directive entered into force on 20 March 2014, and its requirements need to be transposed by Member States in their national legislation by 21 March 2016.

> **Directive** 2014/65/EU of the European Parliament and of the Council of 15 May 2014 **on markets in financial instruments** and amending Directive 2002/92/EC and Directive 2011/61/EU

> **Regulation** (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 **on markets in financial instruments** and amending Regulation (EU) No. 648/2012

The Directive and the Regulation provide for the extending of the concept of a financial instrument as well as require that all organised trading in financial instruments must be carried out at regulated trading venues, providing for the definition of a regulated trading venue respectively. The amendments affect disclosure requirements applicable to pre-trading as well as post-trading information, extending the application thereof also to debt securities, structured finance products, emission trading as well as derivatives. The new piece of regulation provides for an extended reporting on transactions.

The Directive entered into force on 19 September 2014. The Member States are required to adopt and publish laws and regulations as well as administrative provisions that are necessary to comply with the requirements of the Directive by 3 July 2016. Conversely, Member States are required to apply the provisions of the Regulation from 3 January 2017.

> Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (**Market abuse directive**)

> Regulation (EU) No. 596/2014 of the European Parliament and of the Council of 16 April 2014 **on market abuse** (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC

The Directive lays down minimum requirements for criminal sanctions for the most serious cases of market abuse such as insider trading and market manipulation. Conversely, the Regulation modifies (updates) the provisions included in EU Directive 2003/6/EC, among other things, considering market developments, complements the regulatory framework with new types of financial instruments and new kinds of trading in instruments such as trading platforms, the OTC trade, etc., supplements the notions of insider information and market manipulation, as well as provides for a wider and clearer powers of supervisory authorities and cooperation in supervision.

The Directive and the Regulation are applicable in the Member States from 3 July 2016.

> Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on **improving securities settlement in the European Union and on central securities depositories** and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012

The Regulation lays down uniform requirements for settlements with financial instruments in the EU as well as the rules for the organisational structure and activities of central securities depositories aimed at strengthening the security and efficiency of settlements with securities as well as the operation of such central securities depositories that manage securities settlement systems.

The Regulation became effective on 17 September 2014.

Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to **undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions**

The Directive lays down the tasks and responsibilities for depositaries (custodian banks), refines their responsibilities and conditions under which depositary functions may be delegated, lays down the requirements for the development and documentation of the remuneration policy of the undertaking for collective investment in transferable securities, as well as the disclosure of remuneration, and provides for the harmonisation of the sanction regime in the area of undertakings for collective investment in transferable securities.

The Member States are required to transpose the requirements of the Directive by 18 March 2016 at the latest.

Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No. 1060/2009, (EU) No. 1094/2010 and (EU) No. 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (**Omnibus II**)

The Directive amends the *Solvency II* Directive in respect of the duties and powers of the supervisory authorities supervising the EU insurance companies, in particular, for group supervision in relation to the establishing of the European Insurance and Occupational Pensions Authority, as well as lays down additional transitional provisions for the implementation of particular sections of the *Solvency II* Directive and additional rules relating to the determination of technical provisions under financial market stress conditions and for insurance products with long-term guarantees.

The Member States are required to adopt and publish laws and regulations, as well as administrative provisions for the implementation of the requirements of the Directive by 31 March 2015.

Regulation (EU) No. 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)

The Regulation lays down the key elements of investment products, which should be reflected in the document of core information as well as a common format to promote the comparability of products and the liability of the creator of the investment product with regard to the document of core information. The Regulation is aimed at ensuring consumer awareness and protection, when offering sophisticated investment products as well as to improve the transparency of the investment product market for private investors.

The Regulation became effective on 29 December 2014, however it is applicable from 31 December 2016.

At the same time, quite a few Commission delegated and implementing regulations setting the technical standards for the application of certain previously adopted EU legislation have been adopted in 2014, including 19 delegated and implementing regulations, as well as one implementing decision in regard to prudential requirements and supervision (CRR/CRD IV) applicable to credit institutions and investment brokerage firms, three delegated and implementing regulations in regard to the European market infrastructure (EMIR), three delegated and implementing regulations relating to alternative funds (AIFMD, EuVECA, EuSEF), as well as one delegated regulation to implement the single resolution mechanism (http://www.fktk.lv/lv/tiesibu-akti/jaunumi.html).

Proposals published by the European Commission in 2014

Credit institution sector

Proposal for a regulation of the European Parliament and of the Council on **structural measures improving the resilience of EU credit institutions**

The proposal for a regulation provides for structural measures to improve the resilience of EU credit institutions, reduce the systemic risk of large, structurally complex and interrelated credit institutions, prevent financial distress or bankruptcy. Under the proposal, systemic credit institutions will be prohibited from proprietary trading and require the segregation of specific trading activities. The implementation of the Regulation would facilitate the achieving of the multi-annual strategic objective of the European Commission — to contribute to financial stability and restore investor and other market participants' confidence in financial markets, as well as complement the financial regulation reforms already started at EU level.

Financial instrument market sector

Proposal for a regulation of the European Parliament and of the Council on reporting and **transparency of securities financing transactions**

The proposal aims to provide information about the availability of the activities of shadow banking to investors and supervisory authorities for the purposes of the analysis of systemic risk. The proposal for a regulation provides for ensuring a set of measures aimed at improving the understanding of regulators and investors of securities financing transactions. These transactions have had a negative impact and they have been a source of pro-cyclicality during the financial crisis, therefore a proposal has been developed for the in-depth monitoring of such transactions in order to reduce the systemic risk associated with their use in the future. The proposal does not aim to prohibit or restrict such transactions, but rather to make them more transparent and understandable.

Proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC towards regarding **the encouragement of long-term shareholder engagement** and Directive 2013/34/EU as regards **certain elements of the corporate governance statement**

The proposal aims to promote the long-term operation of the EU companies, create an attractive environment for shareholders and promote cross-border voting. The proposal is aimed at encouraging shareholders to engage in the management of joint stock companies on a long-term basis, and it applies only to such joint stock companies the shares of which are traded on the regulated market. The key substantive elements of the Proposal:

1) providing for a regulatory framework imposing the duty on intermediaries (credit institutions, institutional investors an other subjects, hold shares owned by others) to disclose the shareholders and the contact information thereof. If there are several intermediaries in the shareholder chain, at the request of the joint stock company they have the duty to promptly transfer the necessary information to each other;
2) providing for the duty imposed on institutional investors and asset managers to develop policies on the involvement of shareholders and publication of the investment strategy;
3) providing for a framework that focuses on involving shareholders in the determination of the remuneration policy of the management (management board and council members), approving remuneration policy;
4) laying down the requirement for joint stock companies to inform their shareholders about significant related party transactions. The proposal is concurrently related to the commitment contained in the revised strategy on long-term financing of the European economy. It aims at promoting the shareholder long-term perspective to ensure better operating conditions for companies.

Insurance and pension fund sector

Proposal for a directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision (IORPs II)

The Proposal has been developed with a view to facilitate the establishing of occupational pension savings by promoting pension adequacy, relevance and sustainability by increasing the share of supplementary pension in pension income. The proposal provides for the strengthening of the role of the institutions for occupational retirement as institutional investors in the real EU economy and to improve the ability of the European economy to channel long-term savings to growth-enhancing investments.

Proposals under debate carried forward from previous years

Credit institutions and payment services sector

> Proposal for a Directive of the European Parliament and of the Council 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 a wider choice of services, facilitate the provision of innovative payment services and ensure secure and transparent payment services, coordinate provisions in the EU Member States and establish an integrated payment market, ensuring equal treatment 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 the development of the Directive is to harmonise the existing regulation with the revised international anti-money laundering and terrorist financing standards and the supplemented FATF recommendations. 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 instrument 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 (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 the reference values (benchmarks), improvement of the quality of input data and methodology used by the benchmark administrators, ensuring that the providers of benchmark data 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 the regulatory requirements applicable to their operation, to define the investment policy to be implemented by the long-term investment fund, permitted investment objects and requirements for the diversification thereof, as well as to lay down 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 refine the rules for the asset assessment, as well as to establish the capital reserve to absorb the potential losses.

Insurance and pension fund sector

> Proposal for a directive of the European Parliament and of the Council on the insurance mediation

The objective of the proposal for a directive on the insurance mediation is to improve the regulatory framework of the private insurance market, ensuring undistorted competition, consumer protection and market integration, as well as to refine and clarify the scope of the application of the directive, extending it to the insurance mediation. The proposal seeks to ensure a level playing field for all participants of the insurance and reinsurance service market and enhance the protection of policyholders, as well as to increase the level of harmonisation of administrative sanctions and measures in relation to violations of the fundamental rules of the current directive, and to simplify and harmonise the procedure for cross-border access to insurance markets in the EU.

Planned EU initiatives in 2015

Since the newly established composition of the European Commission started its work only at the end of 2014, it does not plan to actively engage in the work aimed at the development and publication of new proposals in the next year.

The most urgent goal of the new European Commission is the work on building a new EU-scale union. i.e. the **Capital Markets Union**. In this regard, the European Commission intends to come forward with a Green Paper as well as a White Paper in 2015, and possibly also a concrete enactment proposal.

With the aim of promoting financial stability and ensuring that non-bank financial institutions are effectively regulated in the event of potential problems, without causing systemic effects, as well as harmonizing the legislation with that of the banking sector regulation, in 2015, the European Commission intends to come forward with a proposal for the recovery and resolution framework for financial institutions that are not credit institutions.

Also in the first half of 2015, the European Commission intends to publish proposals for amendments to the regulations under which the supervisory framework of the **European financial sector was established**. The amendments will be based on the conclusions of the activities of supervisory institutions during the first four years.

The European Commission agenda includes the revising of directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 **on the prospectus to be published when securities are offered to the public or admitted to trading** and amending Directive 2001/34/EC (the so-called Prospectus Directive).

Just like every year, in 2015, the European Commission, will continue, in cooperation with the European supervisory authorities, the extensive work on the development of delegated and implementing measures to ensure the implementation and application of appropriate previously approved first-level legislation (such as the new capital requirements framework (CRR/CRD IV), recovery and resolution framework (BRRD/SRM), the Deposit Guarantee Scheme, alternative funds, the financial instruments market, *Solvency II, Omnibus II*, etc.).

GUARANTEE SYSTEM

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

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

Deposit Guarantee Fund

The guaranteed compensation (GC) to customers (natural and legal persons other than in the cases provided for in the Deposit Guarantee Law) of Latvian banks and credit unions (deposit takers) was 100,000 EUR (or an equivalent amount in another currency) in each deposit taker. The GC is paid in EUR.

The State guarantees that every customer of a deposit taker is compensated an amount of up to 100,000 EUR irrespective of whether there were sufficient funds in the Deposit Guarantee Fund (DGF) at that time or not. Under the Deposit Guarantee Law, if the funds are not sufficient, they would be ensured by the FCMC borrowing them from a bank registered in Latvia or the Latvian branch of a foreign bank, however, if the funds are still not sufficient, by borrowing from the Treasury.

At the end of 2014, the amount of guaranteed deposits with deposit takers in Latvia was as follows:

At the end of 2014, the DGF guaranteed 40.8% of total deposits with Latvian banks: for 99.1% of all depositors, the full amount of their deposit was guaranteed, whereas for 0.9% of all depositors the guaranteed amount was only 100,000 EUR, not covering the deposit in full amount.

The guaranteed compensation disbursement process following the unavailability of deposits at AS Latvijas Krājbanka

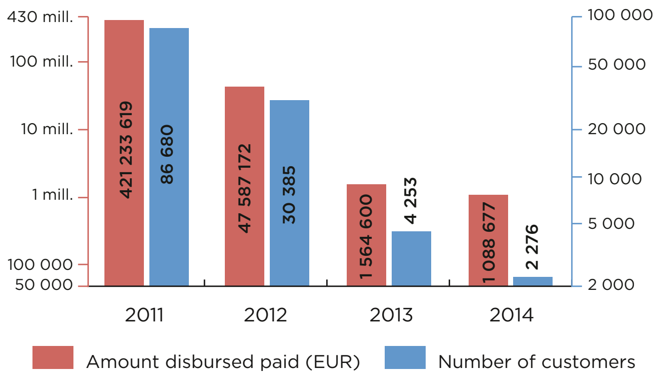
Due to the unavailability of deposits at AS *Latvijas Krājbanka* (LKB) identified by the FCMC, 220 thousand depositors were entitled to receive the GC of 478.6 million EUR in total. For 99.8% of the depositors of LKB, the depositor guarantee scheme fully covered their deposits. The payment of GC was organised as soon as possible, without waiting for the statutory maximum number of days (30 working days).

The claiming of GC took place most actively in the first three months after starting the disbursements.

Table 2.

	AMOUNT	SHARE, %
Total number of depositors	2,308,409	100.0
including up to the amount of the guaranteed compensation	2,287,170	99.1
including above the amount of the guaranteed compensation	21,239	0.9
Average balance of deposits, in thousand EUR	18,467,150	100.0
including up to the amount of the guaranteed compensation	5,414,053	29.3
including above the amount of the guaranteed compensation	13,053,047	70.7
Deposits guaranteed by the DGF, in thousand EUR	**7,537,953**	**40.8**

Figure 17.
Dynamics of the disbursement of guaranteed compensations to LKB customers (2011-2014)

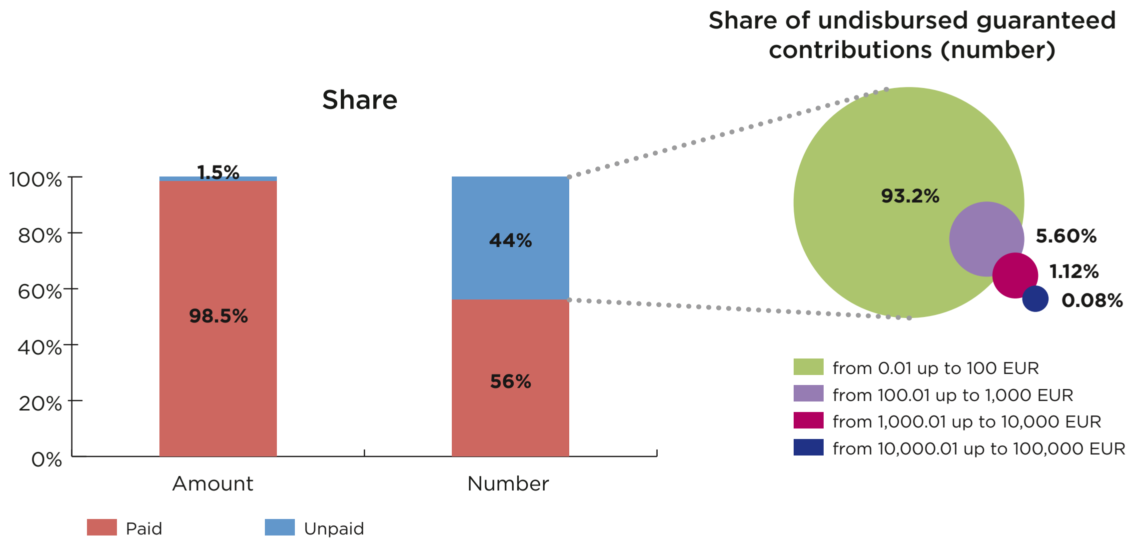


Within three years, 471,474,067 EUR have been disbursed to 123,594 customers.

Table 3.
Ensuring the disbursement of guaranteed compensations to LKB depositors at 31.12.2014

	NUMBER OF DEPOSITORS	AMOUNT OF GC (EUR)	GC RECEIVED (NUMBER)	GC DIS-BURSEMENTS (EUR)	SHARE OF GC NOT RECEIVED, %
AS Latvijas Krājbanka	220,558	478,659,413	123,386	471,134,455	1.5

Figure 18.
Breakdown of disbursed and disbursable GC, breakdown of the receivers of the GC, share of GC amounts, breakdown of depositors who have not received GC yet, breakdown by the amounts of GC at 31.12.2014



Out of LKB depositors who have not yet received guaranteed compensations, 93% are such whose guaranteed compensation is up to 100 euros and their guaranteed compensation totals 623,500 EUR, whereas there are 85 depositors the guaranteed compensation of which ranges between 10,000 EUR and 100,000 EUR, and their total guaranteed compensation amounts to 2,219 million EUR.

The guaranteed compensation disbursement process after the occurrence of unavailability of deposits of Rauna Cooperative Credit Union, Cooperative Credit Unions Metalurgs and Vecumnieki Cooperative Credit Union

Table 4.

Breakdown of the disbursement of guaranteed compensations to the depositors of cooperative credit unions (CCU) at 31 December 2014

NAME OF THE CCU	NUMBER OF DEPOSITORS	AMOUNT OF GC (EUR)	GC RECEIVED (NUMBER)	GC DIS-BURSEMENTS (EUR)	SHARE OF GC NOT RECEIVED, %
Rauna CCU	28	34,601	16	34,212	1.1
CCU Metalurgs	10	100,517	10	100,517	-
Vecumnieki CCU	9	26,498	9	26,498	-

The DGF has the first-level right to claim amounts from the bank which is being liquidated (up to the amount of guaranteed compensations). In regard to the cooperative credit unions that are under liquidation or insolvent, the DGF has the right of an unsecured creditor to claim receivables in the amount of guaranteed contributions.

Under the *Deposit Guarantee Law* deposit takers (banks and credit unions) are required to make a quarterly payment to the DGF amounting to 0.05% of the average balance of deposits with the deposit taker in the previous quarter. In addition, the FCMC also determines the adjustment ratio that is applicable to the payment by each particular deposit taker. In 2014, the mean average adjustment ratio of Latvian banks and the CCU, according to which the payments of each quarter were to be made to DGF amounted to 101.07% and 100.64%, respectively. When establishing the applicable adjustment ratio, the FCMC considers each deposit taker's capital adequacy ratio, liquidity and large exposure indicators, as well as the quality of the loan portfolio of the deposit taker in the previous calendar year. Deposit takers paid 34.5 million EUR to the DGF for 2014.

Under the law, the FCMC ensured the accumulation and management of the assets of the DGF pursuant to the purpose of the law. At the end of 2014, 70.4 million EUR of the DGF funds were held at the Bank of Latvia. In January 2014, the FCMC carried out the settlement of the remaining liabilities of the DGF, i.e., fully repaid the state loan, as well as monitored the process of disbursement of GC and the activities of the administrator of LKB and the administrators of insolvent credit unions. The FCMC also reviewed the received complaints regarding recognition of the guaranteed compensation and took part in all litigation proceedings on the recognition or refusal of the guaranteed compensation.

The FCMC ensures the accounting of the DGF according to the accounting policy developed by it, which contains the description of the most significant FCMC financial accounting principles 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 by the entities of the public sector. The financial statements of the DGF for 2014 and the independent auditor's report thereon are available 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 made up of deductions of 1% by insurance companies from their total gross insurance premiums received from natural persons for the types of insurances specified in the law. At the end of 2014, 16.4 million EUR were accrued in the FPI.

As of the beginning of the operation of FPI, the 12.3 thous. EUR have been paid in guaranteed indemnities. 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, however, not more than 14,230 EUR per policyholder, excluding insurance in respect of a market-related life insurance policy;
2) for other types of insurance set out in the law — 50% of the insurance indemnity, however, not more than 2,850 EUR per policyholder.

In 2014, the volume of the FPI increased by 1.7 million EUR, due to the contributions by fund participants and as a result of the FCMC's investment of the FPI assets in Latvian government internal debt securities and receiving interest payments on them. The FPI investment structure and return on investments depend on the internal central government debt and the amount of cash available to the FPI at the time of the offer.

Figure 19.
Percentage breakdown of the FPI assets (at the end of 2014)

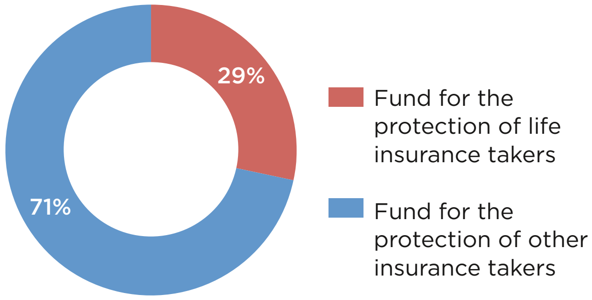


Figure 20.
Dynamics of the FPI volume increase, 2001–2014 (at the end of the year, in million EUR)

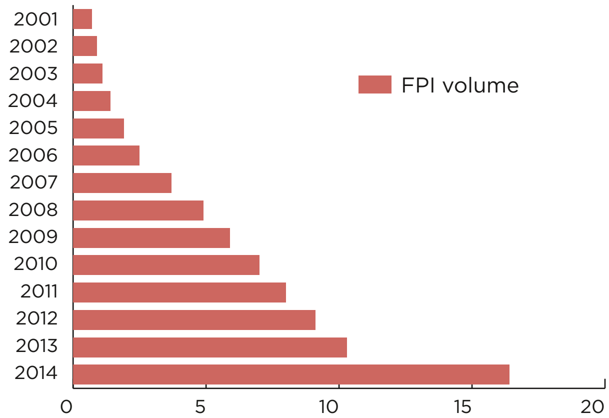
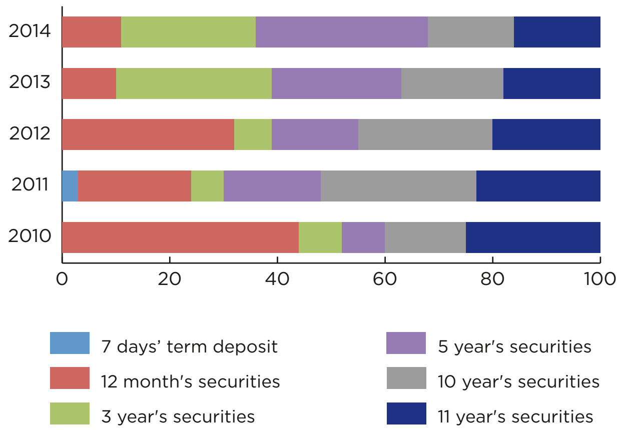


Table 5.
FPI income indicators, 2008–2014

	2008	2009	2010	2011	2012	2013	2014	STRATEGY
Payments by the FPI participants, in million EUR	1.3	1	0.9	1	1	1.2	1.3	1% of total guaranteed insurance premiums
Investment income, in million EUR	0.3	0.4	0.6	0.4	0.4	0.4	0.5	Exceed investment maintenance and investments making costs
Return on assets, %	5.19	6.29	6.84	4.41	4.07	3.46	3.05	In accordance with fluctuations in the rates of fixed income securities of internal central government debt

Figure 21.
FPI investment structure by initial maturity, 2010–2014 (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. The compensation per investor is calculated for irreversibly lost financial instruments of losses caused by a non-executed investment service. The compensation per investor is 90% of the value of irreversibly lost financial instruments or of the loss caused by a non-executed investment service, however, not more than 20,000 EUR. The FCMC ensures the disbursement of the compensations, whereas the Consultative Council of the FCMC monitors the payment of the compensations.

The funds for the payment of compensation are provided 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 under the Investor Protection Law, the FCMC is entitled to borrow a loan for the payment of compensation.

Administration of the Financial stability fee

The purpose of the Financial stability fee (the Fee) is to consolidate the entire financial system 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 as a whole has benefited 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 controls the payment of the Fee into the budget account, the calculation of the Fee, and the completeness and accuracy of the 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 2014, the FCMC did not carry out on-site inspections in respect to the accuracy of the data contained in the returns of the Fee payers for 2013. In 2014, only data cross-sectional inspections were carried out.

Table 6.
Fee payer's indicators, 2012–2014

	2014	2013	2012
Fee payers	26	29[18]	31[19]
Fee object, in million EUR	5,842.8	6,956.6	8,629.9
Fee rate, %	0.072	0.072	0.072
Fee, in EUR	4,211,920	5,008,694	5,864,282
Fee payment received in the State budget, in EUR	4,251,970	5,438,650	4,737,853

Due to the termination of activities of credit institutions, the overpaid Fee had to be paid from the State budget to the legal successor thereof in the following amount:

- In 2014 — to three companies in the amount of 327.7 thous. EUR;
- In 2012 — to one company in the amount of 12.4 thous. EUR;

18 including AS *GE Money Bank* for ten months in 2013, and two banks (AS *Latvijas Hipotēku un Zemes Banka* and AS *UnitCredit Bank*) which operated until 31.12.2013.
19 including AS *Parex banka*, which was the Fee payer for three months in 2012, *Allied Irish Bank*, which was the Fee payer for nine months in 2012.

COOPERATION

Intra-institutional cooperation at national level

In 2014, the FCMC cooperated with other public institutions to ensure the efficient fulfilment of functions prescribed by the *Financial and Capital Market Commission Law*, the laws governing the activities of the participants of the financial and capital market and other binding laws and regulations governing the activities and laying down the functions of the FCMC. The FCMC representatives participated, on a regular basis, 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 in the meetings of the European Affairs Committee of the *Saeima*, when the national position was reviewed regarding the new initiatives of the European Union in the field of financial services. The FCMC management also participated in the meetings of the National Security Committee of the *Saeima*.

In 2014, the FCMC continued a regular information exchange with the Bank of Latvia and the Ministry of Finance. At least once a quarter, 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 macro prudential supervision. The FCMC also 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 regarding the matters regarding the exchange of securities statistics received from investment management companies and managers of alternative investment funds. To provide explanations of the trends of supervision and development of the Latvian financial sector, the FCMC continuously took part in the meetings with the rating agencies, which were organised by the Treasury. During the reporting year, the FCMC cooperated with the colleagues from the Consumer Rights Protection Centre to ensure more efficient protection of consumer rights in respect to the provision of financial services.

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

- in the **Financial Sector Development Council**, which supported the Financial Sector Development Plan 2014-2016 in 2014, debated the regulatory framework of the activities of non-bank creditors and the necessary amendments, the necessary measures for the improvement of the system of preventing money laundering and terrorist financing, and other issues;
- in the **Macro Prudential Council** set up by the Bank of Latvia for the purpose of promoting the stability of the Latvian financial system as a whole, including the consolidation of the resilience of the financial system to shocks and to mitigate risks to financial stability. At the end of 2014, the new framework developed by the FCMC for the determination of the countercyclical capital buffer requirement for exposures in Latvian was presented to the Council. The countercyclical capital buffer requirement was reviewed on a quarterly basis;
- in the **Audit Consultative Council**, where the improvement of the quality of audits in the country and the adoption of the new European regulatory framework in the area of auditing were debated;
- in the working group set up by the order of the Prime Minister **on the improvement of cooperation with international credit rating agencies**, led by the Ministry of Finance. In order to promote the improvement of the country's credit rating in the future and prevent it from lowering, the working group is tasked to cooperate with rating agencies, drawing their attention to the development of the factors and risks specified in their statements, which could be the basis for positive changes in the credit rating, providing comprehensive information on the changes that have occurred as well as planned changes, and based on the criticism and deficiencies pointed out in rating reports, draw the attention of rating agencies to the factors mitigating the factors and improvements. In 2014, all four rating agencies — S&P, Moody's, Fitch and R&I increased the credit rating of Latvia.

- in the **Direct debit subgroup of the National 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, including the compliance of the direct debit as well as credit transfers with the requirements of SEPA. At the same time, the debate was held on replacing of the national direct debit by an alternative solution for automatic payment orders;
- in the **working group set up by the Ministry of Finance**, which reviewed and approved proposals for complementing the Financial Sector Development Plan. The Financial Sector Development Plan was complemented in the autumn of 2014;
- in the working group set up by the Ministry of Finance, which developed draft laws that included provisions arising from the EU Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. The working group developed the **draft of the *Law on Annual Accounts and Consolidated Annual Accounts***, as well as draft laws to other laws.
- in the inter-institutional working group set up by the Ministry of Interior, which aims to assess the situation and to submit proposals on how to ensure the correct reporting of the payment of fines and the cost of covering the expenses of the tests to identify the impact of intoxicating agents in the Register of Punishment. The purpose of the informative report of the working group was to offer solutions that would improve the processes of payment processing and identification. One of the proposed solutions provides for the implementation of a single and **structured payment identification solution — the so-called structured reference**, the number of which will be formed according to the standard ISO 11649: 2009 *Financial services. Core banking. Structured creditor reference to remittance information*;
- in the **OECD Corporate Governance Implementation working group** set up by the Ministry of Justice, the task of which was to prepare the self-assessment of the Republic of Latvia in terms of the compliance of its laws and regulations with the OECD Principles of Corporate Governance, ensuring carrying out the negotiations on joining the OECD in the mentioned area as well as developing the necessary amendments to the laws and regulations to ensure compliance with the OECD Principles of Corporate Governance;
- in the inter-institutional working group for the development of the **draft law *On Application of International Sanctions and Imposing National Sanctions in the Republic of Latvia***. The draft law will lay down a mechanism for the imposing of national sanctions in the Republic of Latvia, as well as improve the regulatory framework of the application of international sanctions.

International cooperation

In the area of international cooperation, the FCMC's priority is mainly to participate in the events taking place in the European Region. The FCMC gets involved in the discussion of laws and regulations in the EU Council and the committees of the European Commission, as well in the work of the European financial supervisory authorities. In 2014, participation in the SSM emerged as a new direction of activity. Equally as important was to continue bilateral cooperation with the supervisory authorities in those countries which have engaged in cross-border cooperation with Latvia. As Latvia has started the negotiation process for accession to the OECD, in 2014, the FCMC was actively involved in the preparation and review of Latvia's reports in the OECD financial market, insurance and pension, investment, and corporate governance committees.

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

2014 was a prolific year in terms of developing and approving new EU legislation in the area of financial services. It was largely due to the fact that 2014 was the year of the European Parliament elections, furthermore, at the end of 2014, the new composition of the European Commission commenced its work. In the light of the above an unofficial goal was set before the re-election of the European Parliament and the European Commission to close negotiations on as many open EU legislative proposals as possible. Therefore, in 2014, 13 pieces of new EU first-level legislation were published (Recovery and Resolution Directive, the Single Resolution Mechanism Regulation, Deposit Guarantee Scheme Directive, Payment Accounts Directive, Directive on Credit Agreements for Consumers Relating to Residential Immovable Property, Directive and

Regulation on Financial Instruments Markets, Directive and Regulation on Market Abuse, Regulation on Central Securities Depositories, Directive on Undertakings for Collective Investment in Transferable Securities (UCITS), Omnibus II Directive, Regulation on Key Information Documents for Packaged Retail and Insurance-Based Investment Products (PRIIPs) basic documents) as well as 27 EU second-level or subordinated (delegated and implementing) legislation. At the very end of the year, political agreement was reached in trialogues between the EU Council, the European Parliament and the European Commission on three more laws (Regulation on the European Long-Term Investment Funds and Directive on the Prevention of Money-Laundering and Terrorist Financing), and as a result of the required technical refinements these pieces of legislation will be published in the EU Official Journal only in the first half of 2015.

Same as in previous years, during the reporting year, the FCMC experts actively participated in debating various legislative proposals within the Financial Services working group of the EU Council and the Commercial Law working group, as well as in the development of the national position on matters concerning the regulation of the financial sector. Additional effort was required of FCMC experts in the work with the EU legislative proposals due to the preparatory work before the Latvian Presidency of the EU Council, as a result of which, in the second part of the year, the FCMC representatives had the opportunity to participate in the trialogue meetings organised by the Italian presidency and learn the nature of work of the presiding country of the EU Council as well as the skills required to lead the meetings of the EU Council working groups.

The first six months of 2015, when Latvia will preside the EU Council, will entail additional duties, tasks and involvement in the works of the EU Council for the FCMC experts, because along with the representatives of the Ministry of Finance and the Ministry of Justice they will take part in advancing the EU initiatives, international debates as well as leading working groups and trialogues on draft legislation, such as structural reforms of credit institutions and disclosure of information on securities financing transactions, insurance distribution, the Payment Services Directive and interbank commission changes, indices that are used as benchmarks in financial instruments and contracts, the activities and supervision of the institutions engaged in occupational retirement activities, as well as the rights of the shareholders of issuers.

At European Commission committee and expert group level, in which the FCMC experts took part, in 2014, work on the European Commission's regulatory enactments subordinated to EU directives and regulations was carried out, debates on transposing the provisions of the adopted directives and regulations into the national legal systems of the Member States were held, and the new initiatives planned by the European Commission for the improvement of the regulatory framework of the financial sector were discussed.

In regard to the EU proposals on financial services which remained unclosed during 2014, it is likely that by the end of 2015, the EU Council, the European Parliament and the European Commission could reach an agreement on legislative proposals such as the draft Directive on Insurance Distribution, on indices that are used as benchmarks in financial instruments and contracts for payment services in the internal market, the interbank commission charges applied to transactions linked to payments by card, as well as on securities financing transactions and the transparency thereof. Also, there are plans that in the beginning of 2015, three pieces of legislation will be published on which political agreement at EU level was reached in December 2014, i.e., the Regulation on the European Long-Term Investment Funds, the Directive on the Prevention of the Use of the Financial System for the Purpose of Money-Laundering and Terrorist Financing, and the Regulation on Information on the Payer Accompanying Transfers of Funds.

Participation in the work of European supervisory authorities

On 1 January 2011, the European System of Financial Supervision launched its activities, the establishing of which was a response to the financial crisis of 2008 and the effects thereof. The European System of Financial Supervision has two levels of supervision — at micro and macro level. At micro-level, there are three European supervisory authorities — the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority. The FCMC representatives also took part in the work of all these institutions as well as decision-making by the Supervisory Board. The main task of the European supervisory authorities is to develop the drafts of technical standards, issue guidelines and recommendations, ensure the application of equivalent EU legal acts, foster cooperation and the application of common supervisory practices by all national supervisory authorities, monitor and analyse market trends, foster the protection of depositor and investors' interests (EBI), promote protection of the interests of policyholders, pension fund participants and their beneficial owners (EIOPA), promote the integrity, transparency and efficiency of the stock market through improving the protection of investor interests (ESMA). The Chairman of the FCMC, participates, in the capacity of an observer, in the meetings of the European Systemic Risk Board (ESRB) that has been vested with the supervisory powers at macro level. The main task of the ESRB is the macro prudential supervision of the EU financial system to timely assess potential threats to financial stability and ensure the timely warning of the emerging of potential systemic risks.

By participating in the work of these authorities, Latvia can influence the building 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 entirety of Europe. It also provides an opportunity to discuss with representatives of other countries the impact of the legislation under process on small financial markets, balancing the regulation so that it would be useful and stimulating development not only to large but also small countries. In regard to various new initiatives, market development trends and new products, the scope of work of the European financial supervisory authorities is also ambitious.

Under the requirements of the Regulation of the European Parliament and of the Council on establishing the European supervisory authorities[20], the European Commission was tasked with the publication of the assessment of the performance of the European System of Financial Supervision in 2014. According to the assessment of the European Commission, despite the short period of operation, the performance of and contribution provided by the European System of Financial Supervision has been assessed positively. Some short-term and long-term tasks have been identified to improve the efficiency of the operation of these institutions. Full text of the assessment is available at the European Commission website http://ec.europa.eu/finance/general-policy/committees/index_en.htm#maincontentSec2.

In 2014, the key priority of the EBA was to continue working on the building of the *Single Rulebook* of the European banking sector, as well as carrying on work aimed at promoting the implementation of the new capital framework CRDIV/CRR in respect of credit risk, market risk, liquidity requirements, as well as at implementing the credit institution and investment brokerage firm recovery and resolution regime. During the reporting period, the EBA systematically analysed the European banking sector in order to identify potential risks, as well as monitored the compliance capital adequacy ratio and capital plans with the new regulation. A lot of effort was invested in the area of consumer right protection, developing the drafts of technical standards and recommendations with a view to successfully implementing the mortgage loan Directive, the payment account directive, etc. For more information on the activities of the EBA, visit the website www.eba.europa.eu.

In 2014, EIOPA's priorities were aimed at strengthening consumer protection, timely developing of top-quality draft regulations, improving the supervisory convergence, and promoting financial stability. During the reporting year, the EIOPA continued the work aimed at the development of technical standards for the introduction of the *Solvency II* Directive (for example, six draft technical standards were submitted to the European Commission and 20 recommendations for the implementation of the *Solvency II* Directive were developed). In the area of pensions, a consultation document on the future work related to the solvency requirements for occupational retirement provision institutions (IORPs) has been published. In the area of consumer protection, the EIOPA has developed and published a discussion paper on prevention of the conflicts of interest, selling private investment and insurance investment products directly and through intermediaries. For more information on the activities of the EIOPA, visit the website www.eiopa.europa.eu.

In 2014, ESMA's priorities were supervisory convergence, promoting the protection of financial consumers, financial stability, the building of the Single Rulebook and supervision of the credit agencies. During the financial year, a lot of effort was put into the implementation of the new EU directives and regulations (e.g., financial instrument markets, market abuse, credit rating agencies, central securities depositories, short

20 Refer to the Regulation of the European Parliament and of the Council of 24 November 2010 No. 1093/2010, 1094/2010 and 1095/2010.

selling and certain aspects of credit default swaps, etc.), as well as developing a number of technical standards or providing proposals for the European Commission delegated acts. In order to promote supervisory convergence, the ESMA continued to work on promoting common application of the requirements of the International Financial Reporting Standards in all Member States, as well as carried out peer reviews of the legislation and supervisory practices of the Member States to identify their compliance with the set of good practice examples. Along with other European supervisory authorities, the ESMA participated in the work of the *Joint Committee* regarding issues that affect all three areas (e.g. financial conglomerates, prevention of money laundering, etc.). During the reporting period, two extensive information technology projects were launched to create a database for centralized collection and maintenance of information on over-the-counter transactions with financial derivatives, as well as financial instrument reference database. For more information on the activities of the ESMA, visit the website www.esma.europa.eu.

During the reporting year, the ESRB continued the work that was focused on building a stable macro-prudential system across the EU, identifying systemic risks that pose threats to the EU financial system and taking measures to remove them. The new capital framework CRDIV/CRR legislation introduced a number of new macro- supervisions tools aimed at assisting the competent authorities to mitigate risks to financial stability. The ESRB developed guidelines on the use of new tools (e.g., the view on the use of the countercyclical capital buffer). Furthermore, the ESRB paid particular attention to calculating the capital requirement for approach to calculating claims against central governments. For more information on the activities of the ESRB, visit the website www.esrb.europa.eu.

Cooperation with supervisory authorities of other countries

Cooperation with the supervisory authorities of the financial sector of other countries plays an important role in the supervision of the financial sector. The priority is cooperation with the financial supervisors of the Baltic States, Nordic countries as well as the ECB. In 2014, the meeting of the management of the supervisory authorities of the Baltic States was held to discuss the proposed changes in the institutions related to the implementation of the SSM and the SRM, as well as latest developments in the supervision of non-banking lenders and other matters. The meeting of the representatives of the Baltic States and the ECB was held to share experience and practices of the supervision of the credit institutions of minor importance. Following the creation of the SSM for banks, changes were required to a number of cooperation agreements on the supervision of banking groups, supplementing them by a new contracting party — the ECB. Bilateral cooperation with other national supervisory authorities was also carried on.

During the financial year, cooperation was continued between the responsible ministries of the Nordic countries and the Baltic States, central banks and the supervisory authorities of the financial sector on matters regarding the cross-border financial stability, crisis management and resolution matters, as well as in the Macro Prudencial Forum in which the heads of the supervisors authorities and the heads of central banks discussed the latest developments of the macro-prudential policy.

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prudential policy (http://www.fktk.lv/lv/komisija/sadarbiba/informacijas-apmainas-ligumi/ligumi-ar-arvalstu-iestadem.html). In order to ensure the exchange of information in the future in the area of the supervision of the managers of alternative investment funds with countries are not EU Member States, another two multilateral co-operation agreements between the supervisory authorities of the EU Member States and those of Korea and Vietnam were signed during the reporting year.

To exchange information on the development trends in the financial sector and latest developments in supervisory matters, FCMC management continued the tradition established in previous years — arranging a meeting with the US public administration and financial supervisory authorities during the annual meeting of the International Monetary Fund.

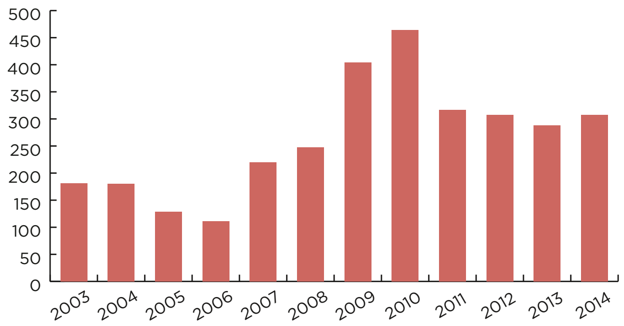
Furthermore, in 2014, a multilateral cooperation agreement was signed between the ESMA and the competent national authorities of the EU Member States on cooperation and exchange of information.

CUSTOMER PROTECTION

In 2014, a key aspect of the supervision carried out by the FCMC was the protection of the rights of the customers of market participants.

In 2014, the FCMC received and reviewed 307 applications about the behaviour of the participants of the financial and capital market, including 183 bank customer complaints, 55 complaints of the customers of insurance companies and branches of the EEA country insurance companies, two complaints about insurance and reinsurance intermediaries, 31 applications about financial instruments market participants, two applications about credit unions, one application about investment management companies, three applications about payment institutions, and 30 applications about various issues related to the financial market.

Figure 22.
Number of complaints received by years



In all cases the FCMC requested market participants to provide explanations, after the assessment whereof the customers were provided answers or consultations by substance within the scope of FCMC competence.

Considering that during the supervisory process of credit institutions the FCMC also monitors whether credit institutions comply with the requirements laid down in the *Credit Institution Law* and the laws and regulations subordinated to it, the FCMC experts verified whether there were any violations of laws and regulations observed in the activities of market participants. Of the 183 complaints by customers of credit institutions, the FCMC identified violations of the laws and regulations in the activities of the credit institutions, in six cases the FCMC identified deficiencies in the management of operational risk and in 18 cases the information contained in customer complaints was used for supervisory needs. The complaints of the customers of credit institutions mostly relate to deposits, account servicing and lending services. After the FCMC got involved in the solution of the particular cases, the deficiencies were eliminated.

In the view of the FCMC, the fact that in 2013 market participants received 4,851 customer complaints, but in 2014 the number of such complaints comprised 4,108 and only 4.5% 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 2014, the FCMC reviewed 55 applications about the activities of insurance companies and the branches of the EEA country insurance companies, as well as two applications about the activities of insurance and reinsurance intermediaries. Upon reviewing the applications about the insurance companies, the branches of the EEA country insurance companies and the activities of insurance and reinsurance intermediaries, the FCMC did not identify any significant violations of laws and regulations attracting statutory sanctions.

Taking caring for the protection of investors and the credibility of the financial instruments market, in 2014, the FCMC published a warning on its website of a possible fraud scheme and encouraged refraining from cooperating with the person who carried out the defrauding of shares from the owners of the shares traded on NASDAQ OMX Riga for much lower price than their market value.

COMMUNICATION WITH THE GENERAL PUBLIC. EDUCATING CUSTOMERS

Moving along the direction undertaken in previous years towards an open and proactive communication with the public, including through the media, the FCMC continued to provide information about its activities and functions, explaining its decisions as well as the developments in the financial sector.

In order to fully inform the public about the current developments in the financial and capital market, in 2014, the FCMC published on its website and distributed to the media 144 communications (in 2013 — 141), as well as organised three media events on topical matters. Last year, the FCMC management gave more than 70 interviews to local and international media. Starting from January 2012, the FCMC has also been communicating through the social network Twitter.com account @FKTK_lv. It has 1,400 followers in 2014.

In May 2014, the amendments to the Law on Credit Institutions and Financial Instruments Market Law entering into force, the FCMC started the publication of its decisions on sanctions applied to all credit institutions and also for certain sanctions applied to investment brokerage firms. Information on the sanctions applied is published on the FCMC's website and distributed to the media, thus contributing to greater transparency of the adopted decisions during the monitoring process. In 2014, four such publications on sanctions applied to credit institutions were published (summarised information is available on the FCMC: http://www.fktk.lv/lv/tirgus-dalibnieki/kreditiestades/2014-10-22-fktk-piemerotas-sankcijas.html).

An important item on the communication agenda was financial education, which is one of the strategic priorities of the FCMC. With a view to raising educate the public on financial matters and raise their awareness of financial matters, previously initiated activities and projects were further developed and new initiatives on financial literacy matters were started.

Financial literacy strategy

The medium-term planning document *National Strategy for Financial Literacy in Latvia 2014-2020* (the Strategy) developed by the FCMC in cooperation with its financial literacy partners and approved in the beginning of 2014, provides for a common strategic approach to raising the financial literacy level of the population, defines the strategic objectives to be achieved, outlines the key areas of activities and tasks, as well as the responsible institutions. Under the Strategy, the strategic objectives for financial literacy in Latvia over the next seven years are as follows:

- a tradition of financial planning and accumulation of funds;
- integrity of the financial services environment;
- financial sustainability and development of the general public.

On 24 February 2014, the strategic partners promoting financial literacy — the FCMC, the Ministry of Education and Science, the National Centre for Education, Banku augstskola, the Consumer Rights Protection Centre, the Latvian Association of Commercial Banks and the Latvian Insurers Association — signed a memorandum on cooperation in implementing the Strategy. Under the memorandum, in the future, a FCMC representative will coordinate the implementation of the Strategy and lead the standing working group, be in charge of control of the attainment of the annual objectives, provide reports to the management of the strategic partners as well as The next step in the course of the implementation of the Strategy, carrying out the first national survey on financial literacy held in Latvia, was the development of the FCMC in cooperation with the research centre SKDS (SKDS) of a new measurement system and the methodology for the aggregation of the results, i.e. the Financial Literacy Index of Latvian Population (the Index). The national survey included questions developed by FCMC experts as well as the OECD reference questionnaire, which will enable Latvia, upon joining the OECD, to compare its financial literacy level with that of other OECD countries.

Overall, the financial inclusion of Latvian population in using the basic financial services has been high in 2014. 91% of the population have a bank account, 89% use payment cards and 65% of the population use Internet banking. Conversely, Latvian population are far less active in using services which require additional cost outlays today, while bringing the benefits in the future.

Only 24% of the population have savings. However, the overall trend to make savings deliberately is increasing. Generally 18% of the population use the saving accounts of commercial banks for making savings, and 6% of them have opened their savings account within the last two years. The questionnaire of the first national financial literacy survey as well as the summary of all results has been published and is available to anyone interested on the educational website portal CUSTOMER SCHOOL: http://www.klientuskola.lv/lv/petijumi/8-latvijas-iedzivotaju-finansu-pratibas-aptauja-2014.html.

Conversely, the new measurement system (the 2014 Index) aimed at assessing the knowledge of the population as well as identifying the common practical action on financial matters, the highest positive points were scored on the topics of routine private financial planning and making savings, while on two topics (loans and pensions) Latvian population overall scored negative points. In 2014, the result of the Index (the sum total of all points on seven financial literacy topics) was +20.6 points (the maximum obtainable score was +99).

Figure 23.
Results of the Measurement of the Index on Seven Financial Literacy Topics

In addition, in 2015, the FCMC has prepared a summary of the indicators characterising the financial stability and sustainability of Latvian households, including its comments with a perspective from 2004, which will be useful for those who want to understand the macro-economic developments in Latvia in the context of households over the last decade. To make the use of the Index and indicator results easier to the general public, the FCMC has launched an interactive tool available on the educational website CUSTOMER SCHOOL under the section *Research*: http://www.klientuskola.lv/lv/petijumi/finansu-pratibas-indekss.html.

In the future, the Index and indicators will be adjusted by reference to the actual data and made public on an annual basis for information as well as for igniting debates. In addition to the future research of the level of financial literacy, in cooperation with SKDS the FCMC carried out an Internet survey of Latvian population to gauge their attitude towards the investment of their private free funds. Overall, 34% of Latvian population fully agreed that the free financial resources should be invested for profit.

Financial Education Week 2014

Continuing the activities already begun, for the second consecutive year, the FCMC was engaged in coordinating the FINANCIAL EDUCATION WEEK in Latvia, hosted from 10 to 14 March 2014 simultaneously with the *Child and Youth Finance International* (CYFI) — children and youth week *Global Money Week*. In 2014, the motto of the partner event was *Find and deliver on your financial goal!*, inviting participants to think about their private financial objectives and the ways of achieving them. The results of the Internet survey on the financial objectives of the population organised by the FCMC and SKDS were published, and the FCMC prepared a new interactive tool as well as the test *How strong is your financial determination?*, which is freely available to anyone on the Internet.

During the reporting year, the teacher professional development workshops *Various methods on how to talk about financial goals and the achievement thereof with students* aimed at the teachers of economics and social sciences, organised by the FCMC and partners, were held in Riga as well as Pieriga, Cesis, Tukums and Daugavpils counties. Sixty-four participants from 19 counties and two Latvian towns attended and were issued with the certificates of the National Centre for Education. Overall, 23 guest lectures prepared by financial literacy partners were delivered in schools across Latvian regions within the Week.

International cooperation

A FCMC representative continued the work in the OECD *International Network for Financial Education group* as the Latvian national co-ordinator ensuring the circulation of information on current events in Latvian within the scope of the OECD, as well as cooperated with the Ministry of Finance, the Ministry of Foreign Affairs and the Ministry of Economics, providing the necessary information for the reports on the readiness of Latvia for full-fledged joining to the OECD family of countries.

On 9 July 2014, the results of the OECD PISA 2012 study on the financial competence of 15-year-old school pupils were published. Among 18 countries, the knowledge demonstrated by Latvian pupils on financial matters was above the OECD average mark — 501 points (the average — 500). The overall conclusions are that while financial education is not sufficiently salient and defined in the curriculum of primary schools, however, Latvian education system better than on average in the OECD countries is able to provide equal educational opportunities for students from families with a varying socioeconomic background.

At the annual CYFI meeting in Europe, the representatives of the Republic of Macedonia (non-EU), the FCMC and the Bank of Latvia shared their best practice experience with their Macedonian peers in their report on the recent experience of public education and the improvement of the content of the national educational curriculum and the development of the national strategy, thus becoming the country providing advice on financial literacy matters.

Table 7.
Pupils achievements in financial competence

POINTS	RATING	COUNTRY	COUNTRIES WHOSE AVERAGE ACHIEVEMENTS ARE NOT STATISTICALLY SIGNIFICANTLY DIFFERENT FROM LATVIA
603	1.	Shanghai (China)	
541	2.	Belgium (Flemish)	
529	3.-4.	Estonia	Australia, New Zealand
526	3.-5.	Australia	Estonia, New Zealand
520	4.-6.	New Zealand	Estonia, Australia, Czech Republic, Poland
513	5.-7.	Czech Republic	New Zealand, Poland
510	6.-7.	Poland	New Zealand, the Czech Republic, Latvia
501	**8.-9.**	**Latvia**	**Poland, USA**
492	8.-12.	USA	Latvia, Russia, France, Slovenia, Spain, Croatia, Israel
486	9.-14.	Russia	USA, France, Slovenia, Spain, Croatia, Israel
486	9.-14.	France	USA, France, Slovenia, Spain, Croatia, Israel
485	9.-14.	Slovenia	USA, Russia, France, Slovenia, Spain, Croatia, Israel
484	10.-15.	Spain	USA, Russia, France, Slovenia, Spain, Croatia, Israel
480	11.-16.	Croatia	USA, Russia, France, Slovenia, Spain, Israel, Slovakia
476	11.-17.	Israel	USA, Russia, France, Slovenia, Spain, Croatia, Slovakia, Italy
470	15.-17.	Slovakia	Croatia, Israel, Italy
466	16.-17.	Italy	Israel, Slovakia
379	18.	Columbia	

Building the CUSTOMER SCHOOL

The educational website of the FCMC — the CUSTOMER SCHOOL — was upgraded during the year, creating a new design concept as well as an additional content. From 2015, the new section (the CUSTOMER ABC) with three-tier structure by reference to the preliminary knowledge level of users offers 17 pieces of A-level educational material, which will be gradually supplemented, as well as an interactive test for testing the acquired knowledge. In the future, more than 70 educational materials will be provided through the CUSTOMER ABC, including B-level and C-level materials on various financial literacy topics, with tests corresponding to each level of knowledge. After the development of key topics, there will be a new CUSTOMER SCHOOL section available in Russian. In 2014, 45 pieces of advice through email (in 2013 — 62) were provided to financial sector customers through the CUSTOMER SCHOOL, in Latvian as well as in Russian.

On 5 August 2014, with a view to promoting the CUSTOMER SCHOOL and ensuring advisory services for the population in rural areas regarding current topics related to the financial sector services, the FCMC started a new activity — the regular column of the CUSTOMER SCHOOL in the newspaper *Latvijas Avīze*. Nine articles were published there in 2014. During the reporting year, the FCMC provided a continuous flow of communication on financial literacy topics on its website, Twitter account, in communication with the media, as well as through direct educational activities — delivering guest lectures and organising seminars for educational institutions and other target audiences.

Participation in the Open Door Day and in the Shadow Day

In order to strengthen the image of the FCMC as an open and contemporary institution and raise public awareness of its activities and functions, for the second consecutive year, the FCMC representatives took part in the campaign *Back to School* by delivering lectures in Latvian schools, as well as in the *Open Door Day*, on which the national public administration institutions are open to anyone interested, including the opportunity of meeting with the officials thereof. Within the 2014 *Shadow Day*, for the first time, the FCMC welcomed school pupils who had the opportunity to learn about the work routines of the FCMC Board and the areas and functions of the supervisory institution.

KEY TASKS IN 2015

KEY TASKS IN 2015

Improving of the regulatory framework is one of the key priorities of the FCMC, providing for the development of a regulatory environment that is adequate and commensurable for the Latvian financial sector and for supervisory purposes in the context of a single EU market. A plan for the development and improvement of the market regulation has been developed for 2015, which covers practically all market segments subject to the supervision of the FCMC.

The implementation of the CRD/CRR will be continued. On 1 October 2015, the liquidity cover indicator will become effective. It is a single liquidity indicator in the EU, which was developed for the purpose of reinforcing the resilience of banks against possible short-term liquidity problems. This was the first attempt to establish harmonised quantitative liquidity requirements for banks. Furthermore, the implementation of the new liquidity reporting for the supervisory needs is envisaged.

In order to ensure the implementation of the requirements of the Directive on Deposit Guarantee Schemes requirements into national laws, it is planned that this year amendments will be made to the *Regulation on the Summarising and Providing Information on Guaranteed Compensations*. Furthermore, new rules are planned, which will establish the procedure for determining the payments of deposit takers and the procedure for the inclusion of payment obligations in the Deposit Guarantee Fund.

In the insurance sector this year, work will be carried out on the implementation of *Solvency II* requirements, which will become effective on 1 January 2016, laying down the transition to a new regime in terms of supervision and capital adequacy ratio. A number of new regulations are in the pipeline, which along with the *Insurance and Reinsurance Law* will fully implement the requirements of the *Solvency II* directive as well as the guidelines of the European Insurance and Occupational Pensions Authority.

With the implementation of the Payment Accounts Directive, this year, amendments are planned to the *Law on Payment Services and Electronic Money*, in order to strengthen consumers' rights to a payment account with basic functions. Namely, anyone will be granted the right to open at least one account with a credit institution, e.g. to receive a [social] benefit. The amendments will contribute to the transparency of the payment account servicing costs so that the consumer is more aware of how the various charges related to the servicing of the payment account arise, and would therefore be able to compare the payment account services offered by different payment service providers and choose the most advantageous service provider.

The European Commission has adopted a number of regulations in the financial instrument market sector (for example, *MiFIR, MAR, CSDR*), therefore this year the work will be continued to harmonise the financial instruments market sectors to the most, regulate new financial instrument structures and define the requirements for the relevant financial instrument market participants. Additionally, a number of European Commission directives and the amendments thereto (e.g., *MiFID II, Market Abuse Directive, Transparency Directive*) need to be implemented in Latvian laws. They are aimed at achieving greater transparency in the financial instruments market, strengthening the protection of investor interests, organising the regulation concerning the places of trading of various financial instruments, liberalising the activities of the central securities depositories across the EU, strengthening the supervisory powers of supervisory authorities, etc.

There will be a focus on information technology security matters, developing Internet payment security requirements and the procedure for reporting significant incidents with regard to payments.

Supervising of the participants of the financial market is also one of the priorities of the FCMC. Therefore, in 2015, the FCMC will have a special focus on it.

Strengthening of macro-prudential supervision is one of the key tasks in the process of strengthening the supervisory framework in order to timely identify systemic risks and take measures to prevent or mitigate them, applying the respective tools. Therefore, in 2015, in cooperation with the Bank of Latvia and the Ministry of Finance, the FCMC will work on the building of an effectively functioning mechanism of macro-prudential supervision.

Considering the new challenges posed by the SSM, this year the FCMC will continue its work on ensuring the compliance of the supervisory methods, instruments and practices with the principles applied by the ECB, developing an active mutually productive cooperation with the ECB, having regard to the nature of the Latvian financial sector.

In order to ensure the performance of the tasks of the FCMC as the national competent authorities (the functions of the resolution institution), one of the priorities not only in 2015 but also for the forthcoming three years will be the implementation of an effectively functioning resolution mechanism that is appropriate for the Latvian financial sector and integrated with the EU system, to consolidate the supervision of market participants and improve the instruments for the prevention of crisis, protect the interests of the general public during the resolution process and preserve financial stability in the country.

Given the changes in the global and Latvian financial market, which have an impact on business decisions and on the activities of market participants, there are plans to pay more attention to the changes and trends in the strategies of market participants through maintaining a continuous and open dialogue with market participants, so to accurately assess the risks and take the necessary measures for market development in a timely manner.

GOVERNANCE AND STRUCTURE OF THE FCMC

STAFF POLICY

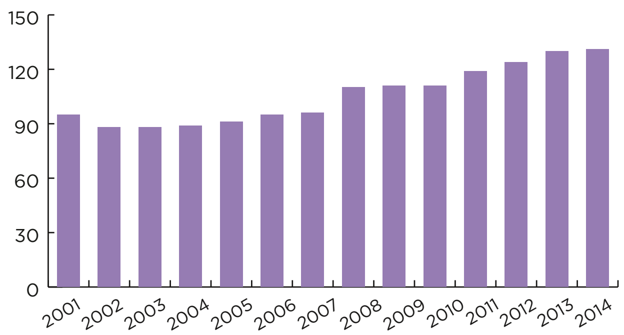
Staff is the key resource of the FCMC that ensure the achieving of the FCMC goals and further development of the institution. In 2014, to prepare for the launching of the functioning of the ECB SSM in November 2014, the FCMC continued the commenced projects such as the assessment of the distribution of workload and responsibilities in support divisions, as well as carried out the analysis of the employee qualifications and job duties in the structural units of its core activities.

Staff breakdown by number and the changes thereof

During the reporting year, the number of job positions increased to 131. To ensure support to the ECB in implementing the Single Supervisory Mechanism, a coordinator of external affairs was hired in the External Communications Division.

In 2014, the structure of the FCMC changed — in accordance with the changes in the external legislation, the Guarantee Fund Division was separated from the Supervisory Department and transferred to the Resolution and Guarantee Fund Division, which is directly subordinated to the Chairman of the FCMC. To optimise the use of resources and improve supervisory processes, the Payment Institution and Non-Bank Monetary Financial Institution Division was set up within the Supervision Department. The structural unit is under direct subordination of the director of the Supervision Department.

Figure 24.
Changes in the number of employees (2001–2014)



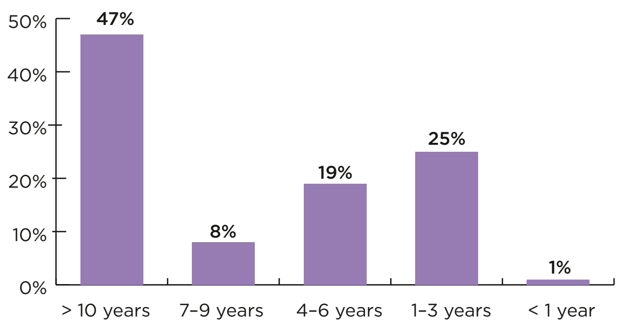
In 2014, the average number of employees, including employees on long-term leave, was 129, of which:

- 102 (79%) were engaged in performing core activities and 27 (21%) were engaged in performing support functions;
- 88 (70%) were civil servants and 41 (30%) were employees;
- all employees were engaged in performing intellectual work.

In 2014, the staff turnover rate was 3%. In the reporting year, six employees were hired by the FCMC. With three of them the FCMC entered into an employment contract for the term of the extended leave of absence of an employee (child care leave). After the probationary period, in accordance with the established adaptation plan, all six employees received a positive assessment and continue employment with the FCMC. During the reporting year, the FCMC terminated employment relationship with six employees, including two employees who had been hired to replace an employee on an extended leave of absence (child care leave). Of the four permanent employees who terminated employment relationship with the FCMC, the two chose to pursue a career in the private sector, while the other two passed the selection competitions and continued their careers in the European financial institutions in the UK and Germany.

In 2014, 93% (121) employees of the FCMC had been employed by the FCMC for more than one year, 46% (59) employees — for 13 years, i.e. as of its establishment in 2001, and 7% (9) employees had been employed by the FCMC for less than a year.

Figure 25.
Breakdown of staff by length of service at the FCMC (%)



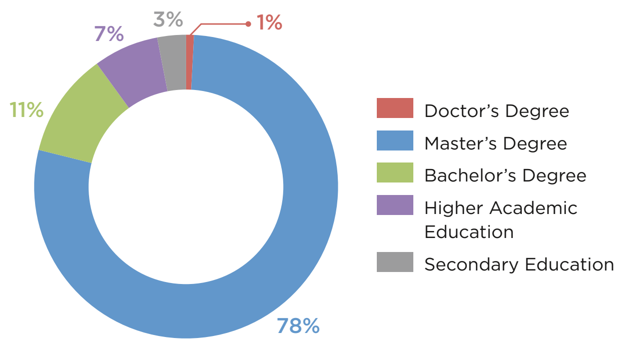
During the reporting year, 68 (52%) employees were assigned on 462 business trips:

- 63 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);
- 28 employees took part in the EBC working groups related to the functioning of the SSM;
- 11 employees took part in the events related to the Latvian Presidency of the European Council;
- The Chairman of the FCMC, as the representative of the Republic of Latvia, participated in the Spring and Autumn sessions of the International Monetary Fund and the World Bank.

Staff qualifications

Educated and professional staff is a key asset of the FCMC. In the reporting year, 97% (126) of FCMC employees had a university degree (of which 78% had a Master's Degree), but 3% (4) employees had general secondary or professional secondary education.

Figure 26.
Breakdown of the FCMC staff by education (%)

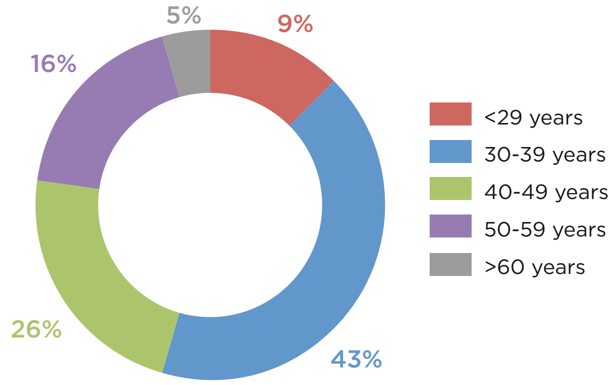


Breakdown of the FCMC staff by gender and age

In 2014, 73% (95) of all FCMC employees were women and 27% (35) were men. During the reporting year, the age of the staff was as follows: 9%% (13) of employees were aged up to 29, 43% (56) were aged from 30 to 39, 26% (33) were aged from 40 to 49 and 21% (28) were aged over 50.

In 2014, the average age of FCMC employees (42 years) is a slightly increase compared to the previous year.

Figure 27.
Breakdown of the FCMC personnel by age groups (%)



Staff performance appraisals

2014 was the fifth year since the FCMC started the carrying out of staff performance appraisals (SPA). In 2014, under the procedure set forth by the FCMC, 122 employees underwent performance appraisals, including 20 individuals heading the structural units (including three members of the management board) and 102 were experts.

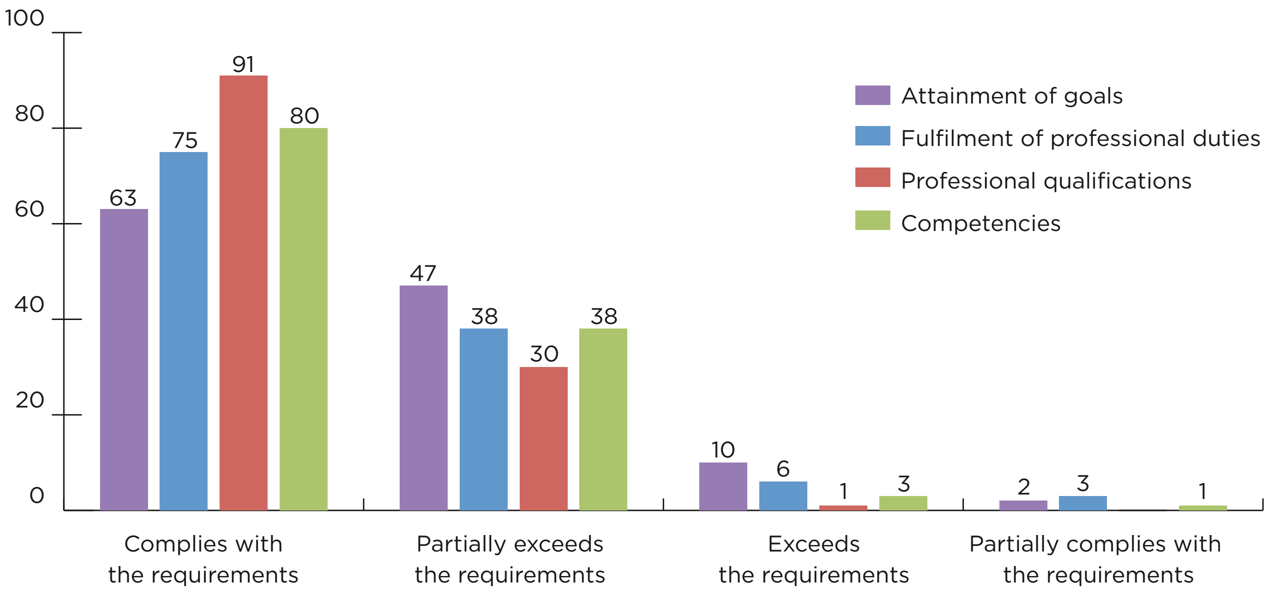
Four criteria were assessed within performance appraisals: attaining of the established goals, fulfilment of professional duties, compliance with the requirements of professional qualification (including the level of education, professional experience, professional knowledge and skills, language proficiency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

Sixty-one per cent of employees received the overall assessment of all criteria as *Complies with the requirements*, 36% of employees received the assessment *Partially exceeds the requirements*, 2% of the employees received the assessment *Exceeds the requirements* and 1% of the employees — *Partially complies with the requirements* In 2014, none of the employees received the overall assessment of all criteria as *Fails to comply with the requirements*.

The majority of employees received the assessment *Complies with the requirements* also for each criterion separately — for attaining the established goals — 52% (63) employees, for the fulfilment of professional duties — 61% (75) employees, for compliance with the requirements of professional qualification — 75% (91) employees and for the required job-related competencies — 66% (80) employees (see Figure 28).

Figure 28.

Overall assessment under PMA by criteria (number)

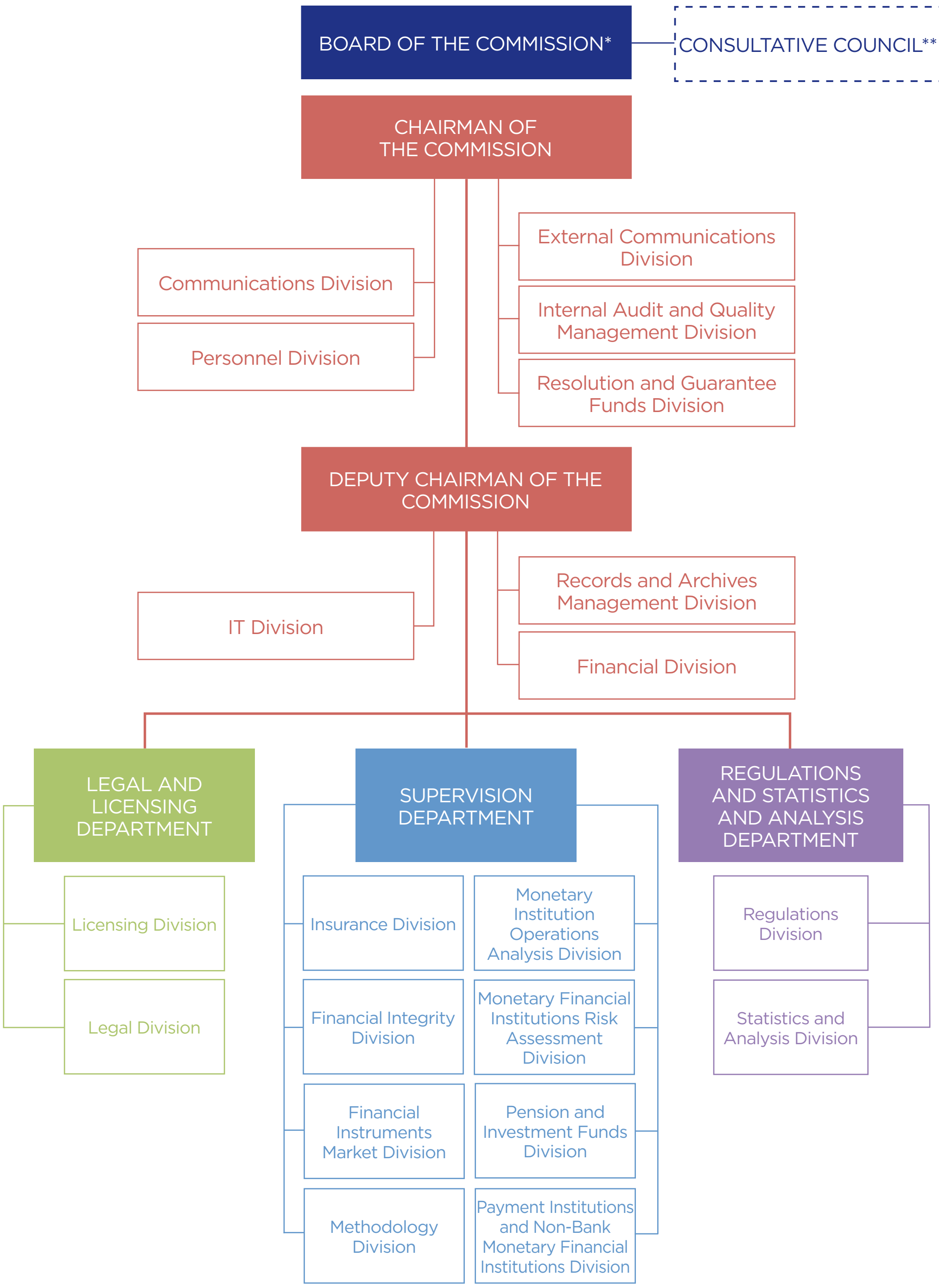


Improving staff qualifications

In line with the strategy of the FCMC, with a view to continuously improving the processes of the activities of the FCMC, increasing the efficiency and productivity of its performance, as well as to performing the supervision of the financial sector, especially of the banking sector, 99 (77%) of the FCMC staff improved their qualification by attending training held in Latvia and other countries related to the carrying out of their job duties. In Latvia, the staff attended seminars aimed at improving their knowledge in the area of administration and application of laws and regulations, financial analysis, risk management, electronic payments, procurement management, record keeping, information technologies and management skills. Eighteen (14%) employees of the FCMC improved their English language skills to be able to actively participate in 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*, the bank capital requirement (*Basel Capital Accord III*) and on other matters related to financial supervision, 65 (50%) of FCMC employees attended seminars abroad.

FCMC STRUCTURE



* The Board consists of five 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 participants.

FINANCING OF THE ACTIVITIES OF THE FCMC

In the reporting year, the activities of the FCMC were fully financed from the payments by the participants of the financial and capital market. In 2014, within the scope of its budget, the FCMC also managed the Deposit Guarantee Fund (DGF) and the Fund for the Protection of the Insured (FPI), as well as administered the financial stability fee. Assets accumulated in the DGF and FPI are used only for the purposes of the funds only, no deductions are made from the funds thereof for the benefit of the FCMC for carrying out the administration thereof. The FCMC does not receive any payment from the State for the administration of the financial stability fee. The financial stability fee is remitted to the State budget.

Table 8.
Financing of the FCMC activities, 2013–2014, in EUR

	ACTUAL PERFORMANCE IN 2013[21]	ACTUAL PERFORMANCE IN 2014[21]	BUDGET FOR 2014[21]	BUDGET VS. ACTUAL IN 2014, %	SHARE BUDGET VS. ACTUAL IN TOTAL IN 2014, %
REVENUE (+)	**6,350,149**	**6,428,323**	**6,430,935**	**100**	**100**
PAYMENTS BY PARTICIPANTS OF THE FINANCIAL,AND CAPITAL MARKET	6,331,748	6,419,633	6,413,005	100	100
REVENUE RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	4,526,895	4,743,541	4,742,890	100	74
Payments by credit institutions	4,492,496	4,663,670	4,706,035		
Payments by credit unions	27,656	29,169	29,880		
Payments by payment institutions	4,762	14,955	4,980		
Payments by electronic money institutions	1,981	35,747	1,995		
REVENUE RELATED TO THE SUPERVISION OF FINANCIAL INSTRUMENTS MARKET AND PRIVATE	577 134	512 633	506 680	101	8
PENSION FUNDS	577,134	512,633	506,680	101	8
Payments by participants of the financial instruments market	426,012	341,685	364,390		
Payments by private pension funds	151,122	170,948	142,290		
REVENUE RELATED TO THE SUPERVISION OF INSURANCE	1,227,719	1,163,459	1,163,435	100	18
Payments by life insurance companies	208,623	219,765	209,160		
Payments by other insurance companies	1,019,096	943,694	954,275		
OTHER REVENUE	**18,401**	**8,690**	**17,930**	**48**	**0.1**
EXPENSES (-)	6,289,399	6,899,390	7,109,670	97	100

21 In accordance with the accruals principle, except accruals for leaves, which are not included in the planning of the budget.

	ACTUAL PERFORMANCE IN 2013[21]	ACTUAL PERFORMANCE IN 2014[21]	BUDGET FOR 2014[21]	BUDGET VS. ACTUAL IN 2014, %	SHARE BUDGET VS. ACTUAL IN TOTAL IN 2014, %
Work remuneration, other payments to employees, and national social insurance mandatory contributions	4,647,999	4,883,630	5,090,610	97	71
Employee insurance	27,012	28,151	28,815	98	0.4
Raising of professional qualifications of the staff and business trips	360,860	525,354	451,035	116	8
Telecommunications, liaison and information	152,277	147,280	163,320	90	2
Information to the general public, internal and external communication	28,365	63,782	78,350	81	1
Maintenance and business expenses	551,299	620,128	597,300	104	9
Professional services	61,209	31,767	29,870	106	0.5
Membership fees in international organisations	356,683	477,754	515,490	93	7
Depreciation/amortisation of capital investments	**103,696**	**121,544**	**154,880**	**78**	**2**
RESULT	**60,750**	**-471,067**	**-678,735**		

To finance the expenses of the activities of the FCMC in 2014, the payments by financial and capital market participants were budgeted to cover 90% of the FCMC budget, while the remaining 10% would be covered from the accumulated funds carried forward from the previous reporting years. If any of the financial and capital market sectors exceeds the scope of financing allotted for the financing of the FCMC, the payment to finance the activities of the FCMC due in the respective year is reduced by the excess. The FCMC recalculated the amount of the payments due from insurance companies, financial instruments market participants and private pension funds for 2014, for them not to exceed the total amount of payment allotted to them to finance the activities of the FCMC. The recalculation of the payments for the above mentioned segments did not include such market players who for the purpose of the financing of the FCMC made payments in the minimum amount as required by the special legislation applicable to the market participant or in instances where the excess balance of their financing did not exceed 100 EUR. The revenue of the FCMC from the payments of market participants' payments was by 6.6 thousand EUR higher due to the compliance with the mentioned restrictions. The coefficient specified for ensuring the budgeted revenue was applied for recalculations — 82% for monetary financial institutions, financial instruments market participants and private pension funds, and 18% for insurers.

Table 9.
Changes in the FCMC financing structure (2013–2014, %)

FINANCIAL AND CAPITAL MARKET SEGMENT	SHARE OF BUDGETED REVENUE, 2013	SHARE OF BUDGETED REVENUE, 2014
Supervision of monetary financial institutions, financial instrument market and private pension funds	81%	82%
Supervision of the insurance market	19%	18%

In 2014, the total expenses of the FCMC amounted to 6,940 thousand EUR. In 2014, the FCMC expenses, excluding provisions for annual leaves as provided for in the FCMC budget amounted to 6,899 thousand EUR, which was 3% lower than budgeted (7,109.7 thousand EUR). Although the FCMC budget was planned to result in a deficit of 678.7 thousand EUR, the FCMC was able to achieve savings on some expenditure items and ended the year with a smaller deficit of 471 thousand EUR. In 2014, the excess of expenditure over income, including accruals for remuneration amounted to 511.7 thousand EUR, which lowered the budgeted performance of the FCMC.

The amount of payments by the financial and capital market participants into the revenue budget of the FCMC is directly proportional to the payment rates specified for them for the financing of the activities of the FCMC and the changes (increase or decrease) in the performance indicators of the financial market, taking into account the cost of supervision of the relevant market segments.

The changes in the FCMC financing structure are also related to the share of the costs of supervision of the respective sector, as well as the sector's ability to ensure the necessary amount of financing. From year to year, the financing of the FCMC from market segments has been in proportions corresponding to the share of costs related to the supervision of the respective sector. Due to the reduction of the share of the costs of supervision of the insurance sector in total costs, the share of the financing from this sector has been gradually reduced also in the overall budget of the FCMC. In contrast, the financing from the monetary financial institutions funding has increased.

The revenue and expenditure budgets of the FCMC for 2013 and 2014 have been planned having regard to the needs of ensuring the activities of the FCMC. The actual revenue has reached the budgeted amount because in the cases of over-financing, the payments has been recalculated for market participants. The actual expenditure is lower than budgeted due to cost savings.

In 2014, staff remuneration costs accounted for the largest share (71%) 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 as well as changes in remuneration in the financial sector, which the FCMC follows in determining the salaries of employees and observing the restrictions in the field of work remuneration and social guarantees laid down for the employees of public administration institutions. The remuneration of the officials and employees of the FCMC 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. The remuneration of the FCMC Chairman may not exceed the average monthly salary of the employees of the financial and insurance sector in the year before the previous year, i.e. 2012 published by the Central Statistical Bureau in its official statistical statement, after applying a ratio of 4.95 thereto. There have been no changes in the remuneration to the FCMC Board members since 2011. The breakdown of the FCMC staff remuneration is presented in Table 10.

Figure 29.
Comparison of the budgeted and actual revenue and expenses of the FCMC FKTK, 2013–2014, in million EUR

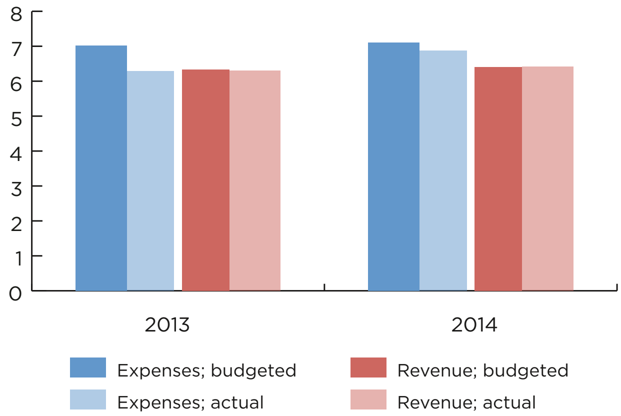


Figure 30.
Breakdown of the FCMC financing (2007-2014, %)

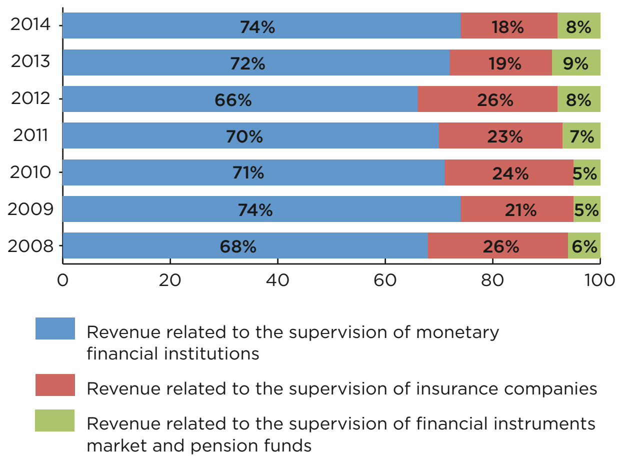
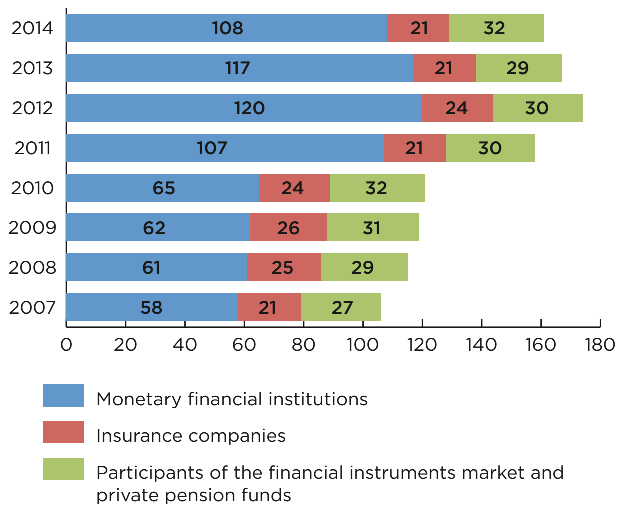


Table 10.
Breakdown of the FCMC staff remuneration, in 2014, in EUR

Remuneration	**4,952,416**
Salaries and similar payments	**4,013,154**
including bonuses	59,169
including additional payments	41,837
incl. Remuneration of the FCMC Board	345,393
incl. Remuneration of the Consultative[22] Council	5,229
National social insurance mandatory contributions (NSIMC)	**911,111**
incl. NSIMC on the remuneration of the FCMC Board	54,729
incl. NSIMC on the remuneration of the FCMC Consultative Council	1,234
Staff health insurance	**28,151**

Figure 31.
The number of the providers of financing 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 (2007–2014)



The FCMC has been continuously investing considerable resources in information technology with a view to optimising its supervisory as well as organisational management processes, such as the electronic circulation of paperwork and a more efficient handling of the financial information of the financial and capital market participants for supervisory needs. The FCMC has been actively using electronic and electronically signed documents. The FCMC documents are mostly signed with a secure electronic signature. In 2014, the FCMC significantly increased its long-term investments in information systems, implementing a new functionality as well as changes to the existing systems and XBRL (eXtensible Business Reporting Language) to ensure the reporting standard of the European authorities. This enabled the implementation of the new EU centralised reporting, it is now possible to send data to the EU organisations in the prescribed format. At the end of the year, the carrying value of information technology accounted for 73% of the total long-term investments.

Membership fees in the EU and global organisations of which the FCMC is a member, account for an increasingly greater share of the FCMC expenses.

22 Under the accruals principle, except accruals for annual leaves, which are not included in the budget planning

Table 11.

Changes in the FCMC long-term investments, 2013–2014 (at the end of the year)

	2014	2013	CHANGES IN 2014/2013
The total carrying value of long-term investments, in EUR	**447,235**	**332,949**	**34%**
Total units	**4,295**	**4,103**	**5%**
incl., the carrying value of software and information systems, in EUR	206,459	124,786	65%
Number of units	2,628	2,508	5%
incl., the carrying value of information technology, in EUR	121,478	99,395	22%
Number of units	443	430	3%

Table 12.

Membership fees paid by the FCMC to the EU and global organisations, 2013-2014

	2013, IN EUR	2014, EUR	CHANGES IN 2014/2013
Payments to EU organisations	332,315	439,951	32%
Payments to global organisations	24,367	34,593	42%
Total	**356,682**	**474,544**	**33%**

Table 13.

Breakdown of the FCMC business trips, 2014, in EUR

Training related business trips	87,203
Job-related business trips	411,604
including business trips for ensuring the supervisory process in Latvia	429
including business trips related to the representation in the EU institutions	365,438
Total	**498,807**

During 2014, the FCMC used a lot resources to prepare for the building of the framework of the SSM for banks to make it fully operational by 4 November 2014. The FCMC staff participated in the events organized by the ECB and the bodies thereof, visiting the ECB headquarters in Frankfurt (Germany) on business trips. The FCMC staff participated in the projects of the European supervisory authorities, which significantly complemented the development of the single framework, by developing the technical standards, which implementing the EU directives and regulations and build (with the help of guidelines and recommendations) a uniform approach towards the implementation of the supervision of the financial sector. Extensive work was carried out by participating in the working groups of the EU institutions to ensure the development and implementation of the requirements of the EU legislation, protection of the interests of Latvian financial market and harmonise supervisory practices. Due to the above, the business trip expenses of the FCMC are increasing.

The financial statements of the FCMC for 2014 and those of the DGF and FPI, which subordinated to it, as well as independent auditor reports on them are available on the FCMC website www.fktk.lv.

Internal audit and quality management

In 2014, the Internal Audit and Quality Management Division, objectively verifying the functions and processes of the FCMC, provided FCMC management with an opinion about:

- the effectiveness 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 the overall governance process by raising awareness of the risks and control in the relevant areas.

Internal audits are planned and carried out based on the risk assessment, with a key focus on the processes of the core activities of the FCMC. The findings of each internal audit are reported to the FCMC Board.

In the reporting year, three internal audit reviews planned for the reporting year were completed and two reviews were started. The performed internal audit inspections covered the following areas subject to audit: the management of corruption and interest conflict risks, the audit of the financial statements of the issuers, the assessment of the usefulness of the outsourced legal services, the compliance of the processing of the personal data of natural persons with the requirements of laws and regulations, the accumulation and use of the licensing information.

According to the findings of the performed internal audit reviews, in the audited areas, the internal control system has been established and is functioning effectively in all material aspects, however, there is some room for improvements, and the assessed controls are generally adequate, sufficient and efficient, which provides sufficient assurance that the FCMC risks are being managed and the objectives of the institution are being reached.

In the reporting year, two internal inspections were carried out, as well as two consulting projects were completed in the areas which were related to the supervision of the elimination of the deficiencies identified during the inspections of market participants as well as the quality control of the supervisory process.

Aimed at the improvement of the functioning of the internal control system and the mitigation of potential risks and adverse effects, during the reporting year, the auditors having carried out the internal audit reviews, had made 44 recommendations aimed at the improvement and enhancing of the internal control system of the FCMC, of which five or 11% were rated as high priority, 35 or 80% were rated as average priority, and four or 9% were rated as low priority areas.

By the end of the reporting year, the management had implemented 91% of the approved recommendations to be implemented during the reporting year and the work on the implementation of other recommendations is being continued.

In the reporting year, to improve and enhance the functioning of the internal control system of the FCMC, through implementing the recommendations provided in the internal audit reports and within the advisory projects, the FCMC continued working on improving the risk management process, as well as carried out a number of measures aimed at consolidating the process of the supervisory activities of market participants.

In the reporting year, with a view to enhancing the effectiveness of the internal audit function of the FCMC, it continued the implementation of the recommendations resulting from the assessment of the compliance of the internal audit function of the FCMC carried out by SIA *PricewaterhouseCoopers*. The majority of the recommendations (75%) have been implemented. The compliance assessment resulted in a number of recommendations, by implementing which, the FCMC would increase the effectiveness of the internal audit function.

To ensure the conformity of the services provided by the FCMC to the interests of the State and its population, as well as the customer interests and requirements laid down in the laws and regulations, using the improvement opportunities and available resources, the FCMC developed a quality management system conforming to the requirements of EN ISO 9001:2008 standard (activity area *Regulations and Monitoring of the Financial and Capital Market and the Activities of its Participants*), which is being continuously improved, having regard to the best practice examples and experience of the supervisory authorities of the financial sector. Based on the FCMC management decision, the quality management system has been maintained without certification as of 8 May 2012. According to the findings of internal audits, the FCMC has been consistently carrying on work aimed at the continuous improvement of the quality management system and increasing the effectiveness thereof.

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