FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

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

2015

CONTENTS

INTRODUCTION

1. VISION, MISSION, VALUES

FCMC VISION

A sound Latvian financial market integrated in the European Union (EU) single market, associated with professional, rigorous and fair supervision.

FCMC MISSION

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

FCMC 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 – in our activities we are open to 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 each and every one of our decisions to the public in an explicit manner, complying with regulatory restrictions on the disclosure of information.

2. CHAIRMAN'S FOREWORD

Changing the standards and changing ourselves

For the Latvian financial sector 2015 was the first full year of the membership in the Single Supervisory Mechanism (SSM) of the European Banking Union. We have reviewed the previous supervisory model and the methods thereof, taking into account the quality standards set by the European Central Bank (ECB). The three largest Latvian banks became subject to the direct supervision of the ECB, and the supervisory process of the rest has been harmonised with the SSM requirements.

Alongside this, in the first half of 2015, our country became the presiding country of the EU Council. Six months in public administration in such status had been a challenging time for many experts, and also a number of FCMC specialists contributed to a successful Latvian Presidency, within the scope of the Working Party on Financial Services and the Working Party on Company Law.

With a view to continue Latvia's orientation towards participation in the Organisation for Economic Cooperation and Development (OECD) launched in 2014, in the reporting year we also took part, under a negotiated procedure, in five OECD committees and two standing working groups – Latvia was represented there both by the FCMC Board Members, and Heads of Divisions and the experts. And we have managed to successfully accomplish all of the above mentioned. This meant working at a new level of national responsibility and in a larger capacity than ever before.

Therefore the OECD criticism regarding material flaws in the anti-money laundering and counter-terrorist financing system (AML/CTF) of Latvia at the very end of 2015 was to be assessed as a step back. It left a serious impact on the reputation of both the sector and the competent authorities. Our country was at the final stage of the accession talks, and then we suddenly faced the need to urgently prevent the deficiencies and restore reputation in the eyes of the developed countries of the world. Of course, it was not flattering, but it should be admitted that many issues were left unattended. We assessed the situation and took the necessary measures required for prevention of the flaws detected by international experts. Most probably, the time was ripe for Latvia to receive these instructions. The relative economic stability over the period of the last years in our country is the best time for us to reform this field. Up to now Latvia has already had quite good and sufficiently rigorous regulation in this field, however now we needed dialogue with the banks regarding its application in practice.

> Money laundering risk, as well as terrorist financing risk in the global economic space is observed in each and every country and almost every bank, nevertheless this risk is considerably larger when we speak about the banks focussed on servicing non-resident business.

The share of non-resident deposits in Latvian banks at the end of 2015 comprised 53.4%. 14 out of 26 Latvian banks were to be considered so-called non-resident banks and their funding is always exposed to a fluctuation risk. The FCMC has considered these risks and the requirements for these banks were higher – Latvian banks having operations with non-residents as their everyday business are very well capitalised and with good liquidity indicators. Nevertheless, the US dollar sales over the period of the last years have not been proportionate to the economic size of Latvia. This, of course, raised concerns for our allies. We should bear in mind that, from time to time, the name of some of the Latvian banks was mentioned in the international money laundering scandals. It's one thing, when something has not been understood, but it's quite another when the bank has intentionally taken the path of abusing the licence. In such cases the profit was obtained through unverified, suspicious transactions on account of the goodwill of the Latvian state and controlling authorities. Therefore 2015 and the beginning of 2016 has been as a milestone in the AMLCTF field – with considerable changes introduced both in the legal framework and supervisory approach. Significant fines were imposed on a number of our banks, in some cases we suspended the bank officials in charge of this field from the fulfilment of their official duties or punished them with a fine, one bank lost its operational licence.

> One thing is for sure – the future of the financial transactions business is possible only in a certain form, namely, it has to be understandable and fully controlled on the part of the service provider.

An abstract client and unknown actual beneficiary have become history. This is why one of the tasks undertaken by the FCMC in 2015 was to ensure the independent assessment of the internal control systems of the non-resident banks in the field of AMLCTF, by attracting experts from the USA. This verification is at the final stage at the moment and the results will determine the planning of our further steps.

There are concerns still present that some Latvian banks might have their correspondent accounts closed for the direct settlement of accounts in US dollars. I think that we as the Eurozone and NATO state, as a part of Western civilisation should be given a possibility to ensure with our AML/CTF regime that there are financial institutions in Latvia for the direct settlement of accounts in US dollars. If we are mainly engaged in US dollar transactions in the non-resident business, then we have to respect the AMLCTF regime applicable in the country issuing this currency. This is the principle to be henceforth closely followed by the FCMC

Logical continuation of these tasks was the decision to set up a new structural unit of the FCMC – the Compliance Control Department will henceforth both carry out the supervision of the financial sector with respect to the AMLCTF, and also develop the necessary legislative changes. AT the same time, both the OECD and our strategic allies the USA have emphasised that the capacity should also be built in other public institutions involved in the chain of prevention of violations in this field. Merely changing the supervisory framework of the financial sector would not be enough to fully prevent the flaws in the AMLCTF system. It is a broader issue of the legal order in the country.

A high risk is inherent to the model of operation of our non-resident banks, which has, up to now, meant high profitability. By raising the AMLCTF standards, one should take into account that the volume of transactions can decrease, reflecting in the profit indicators of the sector, therefore we will pay enhanced attention to the business models and strategies, seeking to understand how to ensure profitability in the future. If Latvia seeks to preserve the status of an international financial centre in the long run, then the banks should be able to fully meet the AMLCTF requirements, adjust their business plans and be ready to invest both in personnel and in new technologies.

Rapid technology development represents an additional challenge for a sector. There are no financial services left, which could only be received in the banks. Competition is rigid, also considering the low profit interest rate environment, because one of the most stable financial instruments – bank deposit – does not ensure a sufficient return anymore. The same problem also accrues in the life insurance segment – we have contracts with terms of 10 and more years, guaranteeing significant profitability rates. Current conditions on the stock markets still provide for the possibility to compensate low interest income from deposits and bonds, however we do not have any actual solutions. Such circumstances make people, also individually, seek increasingly complex possibilities for earning profit with their free funds, bringing along elevated risks. Therefore the financial literacy of the population will also remain within the FCMC's line of sight henceforth.

In 2016 it is planned to set up a new Financial Sector Development Plan. Of course, a fundamental outlook on its future will be provided by the Ministry of Finance, however each separate group of financial market participants should also very clearly define its place and future vision. I suppose this will be an interesting process of adapting our interests and vision to the reality of life, in order to ensure sustainability and further development of the financial sector.

Along with the changes in the regulatory framework during the reporting year, as the authorities of the FCMC grow, the supervisory approach and its effectiveness transforms, as well. Therefore further capacity building of the FCMC staff is needed. In this respect Riga provides for the possibilities, because it is one of the financial competence centres of the Baltic and Northern Europe Region, with a large number of highly qualified specialists in the field of finance and information technologies. Nevertheless, the FCMC works under the circumstances of harsh competition, because in attracting suitable specialists we compete not only with the Latvian financial sector, but also with the ECB and other international financial institutions and their representative offices. We are an autonomous public institution, not financed by the state budget, however at present we are included in a single remuneration system with other public administration institutions, which is primarily intended for the public administration standard. Therewith the FCMC as the financial sector supervisor has limited competitive possibilities in the corresponding labour market segment, and in the medium term this might become a problem. During the next stage of work we will seek solutions for this situation, in line with the understanding already provided at the highest political level, namely, that it is necessary to continue the already launched initiatives of the FCMC both in internal capacity building and in enhancement of the financial system regulation.

2015 is to be assessed as a period of time that brought along serious challenges for the direction of further development of the financial sector and also for its supervisor – the FCMC. In these situations we have selected the right direction on our way of changes.

I would like to thank all of you for the accomplished work and patience!

Chairman of the FCMC
Pēters Putniņš

3. 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 three FCMC departments.

In 2015, the composition of the Board has remained unchanged compared to the previous year: Chairman of the FCMC Kristaps Zakulis, Deputy Chairman of the FCMC Pēters Putniņš, Director of the Legal and Licensing Department Gvido Romeiko, Director of the Supervision Department Jeļena Ļebedeva and Director of the Regulations and Statistics Department Ludmila Vojevoda.

Board of the FCMC at the beginning of 2016

Pēters Putniņš – Chairman of the FCMC

Jeļena Ļebedeva – Member of the Board and Director of the Supervision Department

Ludmila Vojevoda – Member of the Board and Director of the Regulations and Statistics Department

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

Once a week, the Chairman of the FCMC convenes and chairs the meetings of the Board for the review of the most important issues and adoption of decisions. In 2015, 51 meetings of the FCMC Board were held, during which 238 decisions were adopted (in 2014 – 46 meetings with 307 decisions adopted, respectively).

To promote the efficiency of the monitoring of the financial and capital market, ensuring the cooperation of the FCMC with the professional associations of the financial sector, the meetings of the Consultative Council of the financial and capital market are also convened on a regular basis. In 2015, twelve such meetings were held during which 37 draft laws and regulations binding on the financial and capital market were reviewed (in 2014 – 39 draft laws, respectively).

On 1 January 2015 Latvia obtained the status of the presiding country in the EU Council, receiving the baton from Italy. Six months of managing the work of the EU Council has been a time of opportunities and also challenges. The FCMC also contributed considerably in this process, by participating in the EU Council's Working Party on Financial Services and Working Party on Company Law.

In 2015, continuing that which has been started in the previous year, the FCMC took part in the OECD accession talks in its Committee on Financial Markets, Committee on Insurance and Private Pensions, Investment Committee, Corporate Governance Committee, as well as in the OECD's Working Group on Bribery in International Business Transactions. Over the period of 2015, in order to ensure conformity to the standards set by the OECD, both amendments to the laws and regulations were introduced and measures were taken for strengthening the administrative capacities of the FCMC in the field of the AMLCTF. By the end of 2015 we have received positive recommendations regarding Latvia's accession to the OECD from the Committee on Financial Markets and the Committee on Insurance and Private Pensions, and at the beginning of 2016 a positive opinion on the readiness of Latvia to join the OECD was also received from the rest of the Committees.

In 2015, 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-orientated supervisory measures. For more information on the measures taken refer to the section Supervision.

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 2015, the FCMC carried out 47 on-site inspections of market participants, of which 31 inspections were carried out in banks, one – in an insurance company, three on-site dawn raids of insurance and reinsurance brokers (legal entities), three inspections – in credit unions, three – payment institutions, one – in an alternative investment fund manager and three – in private pension funds. In the field of the provision of investment services two on-site inspections were carried out. In 2015, 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, two inspections related to the supervision of payment institutions, and three inspections in credit unions. In 2015 the FCMC also carried out scheduled on-site information systems inspections in six banks (one of which – within the scope of the SSM), in one insurance company and four payment institutions.

> 2015 was the first year of fully-fledged membership in the Single Supervisory Mechanism of banks, bringing about changes to the previous supervisory model of Latvian credit institutions.

The ECB, in cooperation with the national supervisory institutions of the involved EU Member States, including the FCMC, is 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, and to ensure coordinated supervision. In 2015, to facilitate the achieving of the above goals, as well to ensure the implementation of the supervisory principles laid down by the SSM, the FCMC continued reviewing and improving its supervisory methods, taking into account the supervisory practice of other countries and the supervision quality standards laid down by the ECB. According to the SSM regulation, in 2015, three Latvian banks were transferred to the direct supervision of the ECB, therewith the FCMC supervisory processes binding on these banks in 2015 were fully integrated with the single supervisory programme of the ECB.

As regards the AMLCTF field, 2015 marked significant changes in the regulatory framework, in the supervisory processes of the banks' AML/CTF compliance, as well as in ensuring the AML/CTF supervisory function carried out by the FCMC.

In light of the introduction of the new macro-prudential supervision framework, 2015 was the first year when the FCMC started fulfilling the functions of the institution in charge of the application of macro-prudential instruments, mastering the decision-taking procedures providing for coordination with other involved institutions both in Latvia and in the EU, and adopting the first decisions.

With a view of implementing the functions of the institution in charge of resolution, conferred upon the FCMC in Latvia, in 2015 a separate division was set up in the FCMC – Resolution and Guarantee Funds Division, with the activities and functions thereof being segregated from the supervisory functions. The resolution institution is in charge of the preparation of resolution plans, performance of the resolution activities (or recovery) for institutions, the resolution whereof is required in the interests of the public, or of the adoption of decisions on the non-application of a resolution, as well as of the accumulation of funds in the Single Resolution Fund.

In 2015, the FCMC experts also 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 practice 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 summarised in the section *Regulatory Requirements*.

In order to effectively fulfil its mission and objectives, the FCMC continued to actively cooperate with other state institutions, such as the Ministry of Finance, the relevant parliamentary committees, the Bank of Latvia, the Latvian Central Depository, the Consumer Rights Protection Centre, etc. In terms of international cooperation, the priority of the FCMC was still 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. Continuing bilateral cooperation with the supervisory authorities in those countries which have engaged in cross-border cooperation with Latvia was equally as important.

4. STRATEGY OF THE FCMC ACTIVITIES

In order to implement the functions of the FCMC as effectively as possible, promoting the development and stability of the financial and capital market, as well as the protection of interests of the investors, depositors and insured persons, in 2015 the FCMC approved the *Regulation and Supervision Strategy for the Financial and Capital Markets: 2015–2017,* setting out six strategic priorities attracting special focus in the forthcoming three years.

The FCMC's strategic priorities for 2015–2017:

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 tools.

To develop and make the supervisory methods, tools and practices employed in supervising the financial and capital market more efficient. Upon joining the Eurozone, Latvia automatically joined the SSM. Considering the new challenges, within the next three years, it is planned to ensure that the supervisory methods, tools and practices conform to the principles applied by the ECB, continuing active and mutually productive cooperation with the ECB, also taking into account the nature of the Latvian financial sector.

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 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 functions effectively, among other things, improving the tools for the prevention of a 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 functions effectively to consolidate the supervision of market participants and improve the instruments for the prevention of a 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 modern society, raising 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 similarly 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 2015

5. SUPERVISION

5.1. 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.

With a view of promoting the protection of the interests of investors, depositors and insured persons, as well as the development and stability of the financial and capital market, the FCMC carries out regular and comprehensive supervision of market participants by:

- maintaining constant dialogue with the market participants and professional associations regarding the new requirements and sectoral trends and the risks and problem issues pertaining thereto;
- ensuring that new market participants with a sound capital base and clear and viable strategy enter the market;
- carrying out of off-site analysis of the indicators characterising the activities of market participants, continuously focussing on the qualitative and quantitative changes of the financial indicators as well as compliance with the regulatory requirements and the efficiency of corporate governance;
- carrying out on-site inspections;
- within the scope of its competence, assessing the quality of financial services and ensuring consumer protection;
- in cases of non-compliance with the regulatory requirements, timely imposing preventive and corrective measures on the market participants.

2015 was the first year of fully-fledged membership in the Single Supervisory Mechanism or the SSM of the banks, bringing about changes to the previous supervisory model of Latvian credit institutions. 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 2015, to facilitate the achieving of the above goals, as well to ensure the implementation of the supervisory principles laid down by the SSM,

> the FCMC continued reviewing and improving its supervisory methods, taking into account the supervisory practice of other countries and the supervision quality standards laid down by the ECB.

According to the SSM regulation, in 2015, three Latvian banks were transferred to the direct supervision of the ECB, therewith the FCMC supervisory processes binding on these banks in 2015 were fully integrated with the single supervisory programme of the ECB. In turn, as regards the supervision of the remaining 14 banks and 10 branches of the banks (less significant institutions), which remained under the direct supervision of the FCMC and the monitoring of the ECB, the process of harmonisation of the supervisory methods was commenced in 2015. This process provides for implementation of the supervisory programme of less significant banks, based on the proportionality principle and close cooperation and mutual trust of the national supervisors and the ECB.

The FCMC pays constant attention to improving the methods applied in the supervision of all market participants.

5.2.Banking sector

General information

At the end of 2015, 17 banks and 10 branches of banks of the EU member States were operating in the Republic of Latvia. Over the period of recent years, the improved banking regulation as well as capital requirements have contributed to the banking sector becoming stronger and better capitalised than before the crisis.

At the beginning of 2015 *AS LHV Pank* Branch in Latvia started operating in Latvia, being established on the basis of the previous representative office of *AS LHV*

Pank in Latvia. In turn, at the beginning of 2016, along with changes in the plans of *AS LHV Pank* regarding the presence of the bank in other countries, the closing of the recently opened branch was announced.

> In 2015, Latvian banks were exposed to a number of factors that had an impact on the external and internal financial environment in which they operated.

Overall, in 2015 a moderate growth rate was observed in the national economy of Latvia, also ensuring positive developments in the banking sector – the combined profit of the banks continued to grow, effectiveness of operation and capital return improved. Banks continue to keep a high level of capitalisation and liquidity. Positive developments in the field of solvency of internal borrowers continues to also ensure gradual improvement of the quality of the loan portfolio of the banks. The growth rate of new loans is still quite slow, not being able to cover the amortisation costs of the existing loan portfolio, nevertheless, overall, a gradual increase in the demand for loans is observed.

The potential developments in the external macro-financial environment continued to remain the most significant sources of uncertainty and risks. The impact of external environment factors such as global growth risks and increasingly topical geopolitical tension is being observed, and the uncertainty pertaining thereto may have an impact on the probability of growth of the credit risk level, even though the debt burden of the borrowers in Latvia continues to reduce.

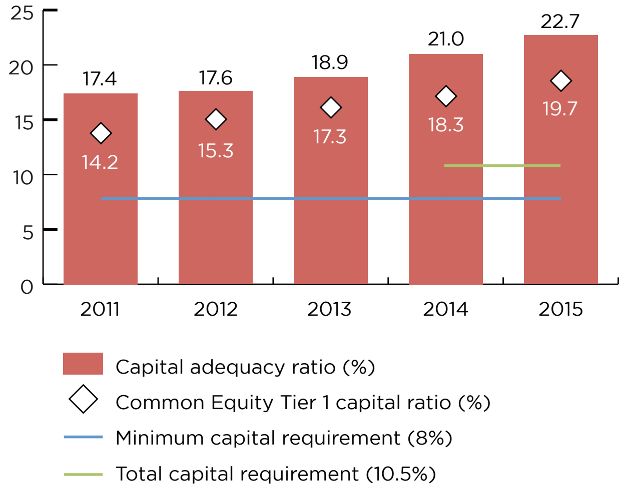
Overall, in 2015, despite some uncertainty in the external environment, the key indicators of the banking sector continued to stabilise and move towards moderate development. The shock tolerance level was still high, especially due to a constantly high level of capitalisation and liquidity of the banking sector.

Banking sector performance indicators

The level of the capitalisation in the banking sector remained high, and at the end of 2015, the combined capital adequacy ratio of the banking sector reached 22.7%, whereas the Common Equity Tier 1 capital (hereinafter referred to as CET1) was 19.7%. The quality of the capital of the banking sector is ensured by the key element of the own funds of banks, i.e. CET1 capital, which currently equals CET1 capital in the case of Latvian banks.

Figure 1.

Figure 1 Bank capital adequacy ratio (%)



The banks also ensure a sufficiently high level of leverage ratio[1], and at the end of 2015 it reached 9.5%, whereas for individual banks it ranged from 3.6% to 17.6% (the minimum threshold set by the Basel Committee on Banking Supervision for the supervisory monitoring period till 1 January 2017 is 3%).

Bank liquidity The banking sector liquidity ratio grew even more, as liquid assets increase at a steeper rate than current liabilities, and at the end of 2015 it comprised 66.7% (the minimum liquidity ratio being 30%).

Since October 2015, banks must also comply with the applicable liquidity coverage ratio requirement, which is determined in an amount of 60% for 2015. Liquidity coverage ratio requirement is met by all banks and at the end of December 2015 the said ratio in the banking sector, overall, reached 306%, considerably exceeding the set minimum threshold.

Thanks to the increase in the amount of deposits attracted, the combined loan and deposits proportion of the banking sector slightly improved and at the end of 2015 reached 63.1% (at the end of 2014 – 66%), *inter alia*, the proportion of loans issued to residents and deposits attracted from the residents at the end of December comprised 115% (at the end of 2014 – 118%), meaning that the loans issued in the domestic market are fully financed by resident deposits.

Earning capacity During the reporting year, the banking sector improved its performance results and the unaudited profit amounted to 416 million EUR (in 2014 it was 311 million EUR), *inter alia*, 15 Latvian banks and five branches of foreign banks, the market share

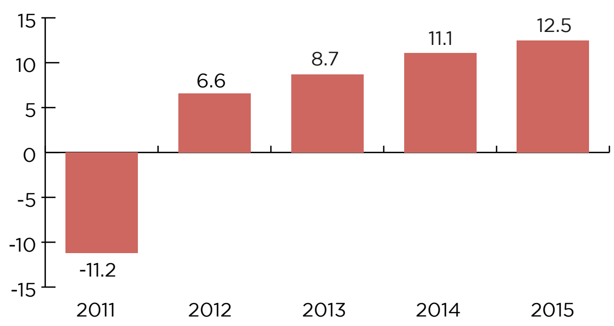
1 The leverage ratio is calculated as the Common Equity Capital Tier 1, divided by the total amount of its non risk weighted assets in percentage.

whereof comprised 96% of the total assets of the banking sector) operated with profit.

During 2015, the earning capacity of banks improved, and the return on equity (ROE) indicator of the banking sector at the end of December was 12.5% (at the end of 2014 – 11.1%).

The growth of profit for the banks orientated to servicing customers – non-residents was mainly ensured by the net interest income growth (interest income from lending activity and from investments in securities grew), as well as the growth of income from the transactions of trading in financial instruments. In turn, the increase of profits of banks orientated to the domestic market was still mainly due to cost reduction (mainly the costs of provisions for doubtful debts and interest expenses decreased).

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

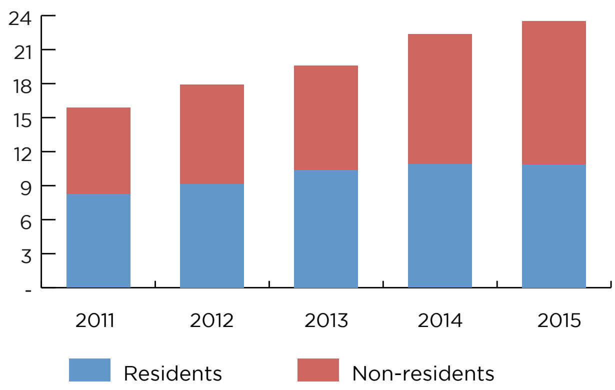


Amount of deposits In 2015, the amount of deposits attracted continued to increase (by 1.1 billion EUR or 4.8%) totalling 23.3 billion EUR at the end of the year, with resident deposits comprising 47% thereof.

Even though a stable increase of private sector resident deposits continued, namely, deposits of private non-financial companies increased by 317 million EUR or 10.3%, household deposits – by 323 million EUR or 6.4% and the deposits of financial companies – by 240 million EUR or 31%, the total increase in the amount of the resident deposits, nevertheless, was not significant (by 110 million EUR or 1.0%), because the amount of governmental deposits decreased significantly (by 745 million EUR or 59%).

An increase in non-resident deposits (by 954 million EUR or 8.3%) was mainly affected by the steep appreciation of the USD (non-resident deposits only increased by 0.9% due to the adjustments to take account of the changes in the USD value).

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



Financing attracted by banks In 2015, the financing attracted from monetary financial institutions (MFIs) (by 588 million EUR or 16.7%) continued to decrease, which was due to both gradual replacement of the financing from parent banks by customer deposits and still slow lending rates.

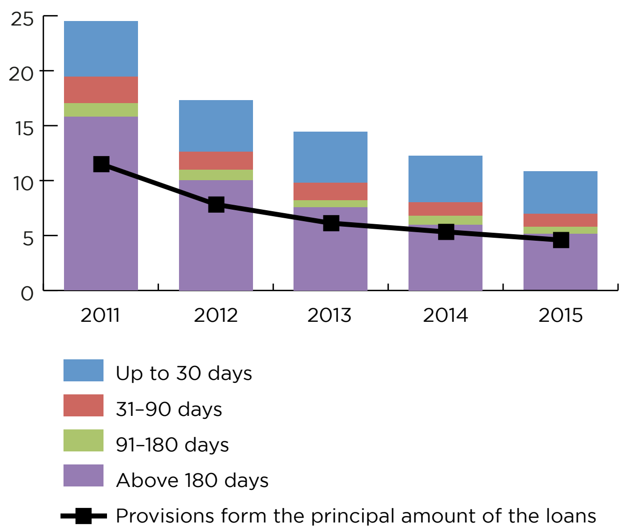
In order to balance out the term structure of financing, banks continued to issue long-term bonds. The share of the issued debt securities increased by 170 million EUR or 33% during the year and totalled 683 million EUR.

Loan portfolio. In 2015, the loan portfolio stabilised, with its share remaining practically unchanged during the year (increased by 0.1%). Significant slowdown was observed in the decrease rate of the resident non-financial companies portfolio (-1.6% during the year), whereas the amortisation and writing off of the resident household loans promoted a further decline of the loan portfolio (by 4%). At the same time, the increase of the USD exchange rate to EUR largely influenced the non-resident loan portfolio increase by 9.9%, whereas along with the adjustments in the USD value changes the non-resident loan portfolio only grew by 3%.

The share of the newly issued loans increased – credit institutions financed both the purchasing of housing for households and resident non-financial companies, i.e., by 11.5% and 8% more than the year before, respectively.

Quality of the loan portfolio In 2015, the quality of the loan portfolio continued to improve, and the share of loans overdue for over 90 days decreased in the total loan portfolio of the banking sector from 6.9% to 6.0%. Improvement was observed both in the resident household and corporate portfolio, whereas the increase of the share of non-resident loans overdue for over 90 days (from 5.3% to 8.8%) was affected by the adverse economic situation in their home countries. The total share of overdue loans in the portfolio decreased from 12.3% to 10.9% during the year.

Figure 4.
Overdue loans and provisions (% of the loan portfolio)



Geopolitical and economic tension in the region found its reflection in the increase of the share and amount of restructured loans. Restructuring was mainly necessary for non-resident loans, and the share of such loans in the non-resident portfolio increased from 8.1% to 15.1% during the year. Increase of restructured loans in the resident portfolio was considerably slower, including in the resident companies portfolio the share of such loans increased to 8.6%, whereas in the resident household portfolio it even declined and totalled 6% at the end of the year.

As the process of purification of the bank balance after the crisis was approaching the end, the share of the written-off loans in 2015 continued to decrease and in total loans in an amount of 181 million EUR were written off (in 2014, loans in an amount of 300 million EUR were written off).

Bank supervisory measures

In 2015, 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 Latvian banks were as follows:

- assessing the adequacy of the capital base of Latvian banks;
- assessing the business models of banks and identifying the factors influencing the sustainability thereof;
- assessing the potential impact of the operating strategies of banks on the structure and size of risks;
- assessing the liquidity maintenance and administration adequacy and quality, taking the business model selected by the bank into account;
- 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 recovery plans of banks, maintaining a dialogue with banks regarding the necessary improvements.

In 2015, supervision of banks was constantly 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.

Off-site monitoring of the bank performance

In 2015, the FCMC carried out an intensive 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 on the banking activities:

- 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 a part of the above mentioned operative information to the FCMC, thus promoting a mutual dialogue between the FCMC and the banks.

In 2015, the FCMC still 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. As a supplementary supervisory tool the stress test developed by the FCMC was applied, within the scope whereof the banks assessed the possible impact of the termination of correspondent relations on the business model, earning capacity of the bank, as well as its ability to meet the regulatory requirements. At the same time, the FCMC also assessed the quality of the cooperation of banks with corresponding banks and encouraged them to pay attention to the issues on the diversification of 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 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.

Along with geopolitical tension in Russia and Ukraine remaining one of the factors affecting the external environment of the banking activities, the FCMC held meetings with both the banks and the representatives of the auditors' companies performing the audit of the annual reports of the banks, in order to discuss the impact of these events on the operation of Latvian banks. At the same time, to carry out as full analysis of the impact of these events on the performance indicators of Latvian banks as possible, 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 an appropriate capital adequacy ratio and the plans of ensuring liquidity in emergency situations as well as the need to reduce the exposure of banks to particular countries. Concurrently, the attention of the banks was directed to the sustainability of their business models and viability of their operational strategy.

Risk-based supervision is still one of the key principles of supervision. Under this principle, the FCMC, using information disclosed in the reports received from banks, as well as other information available thereto, assessed, on a quarterly basis, the performance of banks, the level of risks and the quality of their management, and risk monitoring results were used in planning the necessary supervisory measures, 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 of the FCMC, 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 operations of a particular institution.

The key objectives of the rating system are:

- to assess the risks inherent to the activities of the supervised institutions, 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 supervised institution);
- to ensure efficient and targeted planning of supervision;
- to ensure the continuity and transparency of the supervisory process;
- to promote the establishment of a more advanced approach to risk management in supervised institutions;
- to promote communication and a dialogue with supervised institutions.

As a result of the rating assignment process, each supervised institution 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 2015, 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 activities, 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 bank:	3	12	2

In 2015, the key risks of banking activities 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.

Group supervision

In 2015, the FCMC cooperated with the supervisory authorities of the credit institutions of the Member States, which pursuant to the requirements of the laws and regulations implement the supervision of groups of credit institutions. In 2015, the FCMC staff took part in the work of the boards of supervisory authorities of the credit institutions of five EU Member States, including the chairing of one board of supervisory authorities in the capacity of the responsible supervisory authority. As regards two major Latvian banks, along with the establishment of the ECB's SSM the EC's SSM takes part in the boards of the supervisory authorities in the status of a member, while the FCMC has assumed the observer status in these boards of supervisory authorities, enabling the FCMC to participate in the work of the boards of supervisory authorities and ensuring access to the information necessary for the FCMC to carry out supervisory work.

In addition, in one instance in 2015, the FCMC has initiated the establishment of the board of the supervisory authority and conclusion of the cooperation agreement with the supervisory authority of the credit institutions outside the EU and has assumed the role of the chair of this board.

In 2015, 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 30 inspections in banks, paying particular attention to assessing capital adequacy ratio, the lending 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 (including four on-site inspections carried out in the major banks). The deficiencies and irregularities identified during inspections were discussed with the bank management and action plans were coordinated to implement the necessary improvements. Follow-up monitoring was carried out within the scope of off-site supervision by controlling the course of the implementation of the action plan in the field of prevention of deficiencies.

Taking into account that banks, by extending the range of provided services, are offering e-commerce services, including the provision of payment card processing, during the reporting year one on-site inspection was carried out in the bank aimed at assessing risks inherent to the cooperation of the bank with payment institutions, electronic money institutions and internet traders and the quality, adequacy and appropriateness of methods applied by the bank for the management of these risks in light of the size of operations thereof, as well as assessing the compliance of the activities of the bank with the requirements of the laws and regulations. With respect to the planned provision of the e-commerce services, procedures on cooperation with payment institutions, electronic payment institutions and internet traders submitted by three banks, were assessed.

Capital adequacy

During 2015, 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 lending growth rates. In 2015, four banks increased their paid-up share capital by 24 million EUR in total.

Within the scope of the supervisory process, the FCMC paid attention to and assessed the adequacy of provisions made by the banks 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 2015, the capital adequacy ratio calculations of nine 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, and that a sufficient capital buffer is ensured in the case of the occurrence of potential significantly adverse circumstances affecting their operations.

During 2015, within the scope of the supervisory inspection and assessment process, the capital adequacy ratio assessment process performed by the banks and the results thereof were assessed in all banks, as well as the conformity of the assessment process of the banks' internal capital adequacy ratio to the requirements of the laws and regulations. Some areas for improvements were identified during the inspections performed by the FCMC (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). In separate cases, the FCMC requested updating the results of the process of assessment of the internal capital adequacy and submitting them repeatedly. At the same time, the FCMC engaged in further dialogues with several banks about their business model, strategy 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 2015, within the scope of the supervisory process, upon identifying an unduly high risk, the FCMC, according to the rights vested to the supervisor under the *Credit Institutions Law*, imposed an obligation on 16 banks to maintain their own funds above the minimum capital requirement.

Credit risk

The FCMC's priority in its supervisory work was still ensuring the maintaining of a sufficient capital base by Latvian banks, facilitating efficient debt restructuring. In 2015, the FCMC continued to base its supervisory methods upon the risk assessment of the activities of market participants, using related methods – monitoring of performance of banks, based on the analysis of financial statements and on-site inspections.

During inspections additional attention was paid exactly to the handling by banks of overdue and problem loans, i.e. justification and efficiency of loan restructuring. As a result of 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 collateral. Considering the share of the loans issued to non-residents in loan portfolios of separate banks and additional risks associated with non-resident lending, the lending 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.

Eight of the on-site inspections of banks carried out in 2015 were aimed at assessing exactly the quality of loan portfolios of banks and credit risk management. These inspections covered 14.3% (2.2 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 strategies, Latvian banks have been increasingly focussing on customer service using remote channels, which in turn requires greater investments in the information technology infrastructure to ensure that the information technology infrastructure of banks is up-to-date, secure and protected against cyber attacks. At the same time, to improve their earning capacity indicators, banks continue working at the optimisation of their costs and internal processes. These and other factors arising from the operational strategy and business model of each bank affect the level of operational risk in the bank, and to ensure 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 banks' liquidity indicators still remain consistently high and, overall, the liquidity risk level declines, the uncertainty in the macro-financial environment in relation to constantly topical geopolitical risks was a reason for the FCMC to also continue to pay close attention to the liquidity of banks in 2015.

In 2015, with a view to controlling the trends of changes in the deposits attracted by the banks, forming a significant source for their resources, the FCMC continued to require banks to provide daily operative information about the dynamics of deposits. The results of liquidity stress tests carried out by the FCMC in cooperation with the Bank of Latvia were also 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 2015, within the scope of the supervisory process, upon identifying an unduly high risk, the FCMC, according to the rights vested to the supervisor under the *Credit Institutions Law*, imposed an obligation on 14 banks to maintain their liquidity above the minimum liquidity requirement.

Market risk

In 2015, Latvian banks still 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 19.4% of bank assets (in 2014 – 15.5% of bank assets). Even though in general market risk is not significant in the banking system, it should nevertheless be taken into account that, as securities portfolios of banks increase, the level of this risk tends to gradually increase. Considering the above and external environment factors such as the risks of global growth and increasingly topical geopolitical tension, affecting the sentiment among investors and that could potentially have an impact on the banking system, in 2015, the FCMC continued to perform a focussed 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 also engaged in monitoring whether the financial instruments are presented prudently in financial statements, as well as assessed the liquidity of the existing securities.

In five banks that were subject to on-site inspections in 2015, 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, 52.9% (a portfolio of 3.3 billion EUR) were inspected. The key focus of these inspections was on the method applied by banks to define the level of the market risk and the assessment of the efficiency of the risk management system. Inspections also covered the assessment of the liquidity of the existing 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 2015, carrying out the inspections of banking activities, the FCMC continued to focus closely on the quality of management of each key risk. 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 were considered in the assessment of each risk management function. Particular attention was paid to establishing whether, in managing key risks, banks were using tools such as stress tests and scenario analysis, and 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 banks were requested to carry out improvements.

Bank recovery plans

Taking into account the regulations developed by the European Banking Authority 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 financial stability in the financial sector in general, already in the preceding years, the FCMC have commenced dialogue with the banks regarding the recovery plans developed by them aimed at achieving an objective and quality result. Following the latest documents of the European Banking Authority in this field, in 2016, the FCMC will continue to work with the banks to ensure that their recovery plans are developed taking into account the proportionality principle, as well as updated and enhanced in accordance with the latest requirements.

Sanctions and corrective measures

Within the scope of implementation of the supervision of the banking operations, in 2015, the FCMC imposed sanctions on the banks prescribed by the *Credit Institutions Law, inter alia:*

- expressed a warning to separate board members of a particular bank regarding the violation of the requirements of the Credit Institutions Law;
- expressed a warning to the shareholders of a particular bank regarding the failure to fulfil the duties laid down by the Credit Institutions Law;
- imposed a fine on a particular bank in an amount of

35 million EUR for flaws in the internal control system of the bank;

- imposed a fine on two banks in an amount of 55 million EUR and 105 thousand EUR for violations in the field of anti-money laundering;
- imposed a fine on one bank in an amount of 2, 016, 830 EUR and a fine on the officials thereof in an amount from 8 thousand to 96 thousand EUR for flaws in the internal control system of the bank and violations in the field of anti-money laundering, as well as dismissed the board members from office.

The FCMC also carried out corrective measures, setting additional requirements to four banks in the field of credit risk.

Single Supervisory Mechanism

On 4 November 2014, the Single Supervisory Mechanism or the SSM implemented by the ECB became effective, with the main purpose to ensure the security and resilience of the European banking system and promote financial integration and stability in Europe, and within the scope whereof the ECB has assumed new banking supervision duties. Upon joining the Eurozone, Latvia has also joined the SSM.

After voluminous preparatory works for establishment of the SSM in 2014, 2015 was marked by the fact that the implementation of the supervisory processes was, for the first time, carried out in accordance with the priorities set by the ECB[2], which concurrently represented both the verification of the supervisory methodologies and processes established by the ECB and the setting up of the ECB's supervisory practice.

In the case of Latvia, in 2015 the ECB has taken over the supervision of the three largest banks – *Swedbank, SEB banka* and *ABLV Bank*. These banks are supervised, by the ECB and the FCMC staff participating in established joint supervisory teams, which perform the supervision of major banks on a daily basis. The FCMC continued to supervise less significant banks, whereas the ECB has gradually started to prescribe single key principles and guidelines for supervising this category of bank. In 2015, along with regular supervisory processes in the major banks, for the first time in the history of supervision, the decision on the acquisition of a qualifying holding in AS *Citadele banka* was adopted in close cooperation with the ECB, because in accordance with the SSM Regulations the ECB carries out separate tasks with respect to all Eurozone banks, for example, the issuance or withdrawal of licences for banking activities and the provision of consent in the case of the acquisition of a qualifying holding in the banks.

Due to the Chairman of the FCMC being a member of the Supervisory Board of the ECB, the FCMC was also involved in the process of adopting the SSM decisions, adopting the decisions on both all the major banks under direct supervision of the SSM, and regarding the methodological issues determining the procedure for the implementation of the banking supervision process in the Eurozone as a whole. In 2015, the ECB Supervisory Board adopted 1, 500 decisions, held 38 Board meetings and coordinated and approved draft decisions within the scope of 984 written proceedings. For the purposes of ensuring the decision-making process, the FCMC experts assessed and provided their view on both the issues to be reviewed in the Board meetings and the documents forwarded under written proceedings.

In line with the operational principles of the SSM, providing for the involvement of all Member States in the processes of planning and implementation of the supervision, the FCMC experts constantly took part in the committees and work groups set up by the ECB, contributing their input to the development of the ECB's supervision single methodology and further coordination of the statutory regulation in the European Banking Union space.

The scope of involvement of the FCMC experts and management, as well as intensive information exchange with the ECB had been one of the largest challenges in 2015, but, nevertheless, the gained insight into the developments of the supervisory processes implemented by the Member States has been invaluable and facilitated the experience exchange, thus ensuring the single application of the best practice for banking supervision in the entire Eurozone.

2 https://www.bankingsupervision.eiropa.eu/ecb/pub/pdf/ssmar2015.lv.pdf?fe1a3edc1a5151ee46a7a68a6a96c4e8.

5.3. Insurance sector

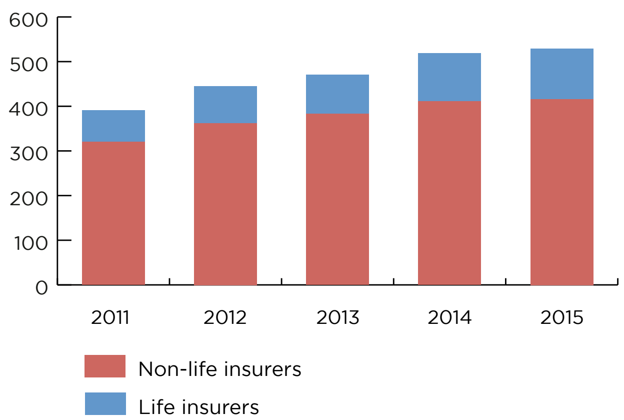
Insurance sector performance indicators

At the end of 2015, eight insurance companies were operating in Latvia (two life insurance and six non-life insurance companies), as well as 14 branches of EU Member State insurance companies (four life insurance and 10 non-life insurance company branches). At the end of December the share of the foreign capital in the shareholders' structure of the insurance companies comprised 44% and was mainly formed of Scandinavian capital.

In 2015, the growth of the insurance market continued, however at an increasingly slower rate. During the year, the volume of gross written premiums of the insurers (insurance companies and branches of foreign insurance companies) only increased by 2.6% to 531 million EUR (including the gross written premiums of the branches of foreign insurance companies, which had grown by 4.2% and reached 29 % of the total premiums written).

The services provided by insurance companies in other member countries of the European Economic Area (EEA) (Lithuania, Estonia, Poland, France, Germany, Spain, Italy) comprised 30% of the total gross premiums written in the insurance market.

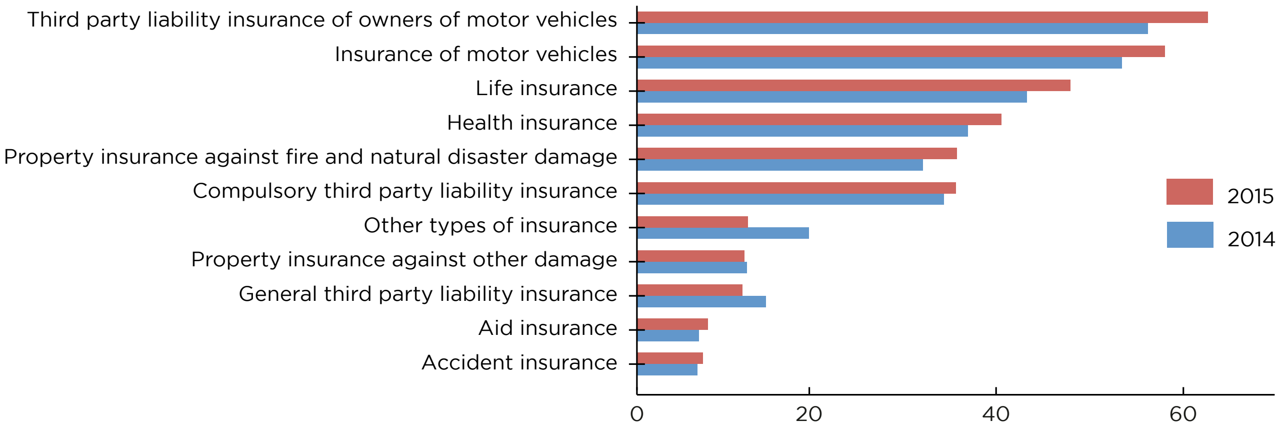
Figure 5.
Dynamics of the premiums written (in million EUR)



Economic growth has facilitated the increase of the interest of the population regarding the long-term investment products. This, in turn, ensures stable growth of the premiums written in life insurance, which, during the reporting period, became one of the most significant types of insurance (the gross written premiums grew by 7.4 million EUR, reaching almost 17% of the total insurance market). The growth in the premiums written was also retained by motor insurance (by 5.9 million EUR), health insurance (by 7.2 million EUR) and property insurance against fire and natural disaster damage (by 13.5 million EUR), but that did not have a material impact on the breakdown of the premiums written in the insurance market.

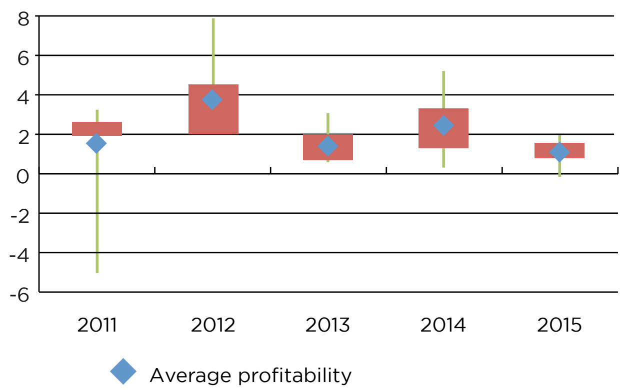
In 2015, the major types of insurance were motor insurance, life insurance products and third party liability insurance of owners of motor vehicles. In terms of the share of the premiums written in the EU Member States, third party liability insurance of owners of motor vehicles, property insurance and motor vehicles insurance prevailed (47%, 21% and 15%, respectively).

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



Along with negative trends in the financial markets, the return on investment of the insurance companies deteriorated – for non-life insurance companies in 2015 it declined by almost one half (from 2.6% to 1.5%), whereas for life insurance companies it declined from 4.9% to 1.1%, which was largely affected by the decline in stock markets (more than one half of investments of life insurance companies were made in equity shares).

Figure 7.
Average annual profitability (%)



During the reporting year the average solvency requirement fulfilment ratio of the insurance companies was almost constantly stable (154%) and exceeded the minimum threshold considerably, among others for life insurance companies – - 202%, non-life insurance companies – 145% (the lowest tolerable threshold of the ratio is 100%).

The prolonged low interest rate environment also had an adverse effect on the earning capacity of the insurers. Overall, in 2015, insurance companies operated with losses (2.5 million EUR), contrary to the profit of the previous year (9.8 million EUR), *inter alia*, the losses of life insurance companies were 915 thousand EUR (largely due to fluctuations in stock prices), whereas the losses of non-life insurance companies were 1.6 million EUR.

The combined ratio[3], characterising the earning capacity of the non-life insurance companies, slightly deteriorated (from 99.9% in 2014 to 101.9% in 2015), evidencing risk underwriting losses) mainly affected by the growth in approved indemnity claims).

In 2015, the types of insurance comprising the sources of profit of insurance companies were mainly property insurance against fire and natural disaster damage (5.9 million EUR) and general third party liability insurance (5.2 million EUR).

Conversely, losses were caused mainly by third party liability insurance of owners of motor vehicles (4.9 million EUR), compulsory third-party liability insurance (6.7 million EUR), as well as property insurance against other losses, motor insurance and health insurance (3 million EUR, 2.5 million EUR and 1.5 million EUR, respectively).

Supervisory measures applied to insurance companies

In 2015, the FCMC carried out two off-site dawn raids of the activities of insurers:

1) off-site dawn raid of the activities of all insurance companies, assessing the fulfilment of the requirements prescribed by FCMC Recommendation No. 296 of 10 December 2014 "Recommendations for the Establishment of an Internal Control System";

3 Combined ratio - approved indemnity claims, operational expenses and other technical expenses as opposed to the premiums earned.

2) off-site dawn raid of the activities of insurance companies and branches of the insurers from the EEA countries in Latvia, assessing the conformity of off-site trade of insurance contracts to the requirement laid down by the laws and regulations.

In 2015, the FCMC carried out an on-site dawn raid of the activities of one insurance company.

During the inspections carried out in 2015, 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.*

The FCMC monitored, 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 2015, the FCMC cooperated with the supervisory authorities of insurance and reinsurance companies of the EEA countries, which implement the supervision of the insurance groups and reinsurance groups whose members were insurance companies licensed in Latvia. In 2015, the FCMC staff ensured the participation in the work of three boards of supervisors supervising the insurance and reinsurance companies of the EEA countries. The topical issues in the work of these boards was the assessment of the financial standing of an insurance and reinsurance group and 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 2015, the FCMC also cooperated with Estonian and Lithuanian insurance supervisory authorities, 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 2015, 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 - providing, on a quarterly basis, information for the needs of the preparation of *Risk Dashboard*, providing information for the needs of the preparation of the *Consumer Report, Spring Financial Stability Report and Autumn Financial Stability Report*, as well as providing answers to other information requests and ensuring the provision of information in accordance with the information requests from the International Association of Insurance Supervisors and the OECD.

In order to implement the requirements laid down in the *Guidelines on the Valuation of Technical Provisions* and *Guidelines on Contract Boundaries* of the European Insurance and Occupational Pension Authority, the FCMC drafted and approved, at the Board Meeting of 6 January 2016, Regulation No. 1 *Regulations on Key Principles for the Calculation of Technical Provisions*.

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 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 2015, 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 2015, the FCMC carried out two off-site dawn raids of the activities of insurance and reinsurance intermediaries:

1) off-site dawn raid of the activities of all insurance and reinsurance brokers (legal entities) registered in the Register of Insurance and Reinsurance Intermediaries maintained by the FCMC, assessing their compliance with the requirements laid down in the *Activities of Insurance and Reinsurance Intermediaries Law* concerning keeping the funds acquired from insurance and reinsurance intermediation distinct from the funds of the insurance and reinsurance intermediary itself;

2) off-site dawn raid of the activities of all insurance and reinsurance brokers (legal entities) and the branches of insurance and reinsurance brokers of the EEA countries in Latvia registered in the Register of Insurance and Reinsurance Intermediaries maintained by the FCMC, assessing the compliance of the off-site trade of insurance contracts with the requirements laid down by the laws and regulations.

In 2015, the FCMC also carried out three on-site dawn raids of the activities of the 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*.

During the carried out inspections, no material violations of the laws and regulations were identified, which would attract sanctions provided for in the *Activities of Insurance and Reinsurance Intermediaries Law*.

To implement the requirements laid down in the *Guidelines for the Review of Complaints Carried out by the Insurance Intermediaries*, the FCMC drafted Regulation No. 206 *Regulations on the Procedure for Reviewing Complaints Regarding Insurance and Reinsurance Intermediaries*, which were approved at its Board meeting on 2 December 2015.

5.4. Cooperative credit unions

Performance indicators of cooperative credit unions

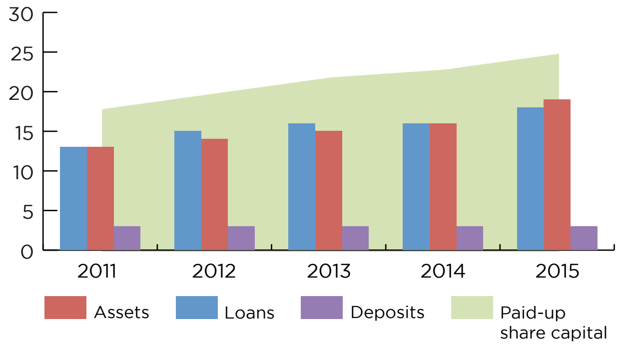
At the end of 2015, 34 cooperative credit unions were operating in Latvia and the total amount of their assets were 25.2 million EUR (i.e., 0.1% of the total assets of the financial and capital market).

The equity of cooperative credit unions / the sum total of the assets and off-balance items ratio, i.e. capital adequacy still remained high in 2015, amounting to 19.6% at the end of December (the set minimum capital adequacy requirement is 10%).

In 2015, the profits of credit unions totalled 408 thousand EUR (in 2014 – 340 million EUR). During the reporting period, the performance of the majority of credit unions (24) was a profit, making 439 thousand EUR in total, whereas the total losses of the remaining credit unions amounted to 31 thousand EUR.

The main source of income of credit unions was interest income on the loans issued to the members of credit unions (66.3%), whereas the most considerable expense items of the credit unions, i.e. administrative expenses, expenses for provisions for doubtful debts and interest expenses on deposits were 43.5%, 30.4% and 18.5%, 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 2015, the balance of loans issued to the members continued to rise (by 1.7 million EUR or 10.2%), totalling 17.8 million EUR at the end of the year, including to the natural persons – 17.6 million EUR and to legal entities – 0.2 million EUR.

During the reporting year the quality of the loan portfolio slightly improved. At the end of December, 60.6% of the loan portfolio of credit unions was assessed as standard, 33.5% qualified as subject to supervision, and 5.9% were the sum total of the non-performing loans (at the end of 2014 – 60.2%, 34% and 5.8%, respectively).

Deposits of members in the financing structure of the unions comprised 99.3%, their balance increased during the reporting year (by 12.3% or 2 million EUR), reaching 18.5 million EUR at the end of December.

Supervisory measures applied to cooperative credit unions

In 2015, the supervision of cooperative credit unions was carried out both 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 the credit unions, as well as by carrying out on-site inspections. During the reporting year, the FCMC experts carried out three on-site inspections and one off-site inspection (in 2014 – 21 inspections in total) 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*.

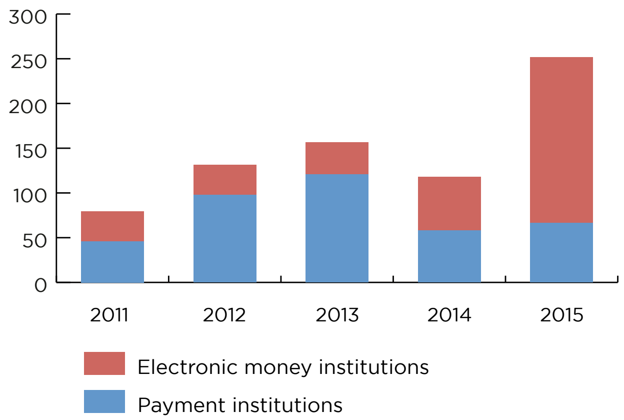
5.5. Payment institutions and electronic money institutions

Performance indicators of the payment institutions and electronic money institutions

At the end of 2015, 35 payment institutions (32 registered, three licensed) and 15 electronic money institutions (12 registered, three licensed) were operating in Latvia.

Along with the development of mobile technologies, fast payments, as well as contactless payments, payment institutions and electronic money institutions are becoming increasingly active in providing payment services. Therewith, in 2015, the total amount of payments performed by the payment institutions and electronic money institutions was 253 million EUR, and increased two times compared to 2014.

Figure 9.
Total annual amount of performed payments (in million EUR)



Sum total of the liquid assets of the payment institutions (funds for the fulfilment of the payments performed by the customers) comprised 2.8 million EUR at the end of 2015, including claims towards the banks for securing payment services – 2.4 million EUR. In turn, liabilities towards the users of payment services comprised 2.6 million EUR.

Supervisory measures applied to payment institutions and electronic money institutions

Supervision of payment institutions and electronic money institutions in 2015 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 volume of electronic money in circulation. Payment institutions and electronic money institutions are required to submit a report on customer funds, in which payment institutions 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, but 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. In 2015, on-site inspections were carried out in three payment institutions. 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 the 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 2015, the FCMC initiated two administrative cases and applied the following sanctions – five payment institutions were removed from the Register of Payment Institutions and Electronic Money Institutions of the FCMC.

5.6. Investment management companies and managers of alternative investment funds

Performance indicators of the investment management companies and managers of alternative investment funds

At the end of 2015, 12 investment management companies were operating in Latvia, whereof six also held licences for the managing of alternative investment funds, and six registered managers of alternative investment funds were operating in Latvia. At the end of 2015, the amount of funds managed by the investment management companies achieved 2.95 billion EUR, whereof 2.35 billion EUR were made up of second-pillar pension investment plans, 331 million EUR – third-pillar pension plans, 223 million EUR – investment funds registered in Latvia (including 217 million EUR – open-end investment funds), 35.7 million EUR – alternative investment funds registered in Latvia, as well as 9.3 million EUR – alternative investment funds registered in other countries. In turn, at the end of the year, the amount of funds managed by the managers of alternative investment funds totalled 52.8 million EUR.

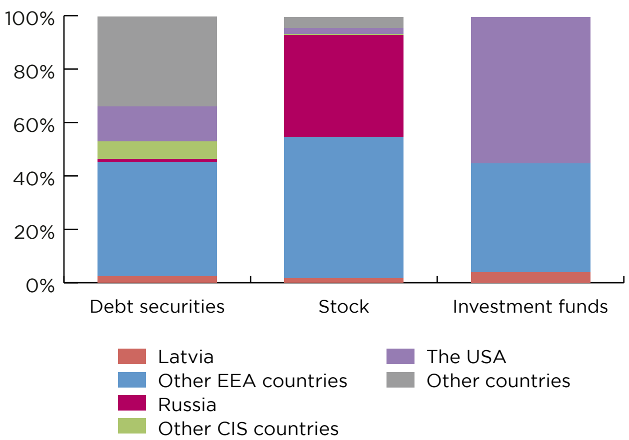
Performance indicators of the open-end investment funds

At the end of 2015, 30 open-end investment funds were operating in Latvia, including 16 bond funds, four mixed funds and 10 stock funds.

In 2015, the total assets of the open-end investment funds grew by 3%., totalling 217.1 million EUR at the end of the year. During the year, both registered money market funds were liquidated (thus, at the end of 2015 there was no money market fund registered in Latvia anymore), as well as one stock fund, but one mixed fund and one bond fund entered the market. At the end of the year, the assets of bond funds totalled 173.8 million EUR, assets of mixed funds – 12.7 million EUR and assets of stock funds – 30.6 million EUR.

Bond 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 (80.8%), followed by investment fund investment certificates (15%), as well as stocks and other variable-yield securities (4%). The greatest share of investments in debt securities and stocks (45% and 54%, 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 was made in the US-registered investment fund certificates (55%), mostly representing the funds traded on the exchange (ETF) (source: *Bloomberg*).

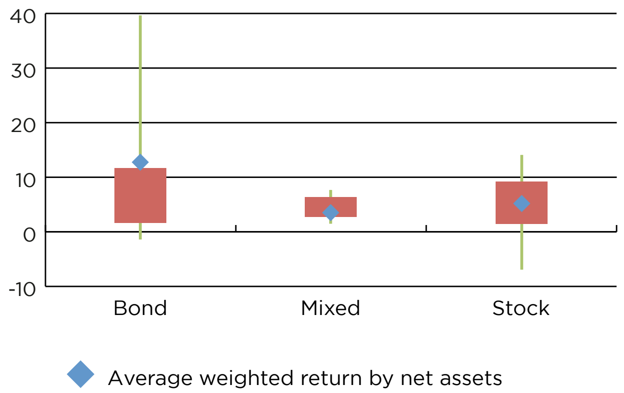
Figure 10.
Securities portfolio of open-end investment funds by type of financial instruments and by group of countries (by the country of registration of the issuer) at 31 December 2015



The majority of investment funds had a positive return in 2015, and their performance was largely determined by the currency of fund investments, namely, large performance in terms of EUR was shown by the funds, whose investment currency is USD, the value whereof considerably grew compared to EUR during the year. The annual return of the open-end bond and money market funds ranged from -1.4% to 39.7% (only two funds had a negative return). The annual return of open-end mixed funds ranged from 1.2% to 8.6%, while that of open-end bond funds ranged from -6.7% to + 13.9% (only one fund had a negative return).

The main focus of the bond funds was on corporate debt securities in the high yield segment, mixed funds had mainly made investments into investment funds certificates and debt securities, which, during the year, totalled 62% and 38%, respectively, of the aggregate securities portfolio of these funds, while the majority of investment of stock funds were made into investment funds certificates (71%), and a considerably significant share – in stock of Russian companies (12%), mainly in the energy and raw materials sectors

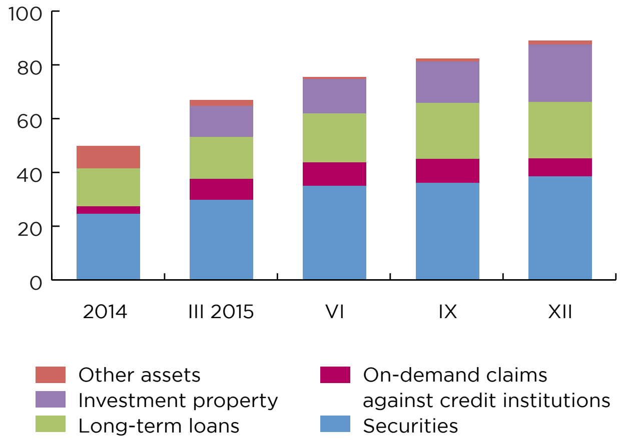
Figure 11.
Annual return of open-end investment funds by type of fund at 31 December 2015 (%)



Performance indicators of alternative investment funds

In 2015, the assets of alternative investment funds grew by 78%, mainly triggered by new investments into real estate, as well as revaluation of the existing investments. At the end of the year, the assets of alternative investment funds reached 88.6 million EUR, the majority thereof being comprised of securities (38.4 million EUR), long-term loans (21.2 million EUR) and investment property (20.9 million EUR). In terms of allocation of strategies, the private capital investments strategy prevailed (60% market share in total assets of alternative funds); the real estate strategy was applied for other funds.

Figure 12.
Structure of the assets of alternative investment funds (in million EUR)



Supervisory measures applied to investment management companies and investment funds

In 2015, the FCMC carried out off-site supervision of investment management companies and investment funds to assess their financial standing, quality of assets, income and costs 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 conformity assessment of key information aimed at investors was carried out, as well as the assessment of whether the synthetic indicators of investment funds set by the investment management funds corresponded to the fluctuation of profitability of the funds.

Closer attention was also 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 received, as well as the planned changes in the area of investment management.

Large exposure profile assessment of investment management companies and investment funds was carried out.

Supervisory measures applied to the managers of alternative investment funds and alternative investment funds

In 2015, off-site supervision of the managers of alternative investment funds (MAIF), to assess the structure of investments in the alternative investment funds managed by them, income and costs structure thereof, as well as the 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.

Special focus was placed on the identification of the MAIF's business models and risks. In order to perform this analysis, several meetings with the representatives of MAIF were organised, debating over the introduction of regulations and the application thereof in practice, in order to achieve uniform understanding on the MAIF business model and the risks inherent thereto. The first on-site inspection of the MAIF was also carried out, which not only allowed the compliance of the activities of the MAIF with the requirements of the laws and regulations to be verified, but also helped to better understand the peculiarities of the activities of MAIF and the differences thereof from other market participants subject to supervision.

Also the meeting of the FCMC representatives with the representatives of all of MAIF was held, during which the MAIF representatives had the possibility to clarify the unclear issues related to the preparation of the supervisory reports and disclosure of assets in accordance with the requirements of the laws and regulations and international standards.

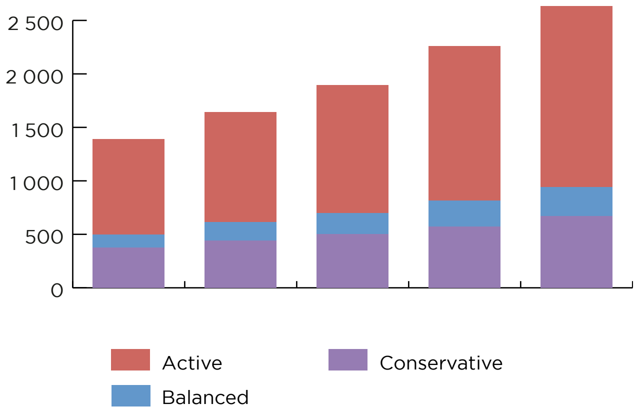
During the on-site inspection of MAIF carried out in 2015, special attention was paid to the appropriateness of the segregation of functions of MAIF to the established organisational structure, adoption and fulfilment of the management decisions, conformity and application of the internal regulatory base and established reporting system. Special attention was paid to the attraction and use of outsourced services. The deficiencies and inconsistencies identified during the inspection were discussed with the management of MAIF 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.

5.7. State-funded pension scheme

Performance indicators of the state-funded pension scheme investment plans

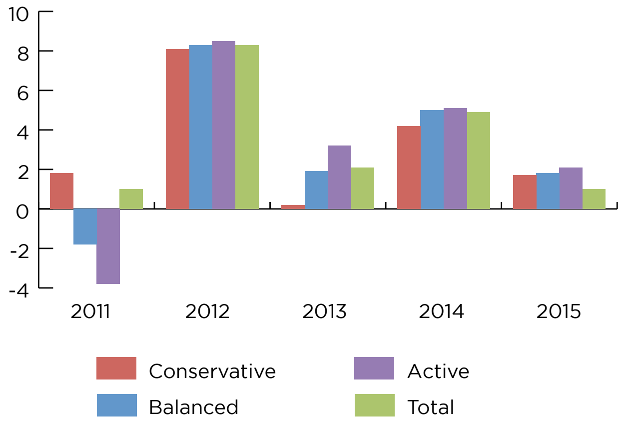
At the end of 2015, 20 investment plans of the state-funded pension scheme were operating in Latvia, including eight conservative plans, four balanced plans and eight active plans. In 2015, the contributions rate to the second pillar pensions was increased, as well as, as a result of successful investments, profit was obtained in an amount of 36.6%. The pension capital accrued in the investment plans of the state-funded pension scheme assets grew by 16.3% or to 327 million EUR in 2015, totalling 2.3 billion EUR at the end of the year. Net assets grew in all investment plan groups, but the steepest growth was observed in the category of active plans.

Figure 13.
Accrued pension capital of the second-pillar investment plans by type of investment plan (in million EUR)



Although 2015 was marked by large fluctuations in financial markets, all second-pillar pension investment plans posted a positive return – for conservative investment plans, which mainly focus on investments in debt securities, it ranged from 0.2% to 2.1%, for balanced funds – from 0.5% to 2.3%, while for active funds, which invest a significant share of funds in stocks or the funds thereof, it ranged from 0.4% to 4.2%. At the beginning of the year, a positive impact on the performance of the investment plans was left by a steep rise in the stock market, mainly triggered by a reduction of interest rates implemented by the leading central banks of the world, while since summer a negative sentiment prevailed in the financial markets, mainly triggered by investor concerns regarding the decrease of economic growth in China.

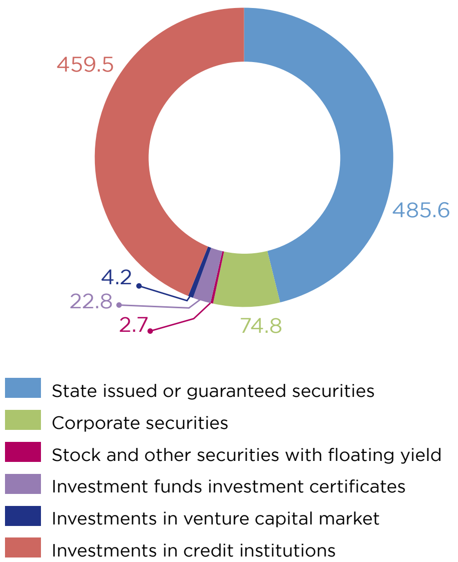
Figure 14.
Weighted average (by net assets) annual return of investment plans (%)



Debt securities accounted for the greatest share in the total investment portfolio of investment plans (46.5%), with the specific weight thereof remaining practically unchanged, compared to the end of 2014. 90% of the debt securities were with the investment credit rating (data source: Bloomberg). By the managers reducing the instability of the investment portfolio and thereby also the risk level, in 2015, the share of term deposits grew from 4.6% to 6.4%, and the share of on-demand claims grew from 8.9% to 13.2, while the share of investments in fund certificates declined (from 37.2% to 31.6%), which is also indicative of the risk level reduction, because the indirect investments in stocks or their indices reduced.

Investments in Latvia grew by 19.8% compared to the end of 2014 and, at the end of the year, they totalled slightly above 1 billion EUR or 45% of total investments (including investments of 485.6 million EUR in the securities issued or guaranteed by the government, 74.8 million EUR – in debt securities issued by commercial companies, 2.7 million EUR – in stocks, 22.8 million EUR – in investment funds, 4.2 million EUR – in the Latvian venture capital market, and 459.5 million EUR was placed with credit institutions). Conversely, investments in securities of the issuers of other EEA Member States accounted for 94% of all the securities of foreign issuers.

Figure 15.
Investments of second-pillar pension plans in Latvia at 31 December 2015 (in million EUR)



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

In 2015, the FCMC carried out off-site supervision of the state-funded pension scheme (SFPS) to assess the quality of assets of investment plans managed by them, 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, 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 also assessed by requesting them to submit internal audit plans and prepared opinions and evaluating them. 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.

In 2015, the large-scale assessment of the risk portfolio of the SFPS investment plans was carried out.

In light of the constantly changing situation in financial markets and availability of the investment objects, more detailed information was additionally required regarding the investments of the SFPS investment plans, in order to assess the trends of changes of portfolios.

Likewise, taking into account the changes in the statutory principles used to calculate the commissions of asset managers, as well as changes in restrictions applicable to investing and notifying the members of the SFPS:

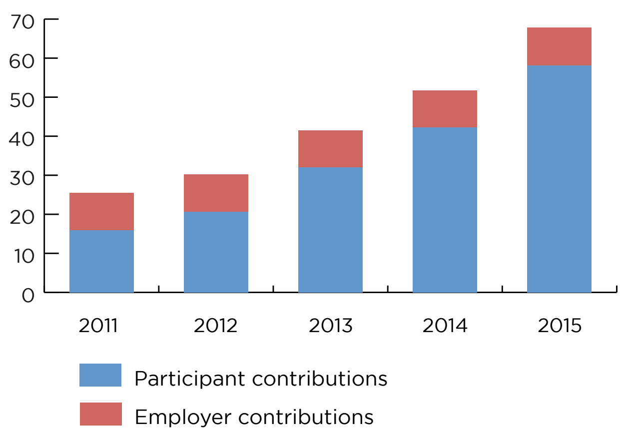
- the key information aimed at the members of all SFPS investment plans were received and reviewed in accordance with the 10 December 2014 FCMC Regulation No. 295 *Regulations on the Preparation of the Key Information to the Members of the State-Funded Pension Scheme*;
- the impact of the new commission calculation principles on the performance of investment plans was assessed;
- the monitoring of the capital increase process of the asset managers of the SFPS was carried out, in order to verify compliance with the new capital requirements.

5.8. Private pension funds and pension plans

Performance indicators of private pension funds

At the end of 2015, five open-end pension funds and one closed-end pension fund were operating in Latvia, administering 15 pension plans in total. Trends such as the steepest increase in the number of participants over the last five years and a new historical maximum in terms of the contributions made by participants were still being observed, just like the year before.

Figure 16.
Contributions into third-pillar pension plans (in million EUR)

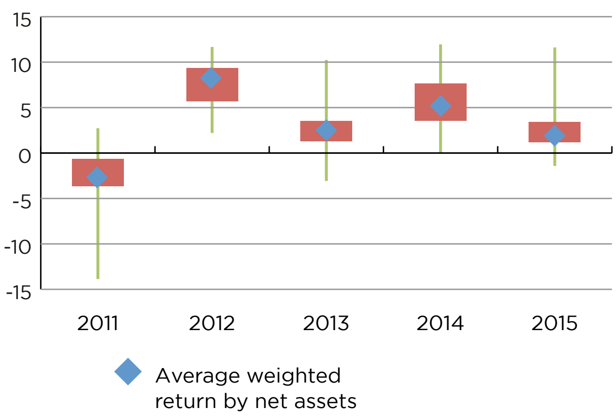


In 2015, 67.5 million EUR were paid into third-pillar pension investment plans, namely, 31% more than in 2014. Along with the improving economic situation of households, during the year, contributions of the participants rose by 38%, and also the employer contributions exceeded the level of the previous year by 2%. At the end of 2015, the capital accumulated by pension plans amounted to 330.4 million EUR, having increased by 17.7% during the year.

During the year, 21.6 million EUR was disbursed from the pension plans capital, which was one quarter more than in the last year, including 97%, where the disbursements were made due to the participants of the plans reaching the retirement age.

Along with fluctuations in the financial markets, mainly triggered by investor concerns regarding a slowdown of the economic growth rates in China and in the world, the return indicators reduced. The average return of pension plans in 2015 was 2% and for individual plans it ranged from 1.2% to 11.3%. For some individual plans an increase in profitability was due to the significant rise in the value of the US dollar against EUR (by 11.5% over the year).

Figure 17.
Average weighted annual return of pension plans (%)

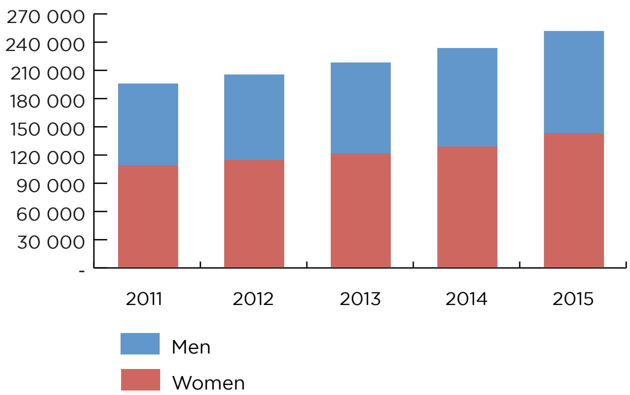


Fund certificates accounted for the major share in the structure of portfolio of pension plans (42%), of which 49% had a focus on stocks or the indices thereof, while 47% had a focus on investments in fixed income instruments. During the year, the share of fund certificates decreased and the share of on-demand claims increased, evidencing the endeavours of the managers to reduce the instability of the investment value, whereas the share of term deposits remained practically constantly low at the level of the end of 2014, triggered by the low interest rate environment. Over the year, the share of debt securities slightly grew, and 72% thereof was comprised of government securities. 88% of the debt securities were with the investment credit rating (data source: *Bloomberg*).

During the year, the amount of investments made in Latvia increased by 21.6 million EUR, totalling 127 million EUR at the end of the year, and also the share of these investments in the total portfolio grew slightly (by one percentage point to 38.4% at the end of 2015). Investments in other EEA Member States accounted for 59.7% of all investments.

In 2015, the total number of participants who joined private pension plans increased by 18.9 thousand or 8%, representing the steepest increase in the number of participants over the last five years, reaching 255 thousand or 25.5% of economically active Latvian residents at the end of the year.

Figure 18.
Number of participants of the third-pillar pension plans



Supervisory measures applied to private pension funds and pension plans

In 2015, the off-site supervision of private pension funds was carried out by assessing the financial standing of private pension funds, quality of assets of pension plans, income and costs 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, on-site inspections of private pension funds were also 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 inspections, particular attention was paid to the appropriateness and sustainability of the internal control system established by the pension fund and the 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. Particular attention was paid 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.

Within the scope of off-site supervision, the FCMC also assessed the critical situation analysis submitted by private pension funds 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 also 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.

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 also carried out in the area of pension fund supervision in committees at the European level. The FCMC representatives participated actively in the work of the European Insurance and Occupational Pensions Authority in the area of pension fund supervision and also in the work of its Occupational Pensions Committee that dealt with topical pension fund supervision issues at the European level. The FCMC 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 updated 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 also 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 ensuring of measures within the scope of the Latvian Presidency of the EU Council.

5.9. Investment service providers

Performance indicators of investment brokerage firms

At the end of December 2015, of the four investment brokerage firms operating in Latvia, three firms operated at a profit of 5.4 million EUR in total. Income from commission fees and other similar income for the services rendered to customers accounted for 98% of all income of investment brokerage firms, whereas administrative

expenses was the highest expense item, comprising 60% of total expenses.

In 2015, two investment brokerage firms were 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 three firms holding licences for the individual management of the financial instruments of investors, customer assets were transferred into management to one firm only.

During the reporting year, the amount of cash of customers, which was held by investment brokerage firms for the performance of transactions in financial instruments, increased by 84%, totalling 12 million EUR at the end of the year.

At the end of 2015, the capital adequacy ratio of investment brokerage firms was 15.2% (the minimum capital adequacy ratio requirement – 8%).

Supervisory measures applied to investment service providers

At the end of the reporting period, four investment brokerage firms licensed in Latvia (in 2015 the licence of one investment brokerage firm was withdrawn, upon its own initiative), 17 banks registered in Latvia, which had obtained the respective permit, 11 investment management companies registered in Latvia and holding the relevant licence had the right to provide investment services in Latvia. Also three branches of foreign investment brokerage firms from other EU Member States, five branches of banks from other EU Member States, as well as over 1, 700 investment service providers from the EEA countries were entitled to provide investment services according to the principle of freedom to provide services.

In 2015, in the field of the provision of investment services the FCMC in total completed two full-scale on-site inspections, commenced one planned full-scale inspection, as well as commenced one ad-hoc inspection, at the end of the year.

In addition to the on-site inspections, two mystery shopping inspections were carried out aimed at obtaining information and assessing the practice of the provision of consultations regarding investments in financial instruments and offering investment products to private customers.

During the inspections, the FCMC assessed the compliance of the provided investment services with the requirements of the laws and regulations, for example, the process of granting customer status, disclosing information to the customer about financial instruments and the risks pertaining thereto, ensuring the customers with the best outcome of the transaction, 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 also assessed the topicality of internal processes and documents of investment service providers and their compliance with the requirements of the laws and regulations.

In addition to the performed on-site inspections, in 2015, one bank poll was carried out aimed at clarifying the situation with respect to the banking practice in Latvia in offering loans to the customers with a floating interest rate accompanied with some derived financial instrument, for example, interest rate swap contract, and the volume of information disclosed to the customers regarding such type of service, paying special attention to whether the customer is sufficiently informed about the risks pertaining to the particular service. In 2016, supplements are planned to be introduced to the FCMC guidelines describing the best practice in offering such products.

Sanctions and corrective measures

For violations and deficiencies in the area of providing investment services detected during the inspections performed in 2015, at the beginning of 2016, an administrative agreement was entered into with one participant of the financial and capital market under which the market participant undertook to eliminate the identified violations and deficiencies within a specified term, as well as to pay a fine of 72, 000 EUR under the administrative agreement. In the rest of the cases, no deficiencies were detected for the FCMC to impose sanctions or corrective measures of another kind.

With the purpose of promoting the protection of investors and uniform understanding of the investment service providers regarding practical application of the requirements of legal acts, in April 2015 the FCMC approved the *Guidelines on the Application of Separate Provisions of the Financial Instruments Market Law Governing the Provision of Investment Services*.

5.10. Financial instruments market

Activities of issuers of the financial instruments listed on the regulated market and supervisory measures applied thereto

At the end of the reporting year, AS *Nasdaq Riga* (Stock Exchange) was operating in Latvia as the only regulated market. At the end of 2015, the shares of 26 joint stock companies (issuers) were listed on the Stock Exchange. The bonds of two new issuers were included in the securities listing in 2015, and, at the end of the year, it included 54 various debt securities issues in a total of 14 issuers, whereof 12 issues were Latvian government debt securities and 42 issues were corporate debt securities.

The FCMC continuously monitored whether the issuers disclosed information in a timely manner and in compliance with the requirements of the *Financial Instrument Market Law* (FIML).

In 2015, having identified the violations and assessed the duration and significance of the commenced violation, in eight cases the FCMC required issuers to take measures to eliminate the deficiencies in disclosing mandatory information in the future (i.e., applied corrective measures), and passed two decisions in the administrative case initiated against the issuer for violations in disclosing mandatory information (administrative acts were issued, applying the following sanctions – in one case a warning was expressed to the issuer and in one case – a fine in an amount of

5, 000 EUR was imposed). In one administrative case initiated in 2015 against the issuer for violations in disclosing information, the decision has not yet been adopted at the end of 2015.

In 2015, 17 off-site due diligence inspections of the annual reports of the issuers and six off-site due diligence inspections of the interim statements were carried out. During the performance of the off-site due diligence inspections of the reports of the issuers, deficiencies were detected in the preparation of the reports and measures were taken for the prevention of material identified deficiencies in the respective reports, ensuring that the users of the report have available financial information of the issuers prepared in accordance with the requirements of the legal acts. At the end of 2015, within the scope of educational measures of the market participants, a letter was sent to all the issuers with the summary of the most frequent deficiencies, to promote the improvement of the quality of reports and prevent such deficiencies from repeating in the reports of subsequent periods.

To promote the observance of the rights of the shareholders provided for in the laws and regulations, in 2015 FCMC also sent two letters to the issuers, directing the attention of the issuers to the relevant requirements of the legal acts.

Trading in financial instruments

In 2015, the regulated market of Latvia – Stock Exchange experienced an increase in the stock market trading activity, mainly related to the mandatory stock repurchase offer of AS *Ventspils nafta*. If in 2015, compared to 2014, the total number of transactions in the stock market increased by 11.6%, the number of traded shares grew by 336%, and the total turnover in the stock market in 2015 was 45.4 million EUR, which is 163% higher than in 2014. At the end of 2015, the stock market capitalisation in the Stock Exchange, compared to the end of 2014, had increased by 48% to 1, 272 million EUR.

Conversely, on the Baltic alternative market *First North*, also in 2015 the shares of only one company were traded, and the trading activity was very low, with the total turnover amounting to 4.6 thousand EUR in 2015.

To promote the stability of the financial instruments market and transparency of the operations thereof, the FCMC continuously carried out supervision of trading in financial instruments by following the transactions closed by the shareholders and analysing the orders submitted to the Stock Exchange, as well as to the alternative market, 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. In one case regarding possible insider dealing, the FCMC sent information to police for the assessment and adoption of a decision on the initiation of criminal proceedings. In five cases the FCMC directed the attention of the investors to the fact that there are features of market manipulation observed in the closed transaction, and requested them to immediately cease the actions that might mislead other investors regarding stock price, demand and supply (i.e., applied corrective measures).

The FCMC also supervises, on a regular basis, whether the information on changes in a significant holding (5% and more) is disclosed and whether the information regarding the transactions closed by the insider is notified. Having verified whether the persons on the insiders' list have met the requirement of the FIML regarding the provision of a notification to the FCMC on the transactions performed by them, as well as whether the persons, according to the FIML, have notified of the acquisition or disposal of a significant holding, in 2015, the FCMC, in five cases in total, applied corrective measures to the persons (as the identified violations were minor and not long-lasting, the FCMC did not initiate the administrative processes, but rather reprimanded the persons, requesting them to eliminate the deficiencies in the future). The FCMC also initiated two administrative cases against the persons for a failure to timely notify of the transactions closed by the person included in the insiders' list, but, at the end of the 2015, a decision has not yet been adopted in the referred to administrative cases.

5.11. Security of financial services and information systems

In 2015, the FCMC carried out the scheduled on-site information system security audits in six banks (out of which one within the scope of the SSM), in one insurance company and four payment institutions. Particular attention was paid to the security of the provision of remote services.

Considerable work input was made in assessing the conformity of the applications of market participants for the registration or licensing of new services or new market participants to the requirements of the statutory regulations of information systems.

In 2015, the FCMC, taking into account the guidelines approved by the European Banking Authority on the security of internet payments addressed towards a higher level of security of internet payments, included these requirements into its regulations on information systems.

During the reporting year, the FCMC maintained close cooperation with the authority for the prevention of security incidents of information technologies CERT.LV and took part in the meetings of the working groups of the Information Technologies and Information Systems Security Expert Group (SEG), sharing experience regarding topical information systems security hazards and the methods for the prevention thereof.

5.12. Anti-money laundering

As regards the AML/CTF field, 2015 marked significant changes in the regulatory framework, in the supervisory processes of the banks' AML/CTF compliance, as well as in ensuring the AML/CTF supervisory function carried out by the FCMC.

The need to refine the regulatory framework was determined by both the growing requirements in accordance with the EU AML/CTF Directive IV, and the international AML/CTF standards, as well as the money laundering and terrorist financing (ML/TF) risk profile of the Latvian financial sector, including mastering the high risk market segments and development of the high risk financial services, as well as the increase in the volume thereof. The AML/CTF risks grow along with the volume of transactions, new technologies impede the possibility of the banks to identify the actual person in whose interests the transactions are closed, but the operation of the global financial system in an uninterrupted mode significantly eases the fast concealment of proceeds from criminal activity (in the AML/CTF terminology – integration, layering and placement). Risk is also enhanced by the geopolitical tension and international terrorism. The AML/CTF compliance requirements increase throughout the world, and, if Latvia wishes to maintain, in the long run, its status of the regional financial centre in the global financial services market, its financial sector must be able to meet the AML/CTF requirements to the full extent and be ready to make the necessary improvements and investments both in staff resources and technologies. The process of Latvia's joining the OECD played the role of the catalyst, as, within the scope thereof, the comprehensive assessment of the national risks were carried out aimed at identifying their level and the measures to be taken for risk mitigation. For Latvia, as a new and growing regional financial centre servicing a considerable volume of non-resident funds, including from countries with elevated corruption and ML/TF risk, one of the key sections was exactly the adequacy of the ML/TF risk management. Special attention was paid to combating corruption and bribery of foreign officials, therefore the issue was reviewed by the relevant OECD committee, focussing exactly on the financial services to non-residents and the management of the ML/TF risk pertaining thereto. Regulation, banking supervision results, as well as information available in the mass media regarding the possible involvement of the banks of our country in illegitimate financial transactions was assessed. In accordance with the requirements the FCMC developed a number of draft law amendments, as well as refined its own regulations and recommendations for the ML/TF risk management processes. The amendments to the *Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing* are to be mentioned as the key ones, including, on the basis of the requirements of the EU AML/CTF Directive IV as regards the extended definition of the politically exposed persons (PEPs), not only local officials, but also seven new PEP categories (judges, heads of municipalities, etc.). Also the circle of family members of the PEP was extended (adding grandchildren, grandparents, adopted children), as well as close associates thereof, including not only business partners, but also the persons with whom PEP has established close relations. To put the PEP identification and the management of risks associated with the transactions thereof in more detail, the FCMC developed guidelines for the fulfilment of the supervision of PEP and risk mitigation measures.

The FCMC refined the regulations on the due diligence of high risk customers (approved by the FCMC Council on 23 December 2015), stating detailed requirements to carry out, during cooperation with the customer, a segmented customer risk assessment, including with respect to the customer itself, its beneficial owner, geographical risk, services to the provided and their delivery channels. The FCMC regulations were developed and adopted on the ML/TF risk management of the banks, setting the requirements for the banks to identify its ML/TF risk appetite (numerical limits), to follow, on a regular basis, the observance thereof and to submit reports to the FCMC regarding this risk exposure, as well as carry out the ML/TF risk stress testing, on an annual basis. The FCMC also developed the recommendations with respect to the use of agent services for customer identification, as well as the supply of information technologies and staff necessary for the ML/TF risk management, which must be adequate for managing the existing and planned ML/TF risk exposure of the bank.

The FCMC also prepared the necessary amendments not only to the Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering), but also to the *Law on the Financial and Capital Market Commission* and to the *Credit Institutions Law*, to ensure the necessary authorisation for raising the efficiency of the supervisory functions (appointment of external audit for the AML/CFT compliance checks of the banks and testing the supply of information technologies, additional delegation for the development of statutory requirements, specific online access rights to the informative resources of the bank, etc.). The banks became subject to increased fines for violations of the AML/CFT requirements and enhanced personal liability of the officials. The accomplishments of 2015 also triggered a positive outcome in the process of joining the OECD.

The FCMC has developed new key principles for AML/CTF supervision, providing for:

- risk-based approach to banking supervision, defining different supervisory requirements for the banks with different ML/TF risk exposure;
- considerably increased AML/CTF supervisory resources both in terms of the number and qualification of employees and information technologies supply;
- regular AML/CTF conformity assessment of the banks (including the supply of information technologies corresponding to the AML/CTF requirements) with the participation of the independent audit;

The AML/CTF conformity check in the sector of Latvian banks focussing their activities on servicing non-residents has already been commenced in 2015, carried out by professional US consulting companies with considerable experience in the AML/CTF field. Results of the inspection will allow the set of the necessary improvements to be carried out by the banks in the AML/CTF field to be identified, in order to maintain and successfully develop the cooperation with international financial institutions and, mainly, US correspondent banks.

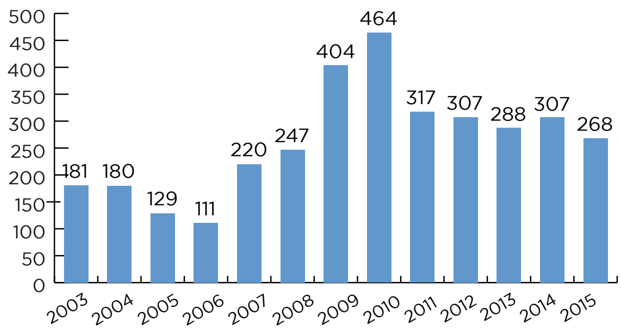
At the same time, the FCMC continued its regular supervision in the AML/CTF field, and, already at the end of 2015, the bank, the deficiencies in whose internal system formed the basis for involvement of the bank in the servicing of large-scale flows of proceeds from criminal activity, received the up to now largest fine, and a requirement was also set for it to take a number of material corrective measures, including change of the management board. This decision of the FCMC proves that the servicing of non-transparent cash flows in the Latvian financial sector will not be a profitable and safe business anymore.

5.13. Review of customer complaints on the actions of market participants

The protection of the rights of customers of market participants and review of complaints on the actions of market participants remained a considerable aspect of the FCMC supervision in 2015 as well.

In 2015, the FCMC received and reviewed 268 applications in total regarding actions of the financial and capital market participants – 154 – on the credit institutions, 63 – on insurance companies, three – on insurance intermediaries, 16 – on the financial instruments market participants, one – on the credit union, two – on investment management companies, three – on payment institutions, nine – with respect to the market participants under liquidation, and 17 more applications were received regarding various issues related to the financial market.

Figure 19.
Number of received complaints by years



In all cases, the FCMC asked the market participants to provide explanations, after the assessment whereof, the FCMC provided answers or advice on its merits to the customers, within the scope of the FCMC competence.

Taking into account that within the process of supervision of credit institutions it is being controlled, whether the credit institutions meet the requirements of the *Credit Institutions Law* and the laws and regulations subordinated thereto, the FCMC experts verified whether the actions of the credit institutions have the features of violations of these laws and regulations. Having reviewed that which was mentioned in 132 complaints, the FCMC has not detected violations of the Credit Institutions Law and the laws and regulations subordinated thereto in the actions of the credit institutions, but the FCMC will use the findings mentioned in 16 complaints for the needs of supervision. In turn, having verified that which was mentioned in six complaints, deficiencies in the internal control system of the credit institution were detected. In 2015, the most frequent cause of complaints of the customers of the credit institutions to the FCMC – 48 times – was servicing of deposits and accounts, 42 times – lending services, 16 times – fulfilment of the orders of sworn bailiffs, 11 times – cooperation with the bank, 19 times – other causes were mentioned and 10 complaints were filed regarding payment cards, four – regarding authorisations and two – regarding the commission and transactions in financial instruments.

Having reviewed 63 complaints from the customers of insurers, the FCMC has not detected any violations of the laws and regulations, which would attract sanctions provided for in the *Law on Insurance Companies and the Supervision Thereof*.

6. LICENSING

In 2015, minor changes could be observed in all financial market segments. The trend observed in 2014 was still present, namely, that, with the coming into effect of the law on *Alternative Investment Funds and the Managers Thereof*, market participants carried out their core activities in compliance with the law, thereby registering or receiving a licence from the FCMC – in 2015, four managers of alternative investment funds were licensed and one manager of an alternative investment fund was registered. In 2015, all 17 banks continued their activities. In 2015, one new branch of the bank – *AS LHV Pank Branch in Latvia* – started to operate, but it, nevertheless, was already dissolved on 1 March 2016.

Also in the licensing of the banks, in 2015, the refining of the SSM continued and the ECB was in charge of decision-making in areas such as the issuing of licences 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 also been actively involved in this process, and it is still the authority responsible for the examining of the submitted documents and preparation of a draft decision, which is subsequently submitted to the ECB for a final decision.

In 2015, the number of cooperative credit unions grew and the licences were issued to two new credit unions.

In 2015, changes also occurred in the number of licensed payment institutions and electronic money institutions, namely, the licence was received by three new payment institutions and one electronic money institution, and these changes were mainly related to the growth and expansion of business.

2015 was a relatively calm year for insurance companies and investment brokerage firms, where there were minor changes in the number of participants.

Table 1.
Changes in the number of licensed market participants in 2015

	AT THE BEGINNING OF 2015	AT THE END OF 2015	NEW MARKET ENTRANTS IN 2015
Banks	17	17	0
Branches of EU Member State banks	9	9 (-1 company)	+1[4]
Cooperative credit unions	32	34	+2[5]
Providers of banking services from the EEA	309	312 (-5 companies)	+8
Insurance companies	7	8	+1[6]
Branches of EU Member State insurers	14	14 (-1 company)	+1[7]

4 Branches of EU Member State banks: On 2 February 2015 *AS LHV Pank Branch in Latvia* was registered (dissolved on 1 March 2016). On 14 December 2015 *Skandinavska Enskilda Banken AB* Riga Branch announced the termination of the provision of financial services

5 Cooperative credit unions:
On 6 July 2015 a licence was issued to the *Cooperative Credit Union Latvijas Lauksaimnieku krājaizdevu sabiedrība*.
On 1 October 2015 a licence was issued to the *Cooperative Credit Union Rīgas kooperatīvā krājaizdevu sabiedrība*.

6 Insurance companies:
On 16 June 2015 a licence was issued to *AAS BTA Baltic Insurance Company*.

7 Branches of EU Member State insurance companies:
On 28 October 2015 the Latvian branch of *Compensa Vienna Insurance Group UADB* was registered.
On 22 October 2015 the Latvian branch of *MetLife Towarzystwo Ubezpieczen na Zycie i Reasekuracji Spolka Akcyjna* terminated its operations.

	AT THE BEGINNING OF 2015	AT THE END OF 2015	NEW MARKET ENTRANTS IN 2015
Branches of EU Member State insurers	501	524 (-5 companies)	+28
Providers of insurance services from the EU	12	12	0
Investment management companies	23	23	0
Providers of investment management services from the EEA	5	4 (-1 company)[8]	0
Investment brokerage firms	2	2	0
Branches of investment brokerage firms of the EU Member States	1 828	1 857 (-89 companies)	+118
Providers of investment brokerage services from the EEA	24	26	+2
Tied agents of providers of investment services from the EEA	6	6	0
Private pension funds	88	89 (-5 companies)	+6[9]
Insurance brokerage firms	544	512 (-58 agents)	+26
Insurance agents	234	291 (-11 companies)	+68
Providers of payment services from the EEA	34	33 (-5 companies)	+4[10]
Payment institutions (registered)	0	3	+3[10]
Payment institutions (licensed)	11	12	+1[11]
Electronic money institutions (registered)	2	3	+1[11]
Electronic money institutions (licensed)	50	70 (-1 company)	+21
Electronic money institutions from the EEA	2	5	+3[12]
Licensed managers of alternative investment funds	6	7	+1[12]

8 Investment brokerage firms:
On 22 July 2015 the licence of the investment brokerage firm *Prudentia* was withdrawn.

9 Insurance brokerage firms:
On 25 June 2015 SIA *Eirope Marine Group* was registered.
On 1 September 2015 SIA *INVESTIMUS* was registered.
On 22 September 2015 SIA *Apdrošināšanas veikals* was registered.
On 27 November 2015 SIA *Globale Insurance* was registered.
On 8 December 2015 SIA *AZ Brokers* was registered.
On 16 December 2015 SIA *B Service* (currently - SIA *Insteligent Brokers*) was registered.
In 2015, the entries related to the following insurance brokerage firms were withdrawn from the Register of Insurance Brokerage Firms: SIA *LG Broker*, SIA 96 *Apdrošināšanas Brokeris*, SIA *Baltic Insurance Group*, SIA *BB Broker Systems*, SIA *PrivatBrokeris*.

10 Payment institutions:
On 16 September 2015 a licence was issued to SIA *Baltic Payment Solutions*.
On 11 June 2015 a licence was issued to SIA *Monetizator* and to SIA SOLLO LV.
In 2015, the following payment institutions were registered: SIA *Bilderlings Pay*, SIA *Money Express*, SIA *PayB*, SIA *PAYDELTA*.
In 2015, the entries related to the following payment institutions were deleted from the Register of Payment Institutions: SIA *MAXIMA LATVIJA*, SIA *KOMUNĀLKASE*, SIA *E-Pays*, SIA *DIXIPAY*, SIA *Plus Punkts*.

11 Electronic money institutions:
On 29 July 2015 a licence was issued to SIA *Dukascopy Payments*.
In 2015, the electronic money institution SIA LRG Service was registered.

12 Managers of alternative investment funds:
On 11 February 2015 a licence was issued to AS *Aquarium Investments* Investment Management Company.
On 9 September 2015 a licence was issued to the investment management joint stock company *INVL Asset Management*.
On 16 September 2015 a licence was issued to AS NORVIK *ieguldījumu pārvaldes sabiedrība*.
On 7 October 2015 the investment management joint stock company *M2M Asset Management* was registered as the manager of alternative investment funds.

7. RESOLUTION MECHANISM

Noregulējuma mehānisma principi

In 2015, the new directive (*Bank Recovery and Resolution Directive* (BRRD)) came into force in all EU Member States regarding a framework for the recovery and resolution of credit institutions and investment firms, establishing one of the three stability pillars of the financial system – single resolution mechanism.

The main objectives of the introduction of the resolution mechanism are as follows:

- to determine a single approach and efficient tools throughout the entire EU, to timely prevent the consequences related to the banking crisis;
- to protect the stability of the financial system and ensure the continuity of the critically important functions of the banks;
- to considerably minimise the possibility of losses for the tax payers, stating that the expenses for saving a credit institution important to the financial sector or the economy of the country are covered by the shareholders and creditors of the credit institution;
- to establish an efficient cross-border banking groups resolution mechanism

To promote the achievement of these objectives, when introducing the BRRD in Latvia, a new law was developed and took effect on 1 July 2015 – *Law on the Recovery and Resolution of Credit Institutions and Investment Firms*, and the amendments related to the introduction of the resolution mechanism were also introduced to four more laws. The FCMC experts got actively involved in the development of legal acts related to the introduction of the resolution mechanism, providing methodological support to the Ministry of Finance, as well as developed several FCMC regulations related to the practical implementation of the resolution mechanism.

According to the changes in the Law on the Financial and Capital Market Commission the functions of the authority in charge of the resolution in Latvia were vested upon the FCMC. To implement the referred to function, a separate structural unit was set up in the FCMC – Resolution and Guarantee Funds Division, the activities and functions whereof are segregated from the supervisory functions,

as provided for by the BRRD. The resolution institution is in charge of the preparation of resolution plans, performance of the resolution activities (or recovery) for institutions, the resolution whereof is required in the interests of the public, or of the adoption of decisions on the non-application of a resolution, as well as of the accumulation of funds in the Single Resolution Fund.

2015 was the period of implementation of the resolution mechanism. A Single Resolution Board (SRB) was established, which, in cooperation with the involved national resolution authorities of the EU member States (including the FCMC) will be in charge of the efficient and coordinated operation of the single resolution mechanism, of the establishment of the Single Resolution Fund, the management and use of the assets thereof, as well as of the performance of functions of the resolution authority with respect to the credit institutions under the direct competence of the SRB.

The resolution mechanism is also applicable to the investment brokerage firms, subject to the minimum equity requirement in an amount of 750, 000 EUR. For the time being, there is no such investment brokerage firm in Latvia.

The process of formation of the single resolution mechanism will also continue in 2016. Regulation of the European Parliament and of the Council establishing the Single Resolution Mechanism has come into full effect as of 1 January 2016.

Introduction of the resolution mechanism

The single resolution mechanism implemented by the SRB, with the main objective whereof being to ensure the stability of the European financial system, has already partially taken effect on 1 January 2015. Taking into account that Latvia is a Eurozone country, it automatically obtains the status of a member state of the single resolution mechanism. Therewith Latvian credit institutions subject to the direct supervision of the ECB, within the scope of the SSM, as well as cross-border group credit institutions automatically become subject to the competence of the SRB as the resolution authority. These are credit institutions under the supervision of the ECB such as *Swedbank, SEB banka, ABLV Bank*, as well *Citadele banka*, because it has its subsidiaries in Lithuania and Switzerland. The functions of the resolution authority of these market participants are fulfilled by the SRB, while the FCMC ensures the preparation of the SRB decision and the implementation of the adopted decisions. Decision-making regarding the application or non-application of the resolution for the rest of Latvian credit institutions, for the time being, is under the competence of the FCMC as the national resolution authority.

To ensure the efficient resolution of the banking groups engaged in cross-border operation, there are 76 resolution colleges organised, within the scope of the EU. The FCMC experts, jointly with the SRB, take part in the colleges organised by the Swedish resolution authority for the *Swedbank* group, *SEB bank* group and *Nordea* bank group (taking into account the importance of the *Nordea* Branch in the Latvian market).

By the Head of the FCMC's Resolution and Guarantee Funds Division participating in the work of the SRB, the FCMC also took part in the process of establishment of the single resolution mechanism.

Planning of the resolution

One of the tasks implemented by the FCMC in 2015 in cooperation with the SRB, within the scope of the single resolution mechanism, is the planning of the resolution of the bank, with the cornerstone and the starting point whereof being the identification and evaluation of the functions of the bank critically important to the stability of the financial sector and the economy of the country.

According to the action plan of the SRB for 2015, out of approximately 150 banks under the direct competence of the SRB as the resolution authority about 40 banks were selected, for which the transitional resolution plan was prepared in 2015. *ABLV Bank* was also among these institutions.

The objective of the resolution plan of the credit institution is to timely prepare for action in the case of crisis:

- to define the critically important functions of the institution and to describe how the continuity thereof will be ensured;
- to assess the possibility and commensurability to apply resolution activities to the institution;
- to select the resolution strategy and suitable resolution tools (asset segregation, sale of the undertaking, temporary institution, internal recapitalisation);
- to determine the minimum requirements for own funds and eligible liabilities (MREL requirement) for the credit institution, to be constantly ensured by the institution so that, in the case of internal recapitalisation, the bank capital is restored at the expense of the creditors.

The preparation of the resolution plan provides for the possibility to conclude that the resolution (or recovery) of a credit institution is not commensurate to the interests of general public and therewith, in the case of crisis, the credit institution, will, most probably, be subject to an insolvency procedure. For such credit institutions the MREL requirements will be equal to the requirement for own funds.

In 2015, the MREL requirement was not yet defined in the transitional resolution plans. The preparation of the resolution plans will continue in 2016.

Single Resolution Fund

The task of the Single Resolution Fund is to ensure the funds, which, in the case of crisis, can be used for funding the resolution of the credit institution, provided that the shareholders and creditors of the credit institution have already made a contribution for absorbing the losses and recapitalisation of the institution in an amount of at least 8% of the total assets of the credit institution.

The Single Resolution Fund is financed by the contributions of the Member States banks (including Latvian banks), aimed at achieving, gradually, by 2024, the amount comprising 1% of the covered deposits in all credit institutions in all involved Member States, which is approximately 55 billion EUR.

Starting from 2016, when the Regulation on the Single Resolution Mechanism has come into full effect, the SRB, in cooperation with the national resolution authorities, is obliged to calculate and collect the contribution of each bank into the Single Resolution Fund. Whereas in 2015, the FCMC was in charge of the calculation and collection of the contributions of the banks and transfer of funds to the SRB.

In 2015, about 6, 000 banks of the Eurozone countries, including 17 Latvian banks, made contributions to the Single Resolution Fund, paying 7.6 million EUR in total. According to the Delegated Regulation of the European Commission regarding contributions in the fund, comparatively small fixed contributions were determined for the minor banks (according to the amount of eligible liabilities). In turn, the major banks, having larger probability that the Single Resolution Fund assets will be used, were subject to the calculation on the basis of the risk ratio. Among Latvian banks, the largest contributions to the Single Resolution Fund were performed by *SEB banka, Swedbank, ABLV Bank* and *Rietumu Banka*.

8. REGULATORY REQUIREMENTS

8.1. National laws and regulations

In 2015, the FCMC continued to improve the regulatory framework governing the activities of the financial and capital market participants. Intensive reforms of the regulatory framework continued, based upon the experience and lessons learned during the financial crisis. To ensure stable development of the Latvian financial and capital market, on the basis of the laws and regulations issued by the EU institutions and taking into account the specificity and dynamic financial environment of the Latvian financial sector, in 2015, the

> FCMC refined the national laws and regulations, not only regulating the activities of the Latvian market participants, but also promoting the protection of interests of the investors, depositors and the insured persons.

In the field of credit institutions the result of those crisis lessons was the **Basel III standards**, the active work on the implementing whereof also continued in 2015. Overall, for supplementing the national regulatory framework four draft amendments to the laws and regulations and four new draft laws and regulations were prepared and approved, binding on the credit institutions, investment brokerage firms, as well as the managers of alternative investment funds. The most important thereof are as follows:

- **Regulations on Calculation of the Countercyclical Capital Buffer Norm Specific to a Credit Institution**, kstating the transactions exposed to a credit risk subject to the countercyclical capital buffer norm, procedure for determination of the countercyclical capital buffer norm applicable to the transactions exposed to a credit risk with Latvian, Member State and foreign residents, date from which the respective countercyclical capital buffer norm is applied, as well as the algorithm according to which the countercyclical capital buffer norm specific to a credit institution is calculated. The FCMC, on a quarterly basis, determines and publishes the countercyclical capital buffer norm for the transactions with Latvian residents, which, for the period of 12 months after the determination thereof, is to be applied in calculating the countercyclical capital buffer norm specific to a credit institution. The geographical structure of the transactions of a credit institution and the countercyclical capital buffer norms determined in the corresponding countries are to be taken into account in calculating the countercyclical capital buffer norm specific to a credit institution;

- **Regulations on Reports of the Funding Plans of Credit Institutions**, which were developed to introduce the guidelines of the European Banking Authority on harmonised definitions and reports for funding plans of credit institutions, applied by credit institutions for reporting purposes to the competent authorities in accordance with the 20 December 2012 Recommendations of the European Systemic Risk Board (ESRB/2012/2). Reports on funding plans provide information regarding the funding plans of the credit institutions for the next three years and allow the planned sources of funding of the credit institutions to be evaluated from different angles (by type, term, price) and the possible impact of the measures provided for in the funding plans, inter alia, on the loan supply for the actual economy of the country.

- **Regulations for the Disclosure of Encumbered and Unencumbered Assets**, defining the conditions according to which the credit institutions and investment brokerage firms disclose information on encumbered and unencumbered assets. The Regulations also prescribe the assets to be treated as encumbered, the characteristic features thereof, minimum requirements for the descriptive information to be additionally provided and uniform templates for public disclosure of the encumbered and unencumbered assets recognised in the accounting records. Uniform templates for the disclosure of information (within the scope of Pillar III) are harmonised with the reports for supervisory needs. The frequency of disclosure of information, means and place for the publishing thereof is stated in accordance with EU Regulation No. 648/2012.

Additionally, the following draft amendments to the laws and regulations and new draft laws and regulations were also prepared and approved: **Regulations for the Review of a Proposal for the Transfer of a Credit Institution Undertaking, amendments to the Regulations on Assets Quality Assessment and Provisioning, amendments to the Regulations on the Preparation and Submission of Information on the Occurrence of the Operational Risk Events, amendments to the Regulations on Reporting**

Requirements for Alternative Investment Fund Managers and the amendments to the Regulations on Remuneration Policy Principles for Alternative Investment Fund Managers.

The requirements of the **Solvency II** Directive, which came into full force as of 1 January 2016, provide for considerable changes in the solvency and supervisory regime for the insurance and reinsurance sector of the EU, as well as stipulate the transition to the new procedure for the calculation of capital requirement based on risk assessment. Unlike the *Solvency I* regime, the new requirements provide for the calculation of capital requirements based not only on the amount of premiums or indemnities, but also on the market risk, credit risk and operational risk, thereby covering all investment -related risks, to which an insurer or a reinsurer is exposed. Changes introduced by the *Solvency II* also refer to fields such as the calculation of technical reserves, evaluation of assets and liabilities, governance system, own funds, supervisory reports, information disclosure and cross-border group supervision. To transpose the requirements of the Directive into the national laws, the **Insurance and Reinsurance Law** was developed and approved, transposing the requirements of the *Law On Insurance Companies and Supervision Thereof and the Reinsurance Law*, not only incorporating the principles of the *Solvency II* Directive, but also establishing a single regulatory framework for the insurance and reinsurance sector in Latvia. Along with the coming into effect of the law, the protection of the interests of policyholders will significantly improve. Additionally, in 2015, the ***Regulations on the Capital Requirement and Calculation of the Own Funds for the Solvency of Insurers and Reinsurers, the Regulations on Internal Models of the Insurers and Reinsurers*** and the ***Regulations on the Calculation of the Solvency of the Insurance or Reinsurance Group of Companies*** took effect.

Amendments to the Law on Investment Management Companies, the law ***On State-Funded Pensions*** and the law ***On Private Pension Funds***. Due to the accession of Latvia to the OECD, it was necessary to prevent the objections received from the Secretariat of the Investments Committee of the OECD, that the OECD Member States are being discriminated among themselves, stating the circle of the countries in whose credit institutions it is permitted to deposit the assets of the State-funded pensions, private pension funds and investment funds. The FCMC prepared the amendments to the *Law on Investment Management Companies*, the law *On State-Funded Pensions* and the law *On Private Pension Funds*. The amendments to these laws provide for the application of equal criteria to all OECD Member States, allowing deposits to be made in a credit institution that has obtained the licence for the activities of a credit institution in the EU Member State or the OECD Member State, where the credit institutions are subject to the supervisory requirements and requirements regulating the activities similar to those applied in the EU Member States. The evaluation on the countries outside the EU, which ensure a similar regulatory framework and supervision in accordance with Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (Regulation No. 575/2013), is provided by the European Commission. In practice, it means that henceforth it will also be possible to deposit the assets of investment funds in credit institutions in Australia and Mexico, whereas in the case of the State-funded pensions and private pension funds - in credit institutions in Australia, Canada, Japan, Mexico, Switzerland and the USA. It will not be possible to deposit the assets of the State-fund pensions, private pension funds and investment funds in the credit institutions of OECD Member States, which are not EU Member States, such as Chile, Israel, Korea, New Zealand and Turkey, because the European Commission has not recognised the supervisory requirements and the requirements regulating the activities applied to the credit institutions of these countries as similar to the requirements applied in the EU.

Amendments to the Activities of Insurance and Reinsurance Intermediaries Law introduced the decision adopted by the European Commission regarding the changes in the minimum third party liability insurance policy limits (Article 4 of the Intermediary Directive), introduced guidelines for the review of the complaints on insurance intermediaries, adjusting and supplementing Section 29 of *the Activities of Insurance and Reinsurance Intermediaries Law* and delegating the issuance of the regulations to the FCMC, as well as determined the supervisory fee for funding the activities of the FCMC and the fee for the review of the amendments to the documents, eliminated the discrepancies, by improving the quality of the law, – Sections regarding sanctions were supplemented and adjusted, the procedure was defined for the opening of a branch in third countries, supplements were introduced to the procedure, when the FCMC is entitled to refuse the review of the documents filed for registration, additional procedures and information were prescribed to be filed to the FCMC for the purposes of registration, amendments were introduced with respect to the activities of insurance brokers and agents, to prevent the existence of a conflict of interest, etc. The amendments also supplemented the law with the provision that the FCMC is entitled to issue the regulations, determining the requirements for the fulfilment of the deductible liability. With respect to these amendments to the law, the ***Regulations on the Requirements for Securing the Deductible Liability Fulfilment of the Insurance and Reinsurance Intermediary*** and the ***Regulations for the Review of Complaints Regarding Insurance and Reinsurance Intermediaries*** were developed and took effect.

Recommendations within the Pre-Application Process of the Internal Models were developed, on the basis of that which is stated in Article 16(3) of the Regulation of the European Parliament and of the Council (EU) No. 1094/2010 of 24 November 2010 that the competent supervisory shall make every effort to comply with that which is stated in the guidelines and recommendations of the European Insurance and Occupational Pensions Authority, as well to promote the protection of the interests of the insured persons in the Republic of Latvia.

Recommendations for Receipt of the Licence of the Payment Institution or Electronic Money Institution or Registration Thereof with the Register of Institutions Maintained by the Financial and Capital Market Commission were developed for the potential market participants, to explain the process of registration or licensing of payment institutions or electronic money institutions, i.e., the best practice was introduced, on the basis of the previously gained experience.

Amendments to the Regulations on the Issue of Credit Institution and Credit Union Operating Licences, Receipt of Permits Governing the Activities of Separate Credit Institutions and Credit Unions, Coordination or Documents and Provision of Information were developed, in order to harmonise the regulation of the regulatory enactment with the Credit Institutions Law and the Commission Implementing Regulation (EU) No. 926/2014 of 27 August 2014 laying down the implementation of technical standards with regard to standard forms, templates and procedures for notifications relating to the exercising of the right of establishment and the freedom to provide services according to Directive 2013/36/EU of the European Parliament and of the Council, and Commission Delegated regulation (EU) No. 1151/2014 of 4 June 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards on the information to be notified when exercising the right of establishment and the freedom to provide services, to adjust the licensing procedures, taking into account the involvement of the ECB in the process of licensing and supervision of the credit institutions, and to adjust the definitions used in the Regulations, as well as to improve and adjust the requirements and procedure for the provision of information.

Amendments to the Law on Alternative Investment Funds and Their Managers, basically introduced Article 92 of Directive 2014/65/EU, which also introduces the options and discretions not applied up to now, arising out of Article 6(4) and Article 12(2) of Directive 2011/61/EU, as well as prevented the deficiencies specified in the violation letter of the European Commission in the introduction of separate Articles of Directive 2011/61/EU and adjusted separate provisions of the law, the corrections whereof were necessary for the use of the law in practice.

Amendments to the Financial Instruments Market Law were developed, in order to transpose the requirements of Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of the transparency requirement in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, to regulate the rights and obligations of the FCMC arising out of Regulation 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, to adjust the FIML with respect to the requirements set for the prospectus to be published when securities are offered to the public or admitted to trading, taking into account EU pilot case 6446/14/MARK, as well as to refine the FIML with respect to the stock repurchase offers and consolidation of the protection of minority shareholder rights.

Amendments to the Financial Instruments Market Law were developed, in order to ensure the introduction of Article 1 of the 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). Amendments adjust the procedure for sending final offer regulations to the authorities, i.e. the competent authority sends them to the competent authority of the Member State and the European Securities and Markets Authority.

Amendments to the Credit Institutions Law were necessary, in order to define in more detail the supervisory authority for adoption of the decision on the issue or refusal of a licence (permit) for the credit institution or the decision on acquisition or prohibition to acquire a qualifying holding within the scope of the SSM, as well as to adjust the provisions (Clause 1 and 3) arising out of Article 22(1) and Article 91 of the 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.

8.2. Macro-prudential tools

Global financial crisis has shown that the micro-prudential supervision, which was mainly focussed on ensuring stability at the level of individual financial institutions, was not sufficient to ensure the stability of the financial system as a whole. Therefore, in addition to the previous supervisory approach, a new macro-prudential supervision was introduced, providing for taking certain measures, in the case of an increase in cyclical (for example, excessive lending increase) or structural (for example, with respect to the systemically significant (too big to fail) credit institutions) risks. In such cases corresponding tools can be applied – capital buffer norms introduced, minimum capital and liquidity requirements increased, stricter restrictions determined for large exposures, etc. In Latvia, the macro-prudential supervision authority is the Bank of Latvia. The FCMC, in turn, in accordance with the *Credit Institutions Law*, is in charge of the application of the macro-prudential supervision tools. Starting from 2015, the FCMC, on a quarterly basis, determines and publishes the countercyclical capital buffer norm for transactions with Latvian residents. The countercyclical capital buffer norm is intended to ensure that the credit institution, during its economic growth, accumulates sufficient capital base, in order to absorb losses during a slowdown – it will serve as a certain kind of safety buffer for credit institutions, for them to be able to also continue lending activities under unfavourable economic conditions. According to the estimates of April 2016, the countercyclical capital buffer norm for transactions with Latvian residents will be determined in an amount of 0% till 2018.

The financial crisis has demonstrated the presence of systemically significant financial institutions, which, when faced with problems, also influence other financial market participants, as well as the actual economy. The criteria for the institution to be deemed systemically significant are related to its size, replaceability, significance within the infrastructure of the financial system, complexity of operations and cross-border activities, as well as interconnection with other institutions. Taking into account the activities of the systemically significant financial institutions and their material role in the financial sector, the need arises to introduce additional requirements, for example, elevated capital buffer norms, in accordance with the significance of the institution. The use of macro-prudential tools allows the most significant financial market participants to be made considerably more resistant to unforeseen circumstances. According to Section 35.[9] of the Credit Institutions Law the FCMC, on an annual basis, identifies the credit institutions which are OSSIs (other systemically significant institutions)[13], as well as is entitled to determined the OSSI capital buffer requirements for them in an amount of up to 2% of the risk-weighted assets. In 2015, the FCMC identified six systemically significant credit institutions in the local financial sector, the list whereof is posted on the FCMC website, as well as determined that they will not be eligible for allowances, ensuring the observance of separate corporate governance requirements.

8.3. Introduction of the EU regulation

To ensure a harmonised approach, the majority of the EU laws and regulations are being increasingly adopted as directly applicable EU legal norms – regulations and the delegated acts of the European Commission. Therewith, the work during the development of drafts of these directly applicable EU legal norms become increasingly important, participating in the respective working groups and committees, preparing the positions

13 The FCMC carries out the identification of the OSSIs in accordance with the European Banking Authority Guidelines (EBA/PN/2014/10). The Basel Committee on Banking Supervision, in cooperation with the Financial Stability Board, has also identified and published the list of globally systemically significant credit institutions (3 November 2015), which does not contain credit institutions licensed in Latvia, but the list, nevertheless, identifies the *Nordea* Group, with *Nordea Bank AB* Branch in Latvia operating within the scope thereof.

and proposals. After the adoption of the regulations and the delegated acts of the European Commission, the preparatory works must be performed for the application thereof and control over the observance of the requirements of the regulations and the delegated acts of the European Commission. A particular challenge is the introduction of single reporting forms, which is a large-scale and technically complex task, requiring close cooperation of several structural units for both the FCMC and market participants. The FCMC provides methodological support to market participants in the process of preparation of the reports and carries out enhanced control over the quality of the reports, thus obtaining confidence regarding the compliance thereof to the quality requirements.

In 2015, the FCMC also put voluminous efforts into the process of development of ECB Regulation (EU) 2016/445 of 14 March 2016 on the exercising of options and discretions available in Union law, stating the options and discretion of the ECB granted to the competent authorities in accordance with the EU legal regulation regarding prudential requirements with respect to credit institutions, (the Regulation is also applicable to credit institutions under the direct supervision of the SSM) and in the introduction of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No. 575/2013 of the European Parliament and the Council with regard to the liquidity coverage requirement for Credit Institutions, adjusting the procedure for calculation of the liquidity coverage ratio.

8.4. EU directives and regulations adopted in 2015

- **Credit institutions and payment services sector**

Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No. 684/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Document with EEA relevance) and Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No. 1781/2006 (Document with EEA relevance).

The purpose of the Directive is to harmonise the existing regulation with the revised international AML/CTF standards and the supplemented recommendations of the Financial Action Task Force (FATF). 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 of the 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.

The Member States must transpose the requirements of the Directive into national law by 26 June 2017 and the provisions of the Regulation are applicable from 26 June 2017.

Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No. 1093/2010, and repealing Directive 2007/64/EC and Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions.

The Directive and Regulation 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.

The Member States must transpose the requirements of the Directive into national law by 13 January 2018 and the Regulation is to be applied from 8 June 2015.

- **Financial instruments market sector**

Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on 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.

The provisions of the Regulation are applicable from 9 December 2015.

Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No. 648/2012

The Regulation 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.

The provisions of the Regulations, as a whole, must be applied from 12 January 2016, but separate Articles thereof – from 13 July 2016.

- **Insurance and pension funds sector**

Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast)

The objective of the recast wording of 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 insurance mediation. The recast wording seeks to ensure a level playing field for all participants of the insurance and reinsurance service market and enhance 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.

The Member States are required to transpose the requirements of the Directive into national law by 23 February 2018.

At the same time, during 2015, a number of European Commission delegated and implementing regulations were adopted, laying down technical standards for the application of separate previously adopted EU legal norms, *inter alia*, 17 delegated and implementing regulations with respect to the prudential requirements and supervision of the investment brokerage firms *(CRR/CRD IV)*, two – with respect to the implementation of the prospectus directive, two – with respect to the implementation of the directive regarding the harmonisation of transparency requirements in relation to information about issuers, 23 – with respect to implementation of the *Solvency II* Directive in the field of insurance, seven delegated and implementing regulations with respect to the European Market Infrastructure *(EMIR)*, one delegated regulation for the implementation of the directive on the undertakings for the collective investment in transferable securities *(UCITS V)*, as well as three delegated regulations for the implementation of a single resolution mechanism and two – for the introduction of the regulation for the prevention of market abuse *(MAR)*.

Proposals published by the European Commission in 2015

- **Credit institutions sector**

Proposal for Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishing a European deposit insurance system

The proposal provides for gradual establishment of a single European deposit insurance system, entrusting the management of a single deposit insurance fund to the SRB. It is planned to implement the project in three stages, gradually reducing the participation of the Member State deposit guarantee system.

- **Financial instruments market sector**

Proposal for a regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading

The purpose of the Proposal is to ensure such information disclosure rules to all kinds of issuers as are adapted to their specific needs, at the same time making the prospectus be a more appropriate tool for informing potential investors. Therewith, a special focus of this Proposal was on four groups of issuers: 1) issuers already registered on the regulated market or the market for development of small and medium enterprises, willing to attract additional funds, carrying out the secondary issue; 2) small and medium enterprises; 3) frequent issuers of all kinds of securities; 4) issuers of securities other than capital securities. By this proposal it is planned to also henceforth stimulate the use of the cross-border "passport" introduced by the prospectus directive for the approved prospectus.

Proposals under debate carried forward from previous years

- **Credit institutions 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 it is planned to prohibit the systemic credit institutions 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 instruments market sector**

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

Proposal has been developed to improve the regulatory framework according to which the reference values (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 directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards 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 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 only applies 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 and 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.

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 funds (MMF), to improve the asset quality of the MMF and set requirements for the MMF managers to ensure the protection of the investor profile, to refine the rules for asset assessment, as well as to establish the capital buffer to absorb the potential losses of funds.

- **Insurance and pension funds 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 the funded pension savings by promoting pension adequacy, relevance and sustainability by increasing the share of supplementary pension in pension income. The proposal also 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.

8.5. Planned EU initiatives in 2016

On the basis of the action plan for the establishment of the Capital Markets Union approved by the European Commission in 2015, it is planned that, in 2016, the European Commission might come forward with particular legislative initiatives in the fields, where, taking into account the proposals expressed during public discussion, it sees the basis for action at a European level.

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 harmonising the legislation with that of the banking sector regulation, in 2016, the European Commission intends to come forward with a proposal **for the recovery and resolution framework for financial institutions that are not credit institutions**, which has already been planned in the previous year.

Just like every year, also in 2016, the European Commission, will continue, in cooperation with the European supervisory authorities, the extensive work on the development of delegated and implementing measures (please see http://ec.eiropa.eu/atwork/pdf/planned_commission_initiatives_2016.pdf, pages 33 – 60).

9. 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;

9.1. Deposit Guarantee Fund

The guaranteed compensation to customers (both natural and legal persons other than central bank or deposit taker, financial institution, transit fund or an institution financed from the state budget or municipal budget) of Latvian banks and credit unions (deposit takers) is 100, 000 EUR (or an equivalent amount in another currency) in each deposit taker. The guaranteed compensation 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.

Table 2.
Guaranteed deposits of Latvian deposit takers as on 31 December 2015

	AMOUNT (IN EUR)	SHARE,%
Total number of depositors	2 245 004	100.0
including residents	2 130 484	94.9
including non-residents	114 520	5.1
Balance of covered deposits, in thousand EUR	7 874 268	100.0
including residents	5 363 137	68.1
including non-residents	2 511 130	31.9
Amount paid by the deposit takers into the DGF for the guaranteed deposits by 31 December 2015, in thousand EUR	316 783	-

At the end of 2015, the amount of covered deposits, i.e., deposits of up to 100, 000 EUR, comprised 33.8% of the total deposits in Latvian banks, therewith the DGF guaranteed such deposits to 2.2 million depositors.

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 guaranteed compensation of 478.6 million EUR in total. For 99.8% of the depositors of LKB, the depositor guarantee scheme covered their deposits fully in an amount of 100%. The payment of the guaranteed compensation was organised as soon as possible, without waiting for the statutory maximum number of days (30 working days).

The claiming of the guaranteed compensation took place most actively in the first three months after starting the disbursements

Figure 20.
Dynamics of the disbursement of guaranteed compensation to LKB customers (2011–2015)

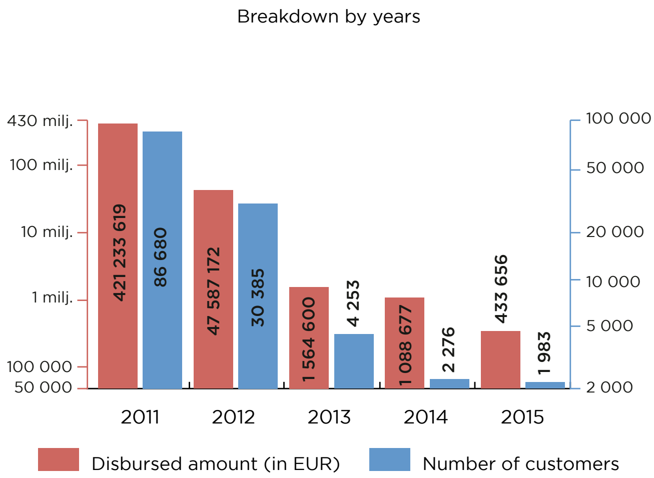


Table 3.
Ensuring the disbursement of guaranteed compensation (GC) to LKB depositors at 31 December 2015

	NUMBER OF DEPOSITORS	AMOUNT OF GC (IN EUR)	GC RECEIVED (NUMBER)	GC DISBURSEMENTS[14] (IN EUR)	SHARE OF GC NOT RECEIVED, %
AS *Latvijas Krājbanka*	220 559	478 207 798	125 337	471 560 236	1.4

Figure 21.
Share of the amounts of undisbursed GCs at 31 December 2015

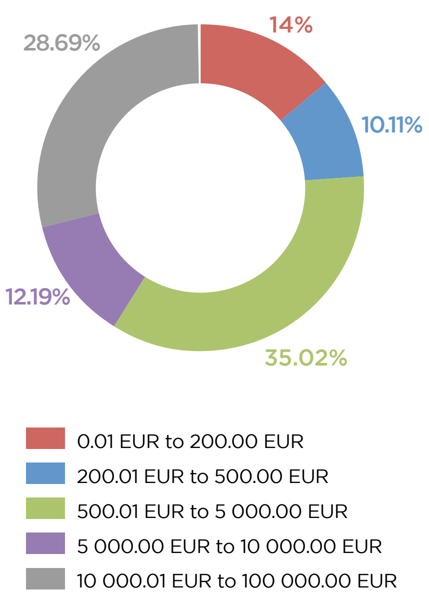
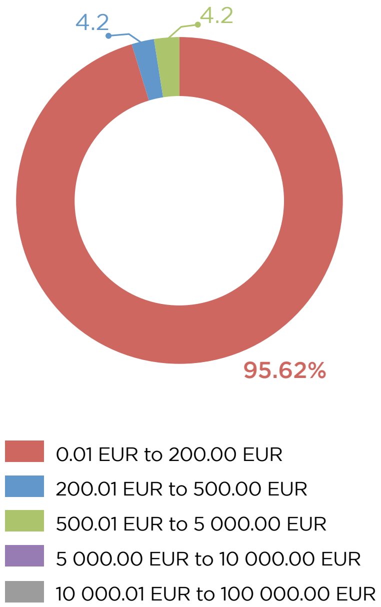


Figure 22.
Share of the number of undisbursed GCs at 31 December 2015



14 Excluding the overpaid GCs.

Out of LKB depositors who have not yet received guaranteed compensation, 96% are such whose guaranteed compensation is up to 200 EUR and their guaranteed compensation totals 930, 3 thousand EUR, whereas there are 76 depositors the guaranteed compensation of which ranges between 10, 000 EUR and 100, 000 EUR, and their total guaranteed compensation amounts to 1, 904 million EUR.

The DGF has the first-level right to claim amounts from the bank which is being liquidated (up to the amount of the guaranteed compensation), but 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 the disbursed guaranteed compensation.

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 guaranteed 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 the first six months of 2015, the mean average adjustment ratio of Latvian banks, according to which the payments of each quarter were to be made to DGF amounted to 99.83%, and as regards the cooperative credit unions – 97.34%, whereas, following the change in the determination of the adjustment ratio starting from 1 July 2015, in the second half of 2015, the adjustment ratio of banks amounted to 124.36%, and that of cooperative credit unions – 101.25%. When establishing the adjustment ratio applicable to the payment, 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 27.6 million EUR to the DGF for 2015. As the deposit takers, starting from 1 July 2015, had to perform the payments to the DGF from the covered deposits only, in 2015 the payments to the DGF decreased by 20%.

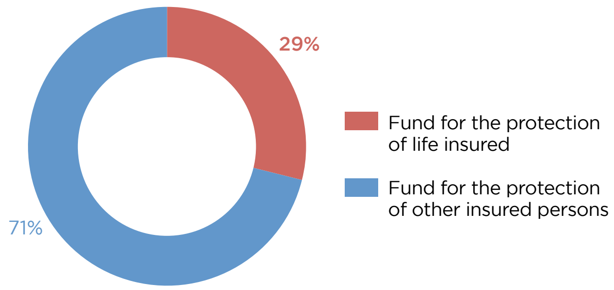
Under the law, in 2015, the FCMC ensured the accumulation and management of the assets of the DGF pursuant to the purpose of the law. At the end of the year, 102.6 million EUR of the DGF funds were held at the Bank of Latvia. In 2015, the FCMC monitored the process of disbursement of the guaranteed compensation and the activities of the administrator of LKB and the administrators of the insolvent cooperative credit unions, as well as additionally assumed the disbursement of the guaranteed compensation to the customers of AS *Ogres komercbanka* under liquidation and AS *VEF banka* under liquidation, for them to be able to complete the liquidation process. In 2015, the DGF accepted funds from AS *VEF banka* under liquidation in an amount of 45.7 thousand EUR and from AS *Ogres komercbanka* under liquidation in an amount of 30.9 thousand EUR, in order to secure the disbursement of the guaranteed compensation to 10 depositors of AS *Ogres komercbanka* under liquidation and 54 depositors of AS *VEF banka* under liquidation. The FCMC also reviewed the received complaints regarding recognition of the guaranteed compensation and, within the scope of its competence, took part in litigation proceedings on the recognition or refusal of 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 2015 and the independent auditor's report thereon are available on the FCMC website at: www.fktk.lv.

9.2. 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 insurance specified in the law. At the end of 2015, 18.2 million EUR were accrued in the FPI.

Figure 23.
Percentage breakdown of the FPI assets (at the end of 2015)

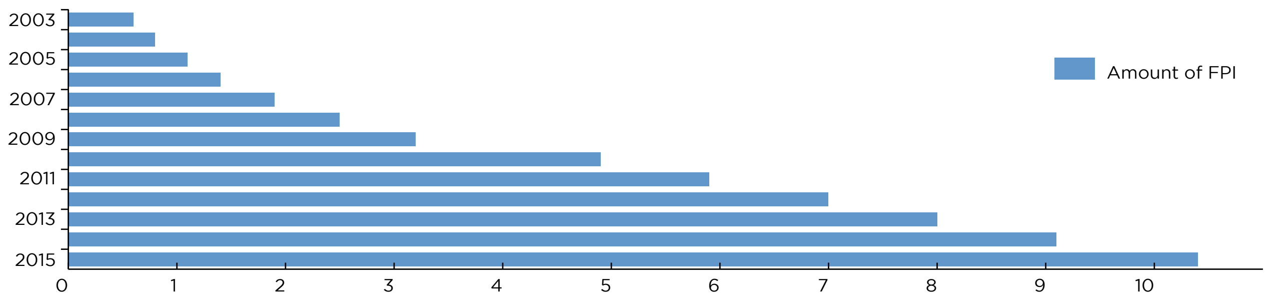


Since the beginning of the operation of FPI, the assets thereof have been allocated in an amount of 12.3 thousand EUR for the disbursement of guaranteed compensation. The payment of insurance indemnity in the case of default on liabilities by insurer may only be received by a policyholder that is a natural person:

1) for life insurance – 100% of the insurance indemnity, however, not more than 14, 230 EUR per policyholder, excluding insurance in respect of to the market pegged life insurance contract;

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.

Figure 24.
Dynamics of the FPI volume increase, 2001–2015 (at the end of the year, in million EUR)



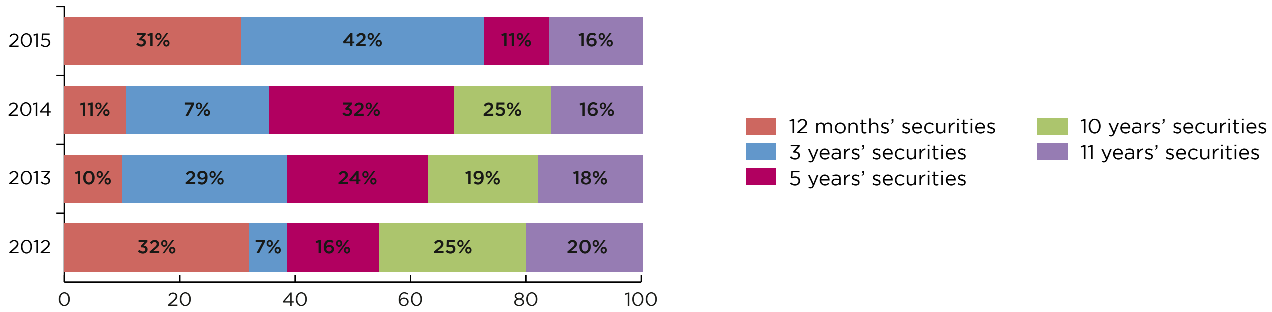
In 2015, the volume of the FPI increased by 1.8 million EUR, due to the contributions by fund participants and by the FCMC placing the FPI assets in Latvian government internal debt securities and receiving interest payments on them.

The FPI investment structure and return on investments depend on the internal central government debt offer of Latvia and the amount of cash available to the FPI at the time of the offer.

Table 4.
FPI income indicators, 2008 – 2015

	2008	2009	2010	2011	2012	2013	2014	2015	STRATEGY
Payments by the FPI participants, in million EUR	1.3	1	0.9	1	1	1.2	1.3	1.3	1% of sum total of the guaranteed insurance premiums
Investment income, in million EUR	0.3	0.4	0.6	0.4	0.4	0.4	0.5	0.5	Exceed investment maintenance and investments making costs
Return on assets, %	5.18	6.29	6.84	4.41	4.07	3.46	3.05	2.87	In accordance with fluctuations in the rates of fixed income of securities of internal central government debt of Latvia

Figure 25.
FPI investment structure by initial maturity, 2012 – 2015
(at the end of the year, %)



9.3. Protection of 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 or 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 compensation, whereas the Consultative Financial and Capital Market Council of the FCMC monitors the payment of compensation

The funds for the payment of compensation are provided by the participants of the scheme that are legal entities to whom the FCMC, under the set procedure, has issued a permit (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 participants of the scheme. The payment of each participant of the scheme for ensuring compensation is established in proportion to the participant's share in the joint financial instruments portfolio of the participants of the scheme. Where the payments of the participants of the scheme are not sufficient to pay compensation under the *Investor Protection Law*, the FCMC is entitled to get a loan for the disbursement of compensation.

9.4. Administration of the financial stability fee

The purpose of the Financial Stability Fee (the FSF) 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 FSF is paid by banks registered in the republic of Latvia and their branches in the Member States and other foreign countries and by branches in the Republic of Latvia of banks registered in the Member States and other foreign countries

countries (the FSF payers).

In 2015, the FCMC controlled the payment of the FSF into the budget account, the calculation of the FSF, and the completeness and accuracy of the information underlying the calculation. The object of the FSF 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 2015, the FCMC did not carry out on-site inspections in respect to the accuracy of the data contained in the returns of the FSF payers for 2014. In 2015, only data cross-sectional inspections were carried out. Nevertheless, at the beginning of 2016, the State Audit Office carried out the FSF collection inspection for 2014.

Table 5.
FSF payers' indicators, 2012 – 2015

	2015	2014	2013	2012
FSF payers	27	26	29[15]	31[16]
FSF object, in million EUR	18 389.5[17]	5 842.8	6 956.6	8 629.9
FSF rate,%	0.072	0.072	0.072	0.072
FSF, in EUR	13 203 974[17]	4 211 920	5 008 694	5 864 282
Fee payment received in the State budget, in EUR	3 856 512	4 251 970	5 438 650	4 737 853

15 Including AS *GE Money Bank* for ten months in 2013, and AS *Latvijas Hipotēku un Zemes Banka* and AS *UnitCredit Bank* which operated until 31 December 2013.
16 Including AS *Parex banka*, which was the FSF payer for three months in 2012, *Allied Irish Bank*, which was the FSF payer for nine months in 2012.
17 The FCMC has detected that part of the FSF payers have failed to correctly apply the changes in the laws and regulations in the determination of the FSF object for 2015, therefore, after the submission of the repeated FSF return, the adjustments will be introduced to the scope of the FSF object and the FSF itself.

Due to the termination of activities of credit institutions, the overpaid FSF 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 thousand EUR;
- In 2012 – to one company in the amount of 12.4 thousand EUR.

10. COOPERATION

10.1. Intra-institutional cooperation at the national level

The FCMC cooperates, on a regular basis, with other public institutions to ensure the efficient fulfilment of its functions. 2015 was marked by significant cooperation with the Ministry of Finance regarding the development of proposals for refining laws and regulations and transposing the requirements of the EU Directives, as well as with respect to the progress of review of these draft laws and regulations in the Cabinet of Ministers and the *Saeima* (Parliament), and regarding the assessment and development of items of the draft EU laws and regulations.

> In 2015, special focus was placed on the cooperation related to ensuring the presidency of Latvia in the EU Council, by the FCMC providing support to the Ministry of Finance and the Ministry of Justice in the work of the presidency in the issues of the financial market.

The FCMC representatives participated in the meetings of the Budget and Finance (Taxation) Committee of the *Saeima*, as well as the meetings of the Defence, Internal Affairs and Corruption Prevention Committee, that reviewed the draft laws related to the 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 EU in the field of financial services. The FCMC management also participated in the meetings of the National Security Committee of the *Saeima*.

In 2015, the FCMC continued a regular information exchange with the Bank of Latvia and the Ministry of Finance with respect to the situation in the financial and capital market. In cooperation with the Bank of Latvia, the work was continued in the issues of macro prudential supervision, monitoring of the securities settlement system maintained by the Latvian Central Depository, and other issues. In 2015, the FCMC also cooperated with the Consumer Rights Protection Centre to ensure the 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 of Ministers and line ministries, including:

- in the **Audit Consultative Council**, where the Report on the Observance of Standards and Codes (ROSC report) prepared by the World Bank in the field of accounting and audit in Latvia was debated, answers to the questions asked by the OECD regarding the audit services and standards in Latvia were prepared, as well as the transposition of the provisions of the new European regulatory framework in the area of auditing was debated;
- in the **working group on Latvia's joining the OECD** set up by the Ministry of Foreign Affairs, where the progress in accession talks to the OECD was monitored;
- **in the working group** set up by the Ministry of Finance, **which developed** draft laws transposing the legal provisions arising out of Directive 2014/56/EU of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and transposing Member States' options and discretions arising out of Regulation (EU) No. 537/2014 of the European Parliament and of the Council on specific requirements regarding the statutory audit of public-interest entities. The working group developed ***amendments to the Law On Sworn Auditors***, as well as prepared draft amendments to other laws;
- in the **working group** set up by the Ministry of Finance, which assessed the need to develop regulatory framework in the **crowdfunding issues** and worked on the proposals for the *Law on Mutual Loan Services*;
- 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, thus promoting, at the meetings of various public institutions with rating agencies, the expression of a uniform view regarding developments in the state in the field of economy and finance;
- in the **group on enhancement of the fast payment system** set up by the Bank of Latvia.

10.2. International cooperation

In the area of international cooperation, the FCMC's priority is to participate in the events taking place in the European Region. The FCMC gets involved in the discussion of draft 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. The meaning of participation in the SSM established in the Eurozone, following the start of its fully-fledged operation in 2015, becomes increasingly more important.

2015 was a prolific year in terms of active involvement of the FCMC in the implementation of two priorities important for the State of Latvia - ensuring Latvia's presidency in the EU Council and in the negotiations for accession to the OECD.

Same as in previous years, the FCMC continued successful cooperation with the supervisory authorities in those countries which have engaged in cross-border cooperation with Latvia.

Participation in the work of the Council of the European Union, Latvian Presidency of the EU Council and the work of the European Commission in the area of financial services

As the new composition of the European Commission only commenced its work in Autumn of 2014, it did not come up with many new legislative initiatives in 2015. Only in the second half of 2015 did the European Commission publish the proposal prospectus for amendments to directives and the new European deposit guarantee system regulatory framework.

In the first six months of 2015 Latvia, as the presiding country of the EU Council, continued advancing the drafts not being agreed upon in 2014. Latvia obtained the status of the presiding country in the EU Council on 1 January 2015,receiving the baton from Italy. Six months of managing the work of the EU Council has been a time of opportunities and also challenges. The FCMC also contributed considerably in this process, by participating in the EU Council's Working Party on Financial Services and Working Party on Company Law. The FCMC experts, along with the representatives of the Ministry of Finance and the Ministry of Justice, took part in advancing and discussing the EU initiatives, international debates as well as leading working groups and trialogues with the European Parliament on draft legislation in the field, such as structural reforms of credit institutions and disclosure of information on securities financing transactions, insurance distribution, the payment services and interbank commission charges, indices that are used as benchmarks in financial instruments and contracts, the activities and supervision of the institutions engaged in the accumulation of additional pension capital, as well as the rights of shareholders of the issuers.

During the Latvian Presidency the final agreement was reached with the European Parliament on the regulations regarding interbank commission charges for card payments, the final agreement with the European Parliament was approved regarding regulation on the European long-term investment funds, the final agreement with the European Parliament was approved regarding the set of anti-money laundering legislation, consisting of the Directive (on the Prevention of the Use of Financial System for the Purpose of Money-Laundering and Terrorist Financing) and the Regulation (on Information of the Payer Accompanying the Transfer of Funds). Likewise, during the Latvian Presidency, the agreement was reached on amendments to the Payment Services Directive, and the agreement in the EU Council was reached regarding the Regulation on structural measures improving the stability of the EU credit institutions, and the agreement was also reached on a single approach to the Regulation on indices that are used as benchmarks in financial instruments and contracts, political trialogue was commenced with the European Parliament and the European Commission, political agreement was reached with the European Parliament on the Regulation on reporting securities financing transactions and the transparency thereof, political agreement was reached with the European Union on the insurance distribution directive and agreement at the EU Council regarding the shareholders' rights directive.

At the European Commission and the ECB committee and expert group level, in which the FCMC ensured the representation of its experts, as well, in 2015, work on the European Commission's and the ECB's regulatory enactments subordinated to EU directives and regulations was carried out (57 implementing and delegated regulations were published), 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.

Participation in negotiations for Latvia's accession to the OECD

In 2015, continuing that which has been started in the previous year, the FCMC took part in the negotiations for accession to the OECD in its Committee on Financial Markets, Committee on Insurance and Private Pensions, Investment Committee, Corporate Governance Committee, as well as in the OECD's Working Group on Bribery in International Business Transactions. The FCMC provided information necessary for the committees regarding the situation in the market and changes in the regulatory framework, as well as participated in the meetings of the committees and working groups, presenting that which was accomplished within the fulfilment of the recommendations set by the OECD committees. Over the period of 2015, in order to ensure conformity to the standards set by the OECD, both amendments to the laws and regulations were introduced and measures were taken for strengthening the administrative capacities of the FCMC for supervising that which was accomplished in the field of the AMLCTF in the financial sector.

> By the end of 2015 we have received positive recommendations regarding Latvia's accession to the OECD from the Committee on Financial Markets and the Committee on Insurance and Private Pensions, and at the beginning of 2016 a positive opinion on the readiness of Latvia to join the OECD was also received from the rest of the Committees and the working group.

Participation in the work of European supervisory authorities

Participating in the work of the European supervisory authorities (the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Securities and Markets Authority (ESMA)) and the European Systemic Risk Board (ESRB), 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.

In 2015, continuing the work on the building of the *Single Rulebook* of the European banking sector, the EBA focussed on the remuneration policy in the banking sector and proportionality aspect in this field, worked on defining a single approach for the calculation of the net stable financing requirement and liquidity risk management. The ABA, as one of the authorities approving the European standards, whose competence is used by the EU, provided proposals for the framework in the field of securitisation and covered bonds, where further work will be performed by the European Commission. The EBA also carried out supervision regarding how the Member States have implemented the banking sector remuneration issues and how they have exercised their options and discretions provided for by the *CRD IV/CRR*. The EBA also completed the work on regulatory standards in the field of deposit guarantee and banking resolution, taking into account that the single resolution mechanism came into force in 2015. However, the EBA did not focus only on the development of the standards. Work on ensuring supervision convergence and identifying the best supervisory practice was equally important. Three priority areas stood out in 2015 in the field of supervisory convergence -activities of the colleges of supervisors, recovery planning and supervisory review and evaluation process (SREP). During the reporting period, the EBA also systematically analysed the European banking sector in order to identify potential risks. For more information on the activities of the EBA, visit the website www.eba.eiropa.eu.

In 2015, EIOPA's priorities were aimed at the timely developing of top-quality draft regulations, improving the supervisory convergence, and promoting financial stability. The largest task of the reporting year was the development of technical standards and guidelines for the introduction of the *Solvency II* Directive (the 2nd set of standards necessary for the introduction of the *Solvency II* Directive was submitted to the European Union), because starting from 2016 the new regulatory framework in the field of insurance and reinsurance takes effect in the EU Member States. In the field of consumer protection the work was related to the insurance distribution regulation and the product monitoring guidelines were developed, as well as, jointly with other financial supervisory authorities, the work on the technical standards for the introduction of the PRIIPs (Packaged retail and insurance-based investment products) regulation. For more information on the activities of the EIOPA, visit the website www.eiopa.eiropa.eu.

In 2015, 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 selling and certain aspects of credit default swaps, etc.), by developing a number of draft 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 centralised collection and maintenance of information on over-the-counter transactions with financial derivatives, as well as a financial instrument reference database. For more information on the activities of the ESMA, visit the website www.esma.eiropa.eu.

During the reporting year, the ESRB continued the work that was focussed 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 main focus was on the risks in the banking sector, however the ESRB for the first year analysed the systemic risks arising out of the insurance sector activities, to contribute to discussions regarding the importance of the insurance sector, and published the report at the end of the year. The ESRB also analysed and collected information about the macro-prudential tools introduced by the Member States. Member States statements on these tools, as well as more information on the activities of the ESRB is available on the website www.esrb.eiropa.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 market supervisors of the Baltic states, Nordic countries as well as the ECB.

Following the formation of the SSM, changes have also been introduced in the cooperation with the supervisory authorities of the Nordic countries, because the heads of the ECB's joint supervisory teams take part in the colleges of supervisors with respect to the major banks *SEB banka* and *Swedbank*, as well as *Nordea*. Cooperation between the central banks and the supervisory authorities of the financial sector of the Nordic countries and the Baltic states, as usual, took place at the Macro-Prudential Forum, in which the heads of the supervisory authorities and the heads of central banks discussed the latest developments of macro-prudential policy.

Bilateral cooperation and information exchange between the supervisory authorities is based upon concluded information exchange and cooperation agreements. All concluded bilateral and multilateral cooperation agreements are available on the FCMC website.

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

11. COMMUNICATION WITH THE GENERAL PUBLIC. EDUCATING CUSTOMERS

Moving along the strategic direction undertaken in previous years towards informing the general public and enhancement of its financial literacy, seeking to facilitate the customer understanding both regarding the financial services and their risks, as well as the essence of the operation of the sector and its supervisor, the FCMC ensured wide information availability on the performance of participants of each market segment, updates in regulatory requirements, the FCMC Council decisions, *inter alia*, sanctions imposed on Latvian banks (in five cases), as well as took part in clarifying the topical issues on the agenda of the general public and the media during the reporting year.

In 2015, active developments were observed in various fields. The legislator expressed several proposals on changes in the supervisory framework ensured by the FCMC up to now, for example, with respect to taking over the supervision of the so-called fast credits or the development of the regulatory framework of the mutual loan service providers or crowdfunding. Extensive public discussions were observed regarding the availability of new loans to the companies in various sectors. By implementing the single supervision within the scope of the European Banking Union, the comments of the Latvian financial supervisor were also ensured regarding the events in the European and global financial markets, developments in the Greek national government debt crisis, EUR rate fluctuations or the so-called Juncker Plan for promoting the economy. In addition, within the scope of the macro-prudential supervision, the

> FCMC, starting from 2015, on a quarterly basis, determined and published the countercyclical capital buffer norm for transactions with Latvian residents.

Each of these cases required appropriate communication from the

> FCMC – data or more extensive explanation, prepared by the Communication Division specialists. Overall, in 2015, the FCMC posted and communicated more communications on its website to the mass media than before – 155

(in 2014 – 144). In addition to the standard communications, the Communication Division prepared three infographics, which, in a visually attractive way, ensured the explication of the necessary information to the general public – on banking activities in 2014, on the topical trends of financial literacy and on the volume of transactions closed during one day in the Latvian financial sector.

To facilitate the planning of information flow to media and other interested persons, in 2015, the FCMC posted a data publication calendar on its website regarding the activities of market participants in 2016.

In turn, interactive tool *BANK COMPASS*, where the key performance indicators of each quarter of the Latvian commercial banks are compared, was supplemented by an educational explanation for several levels of the capital adequacy ratio, correspondingly also ensuring the reflection of this information regarding each commercial bank in the graphic section of this tool.

Starting from January 2012, the FCMC has also been communicating through the social network *Twitter.com* account. At the end of 2015, it already had 1, 615 followers (in 2014 – 1, 400 followers). *Twitter* is a place for posting easy-to-perceive information regarding the FCMC Council's decisions, topicalities of financial literacy and international cooperation, as well as for ensuring fast answers to questions of the followers.

The intensity of publicity in media, in 2015, was similar to that of the previous period, because the FCMC management gave 65 interviews (in 2014 – 70 interviews) to local and international media. During 2015, the name of the FCMC was mentioned in more than 3, 360 various media publications and stories.

During the reporting year, the Communication Division organised three media events – with respect to banking activities in 2014, publication of the new measurement system Financial Literacy Index and the opening of the outdoor object – money-box Smarty *(Gudrīte)*, within the scope of the 3rd Financial Education Week. In 2015, the FCMC experts and management also took part in socially responsible activities such as Open Door Day and Shadow Day.

The results of the annual sociological public opinion poll of the Latvian public in 2015 showed the growth of the trust of the population both in the financial sector (on average by 52% (previously – 50%)), and in its supervisor – the FCMC. Besides, as pointed out by the company performing the poll – SKDS, over the period of one year, the level of trust has grown with respect to all institutions included in the poll, i.e. market participants. The evaluation of the FCMC operation showed that, despite a slight reduction in the number of residents with good knowledge regarding the supervisory authority, the trust in the FCMC performance has, nevertheless, grown from 47% (in 2014) to 54% (in 2015). In 2015, the Latvian population mainly showed trust in insurance companies – 71% (previously – 68%), followed by commercial banks with 67% (previously – 63%), experiencing the steepest growth in 2015. Besides, the number of residents considering that it is safe and very safe to keep funds in Latvian banks, has grown considerably over the year – to 49% (previously – 38%).

> An important item on the FCMC communication agenda is financial literacy issues of the general public, which is one of the strategic priorities of the FCMC.

Implementation of the Financial Literacy Strategy

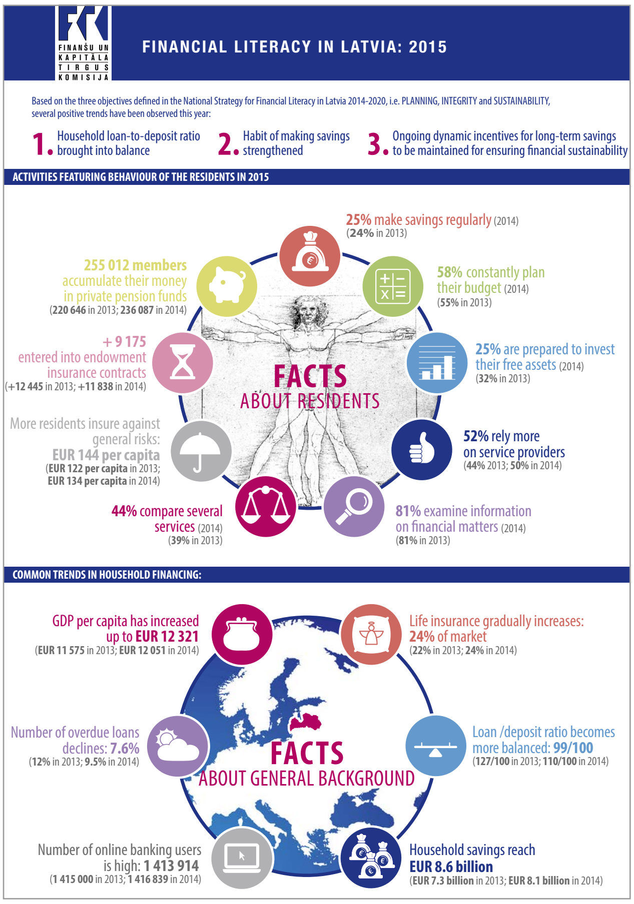
In the second half of 2015, the first year of implementation of the *National Strategy for Financial Literacy in Latvia* 2014 – 2020 (the Strategy) has been assessed since the signing of the cooperation memorandum of the partners on 24 February 2014. The performance indicators showed that the financial literacy of the

> Latvian population has gradually grown, because the planned progress of achievement indicators of almost all objectives was observed.

The inclusion of the Latvian population in using basic banking services was habitually high, just like in other developed countries: 94% of the population have a bank account; besides, an increasingly larger number of residents were switching over to electronic solutions of the services – in 2014, 70% of all residents were already using Internet banking (in 2013 – 65%).

In 2014, the number of households regularly planning their budget had increased – 58%. The total household savings had grown by almost 1 billion EUR, totalling 8.1 billion EUR, whereas the increase in the risk insurance premiums underwritten by the residents was larger than the planned maximum (+9.8%), but the share of life insurance in the insurance market grew to 24%.

Figure 26.
The FCMC infographics (published on 10 June 2015)



At the end of 2015, the analysis of the performance indicators of the Strategy showed further positive progress in enhancement of the financial literacy of the population this year as well – household savings continued to grow, though not as rapidly as before, totalling 8.6 billion EUR; over 9 thousand new accumulating life insurance contracts were concluded, the increase in the number of participants of the private pension plans in 2015 was the steepest in the last five years and the volume of the risk insurance premiums per resident reached 144 EUR (previously – 134 EUR). Further development and sustainability of households is ensure by the achieved almost optimum balance in the loans and deposits proportion or 99% in monetary terms of the sum total of loans to the sum total of deposits (100%), as well as the increased gross domestic product per resident, reaching 12, 321 EUR (previously – 12, 051 EUR).

The second financial literacy survey and INDEX

Along with the first (in Quarter I of 2014) and the second (in Quarter II of 2015) financial literacy survey of the population, the FCMC, as the next step in measuring financial literacy in Latvia, carried out the development of the new measurement system and result aggregation methodology, and established the financial literacy index of the Latvian population (INDEX) or determined the average score in seven financial literacy topics. INDEX has been developed in cooperation with the research centre SKDS.

The result of the first INDEX was published in January 2015: +20.6 points. The second INDEX, in turn, in June of the same year was already higher: +21.2 points. The growth of financial literacy over this period was observed in the Private Finance Planning, e-Security and Awareness, as well as Savings topic. The largest growth of the INDEX was observed in the topic Awareness and e-Security, where the demographic group Retired Persons have almost doubled their financial literacy. Nevertheless, for a second year in a row already, the Latvian general public overall scored negative points in the financial literacy topics – by the financial literacy in the topic Loans decreasing to -0.4 points (in 2014 – 0.2 points), and remaining at a constantly low level in the topic Pension: -0.5 points.

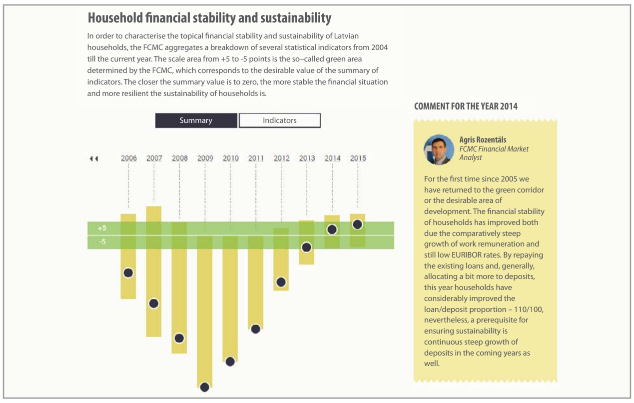
> In addition to the INDEX, the stability and sustainability of Latvian households is also characterised by a summary of the indicators characterising the financial stability and sustainability of households prepared by the FCMC.

At the end of 2014, for the first time since 2005, households have been defined by the FCMC as being in the desirably development area, with the summary value of +2.3, but in 2015 the result was even better: +4.2 (compared to the years of economic slowdown, when it was -59.7). The summary of the financial stability and sustainability of households ranging from -5 to +5, gradually approaching the zero mark, is the desirable development area.

Figure 27.

View No. 1 Knowledge/literacy

View No. 2 Financial situation



For the results of INDEX and indicators to be easily available to anyone in a comparable view by years, the FCMC set up and in 2015 posted and upgraded the interactive tool *CUSTOMER SCHOOL* under the Section *Research*.

Financial Education Week 2015

Financial Education Week 2015 (FEW 2015) was held concurrently with the *4th Global Money Week* organised by the cooperation partner of the FCMC *Child and Youth Finance International* and the first European Financial Week organised by the European Banking Federation. The FCMC, jointly with the partners, this time introducing the outdoors object – money box Smartly *(Gudrīte)* to the general public, with the motto "Save knowledge! Save smartly!", in the centre of Riga, invited anyone to share considerable findings regarding the role of money in life and savings formation habits and to deliver these findings to the money box. At the end of each business day, the Communication Division carried out the aggregation of the findings in the special

Section of the FCMC website *Smartly Store*.

The public opinion poll organised within the scope of FEW 2015 (by the FCMC and SKDS) disclosed that 91% of the Latvian population agree – financial literacy has to be supplemented on a regular basis nowadays. According to the results of the research the FCMC also continued the launched work after FEW 2015, both by building the educational website *CUSTOMER SCHOOL*, and by setting up study aids and texts, as well as ensuring guest lectures in Latvian schools, higher education institutions and other target audiences over the period of the entire year.

Building the *CUSTOMER SCHOOL*

Since 2011 the FCMC has been maintaining the educational website *CUSTOMER SCHOOL* with educational materials on financial services in Latvia, customer rights and the State guarantee system. Since 2014 *CUSTOMER SCHOOL* has been developed, also setting up the Section *CUSTOMER ABC*, where study aids for various cognition levels are offered. During the reporting year, the A-level was supplemented by 27 topics (+10), the B-level was opened with 12 temporary topics and also the knowledge test of this level was posted, as well as the development of the C-level was commenced. During the reporting year, the *CUSTOMER SCHOOL* provided 36 pieces of advice (in 2014 – 45) to the website users. The popularisation of the *CUSTOMER SCHOOL* was carried out through regular guest lectures in Latvian schools and higher education institutions, as well as at the Camp *ALFA* for Winners of the State Study Subjects Olympiads and Pupil Scientific Conference.

Lifelong education activities

To ensure the informing of various audiences regarding new services, customer rights and obligations, as well as to provide the necessary advice to the population of Latvian regions, in 2015, 12 publications were prepared in the regular column of the *CUSTOMER SCHOOL* in the newspaper *Latvijas Avīze*.

The FCMC experts provided lectures for various audiences and on different topics related to the financial and capital market in Latvia – in the seminar in the BA School of Business and Finance (the BA), within the scope of FEW 2015, for school teachers in insurance issues, the BA insurance profile students at the seminar in the FCMC, at the annual seminar of the Bank of Latvia for the teachers of economics and social sciences with the lecture *Financial Literacy – Latvian Households Moving Towards Sustainability*, at the informative lecture for the BA's academic staff regarding the management and topicalities of financial literacy, etc. activities, as necessary.

International cooperation

Since 2014, the FCMC has been participating in the work of the OECD *International Network for Financial Education (INFE)* working group as the Latvian national co-ordinator of the financial literacy activities, ensuring the aggregation of information on accomplishments of Latvia in this field and the submission thereof to the OECD. Latvia's experience in the strategic management of financial literacy is included in the OECD/INFE policy handbook ***National Strategies for Financial Education***, published at the end of 2015, along with other developed countries. Latvian financial literacy survey data (2015) are also submitted for the INFE first analytical data summary regarding the financial literacy level in the OECD countries, to be published at the end of 2016.

Table 6.
Financial competence level in the European countries carrying out financial education assessment (OECD/INFE 2015)
Percentage breakdown of the correct answers provided by the adult respondents by countries (%)

	LOAN INTEREST PAYMENT	CALCULATION OF THE PRINCIPAL AMOUNT OF THE LOAN PLUS INTEREST	COMBINED PERCENTAGE (AND CORRECT ANSWER TO THE PREVIOUS QUESTION)	RISK AND PROFITABILITY*	INFLATION DEFINITION	DIVERSIFICATION*
Albania	88%	48%	16%	77%	75%	65%
Austria	86%	68%	36%	86%	85%	62%
Belgium	91%	63%	39%	83%	80%	56%
Croatia	80%	62%	22%	69%	74%	66%
The Czech Republic	83%	58%	22%	71%	73%	69%
Estonia	89%	79%	38%	85%	88%	65%
France	94%	57%	34%	87%	87%	75%
Hungary	91%	53%	24%	84%	89%	65%
Latvia	89%	72%	44%	82%	86%	64%
Lithuania	79%	68%	31%	75%	67%	75%
The Netherlands	92%	76%	56%	73%	74%	53%
Norway	91%	80%	58%	86%	74%	59%
Poland	77%	61%	21%	77%	69%	56%
Portugal	87%	61%	30%	82%	87%	73%
The Russian Federation	88%	48%	27%	78%	66%	41%
Turkey	84%	54%	19%	90%	84%	74%
The United Kingdom	83%	57%	36%	74%	80%	52%
Total:	**87%**	**62%**	**32%**	**81%**	**79%**	**63%**

* Percentage refers to the correctly answered main question. Alternative option of the formulation has been applied in the Czech Republic (Risk and return) and Albania, the Czech Republic and Lithuania (Diversification).

In 2015, the representative of Latvia also participated in the INFE working group Subgroup on Core Competencies, which is developing the uniform financial literacy competencies standard for the OECD countries for adults, at the same time managing the Latvian working group, which was setting up the draft national standard. This work is still in progress.

In 2015, the sharing of Latvia's experience was ensured on the First Baltic Sea States Forum on Financial Literacy Activities in Vilnius (Lithuania), at the seminar of the Bank of Austria for the Eastern European countries in the Vienna Institute and the *CYFI&McKinsey* London Seminar on the Child and Youth Economic Education Activities in the National Strategies. Over the period of recent years, in the field of promoting financial literacy, Latvia, from the country acquiring the best practice of other countries, has become the country which is itself providing support and advice to both its neighbouring countries and international partners.

KEY TASKS IN 2016

STREAMLINING THE FINANCIAL REGULATORY FRAMEWORK is the strategic priority of the FCMC, providing for the development of a 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. A plan for the development and improvement of the market regulation has been approved for 2016, which covers practically all market segments subject to the supervision of the FCMC.

In the credit institutions sectors, the international credit institutions supervisory standard *Basel III* provides for national options and transitional periods for introducing several requirements, taking into account the differences among the Member States. In 2016, it was evaluated whether in cases, when the selected national approach differs from that defined in the ECB Regulation, the competition is distorted in the Latvian credit institutions sectors, and, if necessary, the options specified by the national law will be revised with respect to the credit institutions that are not subject to the direct supervision of the ECB. In light of the development of the risk management methods and supervisory practice, in 2016 it is planned to introduce **amendments to the FCMC Regulations on the Formation of the Capital Adequacy Assessment Process**. The requirement will be introduced to carry out the assessment of the sustainability of the business model and development strategy of a credit institution, and the type and share of the elements of the own funds will be defined, with which to cover the additional necessary capital determined during the internal capital adequacy assessment process. The asset categories will be extended subject to concentration risk assessment and the inclusion of the stress testing results in the determination of the additional capital requirements will be adjusted. The FCMC plans to supplement the **Regulations on Liquidity Requirements, Compliance Procedures and Liquidity Risk Management** with the requirements for the banks to carry out a liquidity adequacy assessment, entailing the determination of the amount of liquidity reserves necessary for covering risks inherent to current and planned activities of the bank, as well as the assessment of the bank's liquidity risk identification, evaluation and management.

In 2016, **in the field of the AML/CTF**, special focus was placed on the enhancement of the regulatory framework both in the banking segment, and in the payment institutions and electronic money institutions segment. Laws and regulations will be developed in the field of requirements of both the management of risks of cooperation with a politically exposed person, and also the assessment of the combined ML/TF risk profile, and a number of new sectoral regulations will also be prepared prescribing the requirements in high risk segments and banks' ML/TF risk management stages, processes of commencement of cooperation with the high risk customers and their initial due diligence, in the supervision of the activities of the customer who are payment institutions and electronic money institutions, "loro" type correspondent relations risk management and identification of the typology of suspicious transactions.

In the insurance sector, in 2016, it is planned to commence the work on the introduction of the Directive on Insurance Distribution mainly, by developing amendments to the ***Activities of Insurance and Reinsurance Intermediaries Law***. In the field of the financial instruments market, in 2016, it is planned to develop amendments to the **Financial Instruments Market Law** aimed at introducing the requirements of the MiFID II Directive. It is also planned to prepare the **Amendments to the Law on Investment Management Companies** aimed at transposing the Directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities with respect to the depository functions, remuneration policy guidelines and sanctions. The amendments **to the Law on Payment Services and Electronic Money** will be developed, providing for the introduction of the requirements of the Payments Accounts Directive. It is planned that in 2016 **the new International Financial Reporting Standard 9 will be approved for application in the EU** and, starting from 2018, it will also be binding in the financial reporting on the majority of the Latvian financial market participants.

The enhancement of the financial sector risk analysis systems carried out by the FCMC will continue, focussing on the development of the stress test methodology, revision of the thresholds of the risk analysis indicators applied in the risk analysis and introduction of possibilities of visualisation of the risk analysis indicators in information systems.

In 2016, **it is planned to develop a special regulatory framework for peer-to-peer lending platforms**, taking into account that such type of activity is not currently defined in the Latvian laws and regulations and a special regulatory framework will ensure that the platforms can operate in their classical model (without assignment), because the existing special regulatory framework for consumer lending does not provide for it.

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 measures aimed at preventing or mitigating these risks, employing appropriate tools. The mastering of new macro-prudential tools will continue in 2016. Taking into account the considerable role of the systemically significant financial institutions in the financial sector, the need arises to introduce additional requirements – increased capital buffer norms in accordance with the significance of the institution, to strengthen their resilience to unforeseen adverse circumstances. In 2016, the methodology for determination of the capital buffer norm of the local systemically significant banks will be developed, to be discussed at the Macro-Supervision Board.

IMPLEMENTING THE SUPERVISION OF THE FINANCIAL MARKET PARTICIPANTS .

> Considering the new challenges, the work on ensuring the conformity of the supervisory methods, tools and practices to the principles of the ECB will continue, through active and mutual cooperation with the ECB,

also taking into account the nature of the Latvian financial sector. In 2016, the on-site and off-site supervision handbooks will be updated, the procedure and criteria for the assessment of the recovery plans of banking activities will be determined. It is also planned to introduce additional early warning indicators, revising the existing thresholds of the early warning indicators.

In the field of AML/CTF, the key priority in 2016 will be to achieve the efficient operation of the newly established FCMC Compliance Control Department, on the basis of the new AML/CTF compliance supervision strategy.

> Supervisory processes are formed with an aim to ensure comprehensive, integrated and timely identification and assessment of the ML/TF risks of activities of all financial services market participants and the fulfilment of the necessary corrective measures.

The powers and extended delegation for defining the regulatory requirements, vested to the FCMC, within the scope of the amendments to legal acts, form a good basis for that.

In 2016, it is planned to continue refining the process of registration / licensing of the payment institutions, electronic money institutions and cooperative credit unions, paying more attention to the assessment of sustainability and competitiveness of the commercial activities of the institutions. The FCMC employees will continue providing advice to potential and existing market participants in the issues of registration / licensing of the institutions, as well as supervision and filing.

Along with the new Solvency II supervisory regime becoming effective, the priority in the process of supervision of the insurance market participants in 2016 will be to ensure actual supervision in accordance with the requirements laid down by the Insurance and Reinsurance Law, by revising and refining the on-site and off-site supervision handbooks in accordance with the Solvency II principles, and verifying the conformity of the documents and reports filed by the insurers to the requirements laid down by laws and regulations, as well as by carrying out off-site and on-site inspections.

In 2016, the FCMC WILL CONTINUE PROMOTING 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.

> In the field of banking supervision, in 2016, the FCMC will pay special attention to the assessment of the business models and earning capacity of the banks,

with a special focus on the assessment of the recovery plans of the banks and risks related to the earning capacity, as well as the strategy and business plans of the banks. Alongside this, the FCMC will carry out a comprehensive assessment of the internal governance structure of the banks, directing the attention of the banks to the best practice examples and continuing the dialogue with the banks on the implementation thereof. Credit risk and ensuring an adequate level of provisions will remain the focus of the FCMC, paying more attention to the concentration risk in the loan portfolio of the banks. In 2016, in the field of banking supervision, it is planned to refine the methodology for the determination of the supervisory rating of the banks, adjust the procedure and criteria for the assessment of business models and liquidity risk. Also in the insurance sector, within the scope of the *Solvency II* supervision, in 2016, it is planned to assess the business models of insurance companies and evaluate their ability to ensure the solvency capital requirements in accordance with the *Solvency II* requirements.

In order to ensure the fulfilment of **THE TASKS OF THE FCMC AS THE NATIONAL COMPETENT AUTHORITY (THE FUNCTIONS OF THE RESOLUTION INSTITUTION)** in 2016, the FCMC will continue the implementation of a resolution mechanism that is integrated with the EU system, appropriate for the Latvian financial sector and functioning effectively to improve the instruments for the prevention of a crisis, protect the interests of the general public during the resolution process and preserve financial stability in the country.

Also in 2016, the FCMC will move along the previously commenced strategic direction in accordance with the *National Strategy for Financial Literacy in Latvia 2014 – 2020* in informing the general public and enhancing its financial literacy, providing for the promotion of customer awareness both about the financial services and their risks, and about the essence of the activities of the sector and it supervisor, thereb **PROACTIVELY INFORMING THE GENERAL PUBLIC AND RAISING THE LEVEL OF ITS FINANCIAL LITERACY.**

TO ENSURE THE ACHIEVEMENT OF ALL STRATEGIC OBJECTIVES, in 2016, the work on the building of staff capacity of the FCMC will continue, by both expanding the number of vacancies of the FCMC, and solving the issue on ensuring competitive remuneration for the FCMC employees. It is necessary both for raising financial market standards in the AML/CTF field, and for growing obligations of the FCMC within the scope of the SSM. The competitive possibilities of the FCMC on the labour market as the financial sector supervisor are limited, therefore one of the main issues on the agenda is the attraction of qualified specialists. In the second half of 2016, the FCMC will also carry out an evaluation of the efficiency of its work, as well as revise the FCMC structure, to ensure expressly clear and efficient work of the supervisory authority.

GOVERNANCE AND STRUCTURE OF THE FCMC

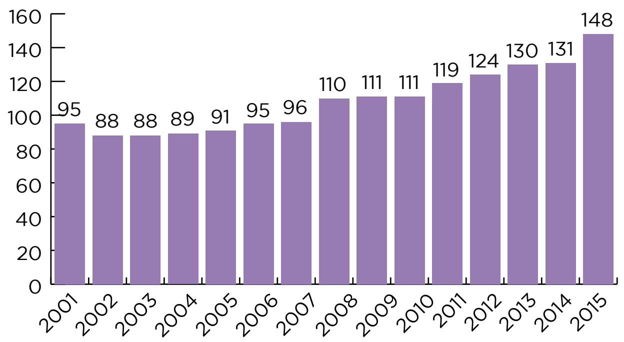
12. STAFF POLICY

Highly educated and professional staff is the key resource of the FCMC that ensures the achieving of the FCMC goals and further development of the institution.

12.1. Staff breakdown by number and the changes thereof

During the reporting year, the number of job positions in the FCMC increased to 148 job positions.

Figure 28.
Changes in the number of employees (2001 – 2015)



To ensure communication between the competent authorities in the AML / CTF issues of the Republic of Latvia, the EU and the USA and to promote the understanding and practical application of the requirements of the USA competent authorities in the FCMC and other competent authorities of the Republic of Latvia, in 2015, the job position of the sectoral advisor - attaché was temporarily opened (for a period of two years). From the moment of granting the diplomatic rank, the attaché fulfils the duties in the USA.

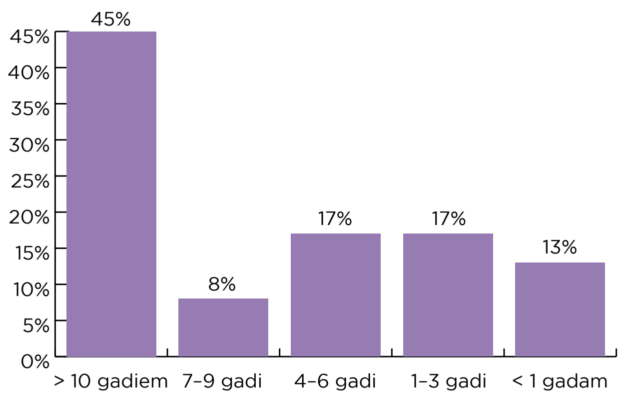
In 2015, the average number of employees, including employees on long-term leave, was 138. As at 31 December 2015, the FCMC employed 145 employees, of which:

- 116 (80%) were engaged in performing core activities and 29 (20%) were engaged in performing support functions;
- 97 (67%) were civil servants and 48 (33%) were employees;
- all employees were engaged in performing intellectual work.

In 2015, the staff turnover rate was 4.1%. In the reporting year, 23 employees were hired by the FCMC, with 20 employees being hired for ensuring core activities and three employees – for support functions, of which five employees were hired by the FCMC for a specified period of time – for the term of the extended leave of absence of employees (child care leave). After the probation period, in accordance with the established adaptation plan, all employees received a positive assessment and continue employment with the FCMC. During the reporting year, the FCMC terminated employment relationships with six employees, including one employee who had been hired by the FCMC to replace an employee on an extended leave of absence (child care leave). Of the five permanent employees who terminated their employment relationship with the FCMC, three chose to pursue a career in the private sector, while the other two passed the selection competitions and continued their careers in international financial institutions in the USA and Germany.

At the end of 2015, 87% (126) of employees of the FCMC had been employed by the FCMC for more than one year, 40% (58) employees – for 14 years, i.e. as of its establishment in 2001, and 13% (19) employees had been employed by the FCMC for less than a year.

Figure 29.
Breakdown of staff by length of service at the FCMC (%)



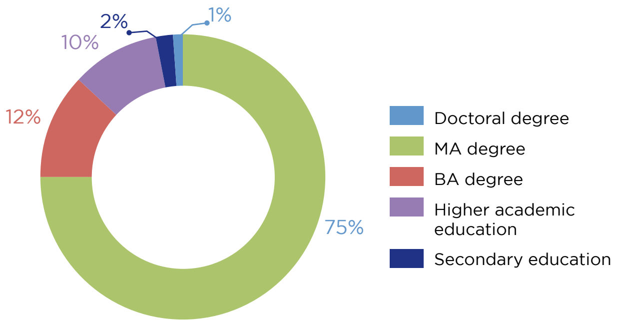
During the reporting year, 82 (57%) employees were assigned on 509 business trips, of which:

- 50 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 (EBA, EIOPA and ESMA);
- 37 employees took part in the ECB working groups related to the functioning of the SSM;
- nine employees took part in 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.

12.2. Staff qualifications

At the end of the reporting year, 98% (142) of the FCMC employees had a university degree (of which 75% had a Master's Degree), but 2% (3) of employees had general secondary or professional secondary education.

Figure 30.
Breakdown of the FCMC staff by education (%)

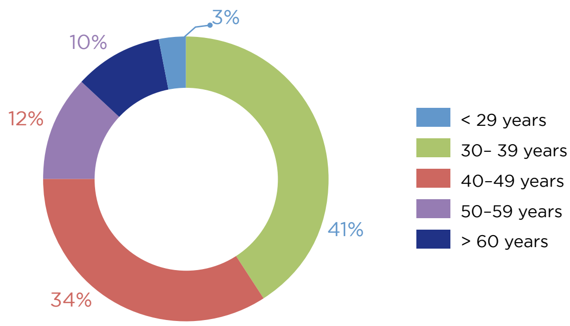


12.3. Breakdown of the FCMC staff by gender and age

In 2015, 72% (105) of all FCMC employees were women and 28% (40) were men. At the end of 2015, the age structure of the staff is characterised by the following indicators: 3% (5) of employees were aged up to 29, 41% (60) were aged from 30 to 39, 34% (49) were aged from 40 to 49 and 21% (31) were aged over 50.

AT the end of 2015, the average age of the FCMC employees slightly increased compared to the previous year and comprised 42 years.

Figure 31.
Breakdown of the FCMC staff by age groups (%)



12.4. Staff performance appraisals

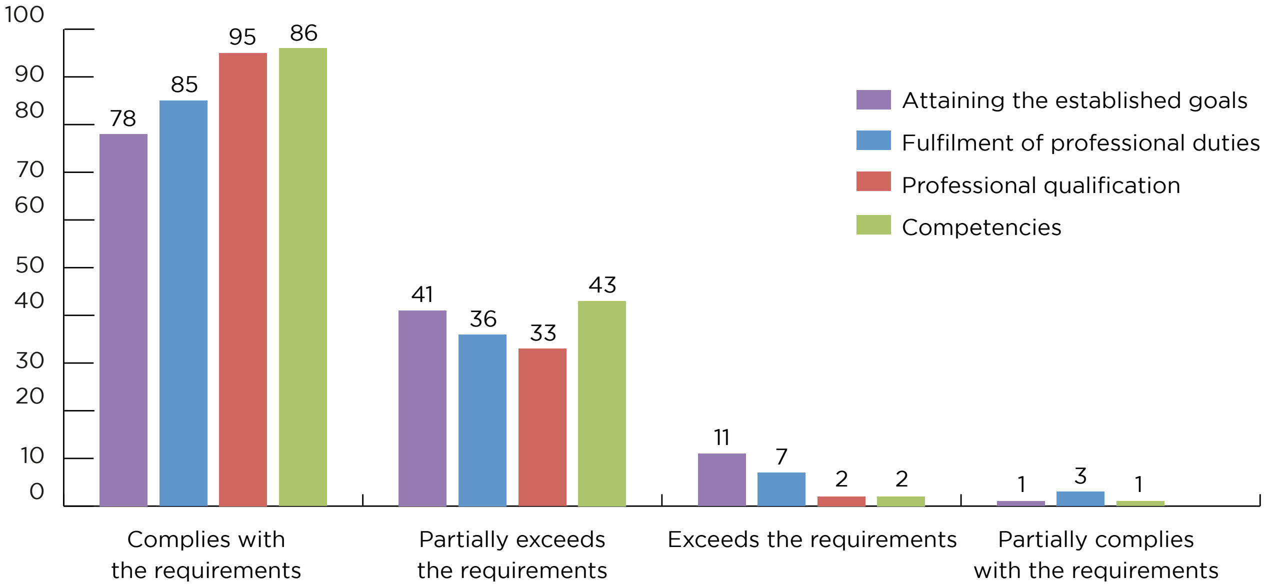
2015 was the sixth year since the FCMC started carrying out staff performance appraisals (SPA). In 2015, under the procedure set forth by the FCMC, 131 employees underwent performance appraisals, including 21 individuals heading structural units (including three members of the board) and 110 were experts.

Four criteria were assessed within the 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-six per cent of employees received the overall assessment of all criteria as *Complies with the requirements*, 33% of employees received the assessment *Partially exceeds the requirements*, and 1% of the employees received the assessment Exceeds the requirements and Partially complies with the requirements. In 2015, none of the employees received the overall assessment of all criteria as *Fails to comply with the requirements*.

The majority of employees also received the assessment *Complies with the requirements* for each criterion separately – for attaining the established goals – 60% (78) employees, for the fulfilment of professional duties – 65% (85) employees, for compliance with the requirements of professional qualification – 73% (95) employees and for the required job-related competencies – 66% (86) employees.

Figure 32.
Breakdown of the SPA assessment by criteria (number)



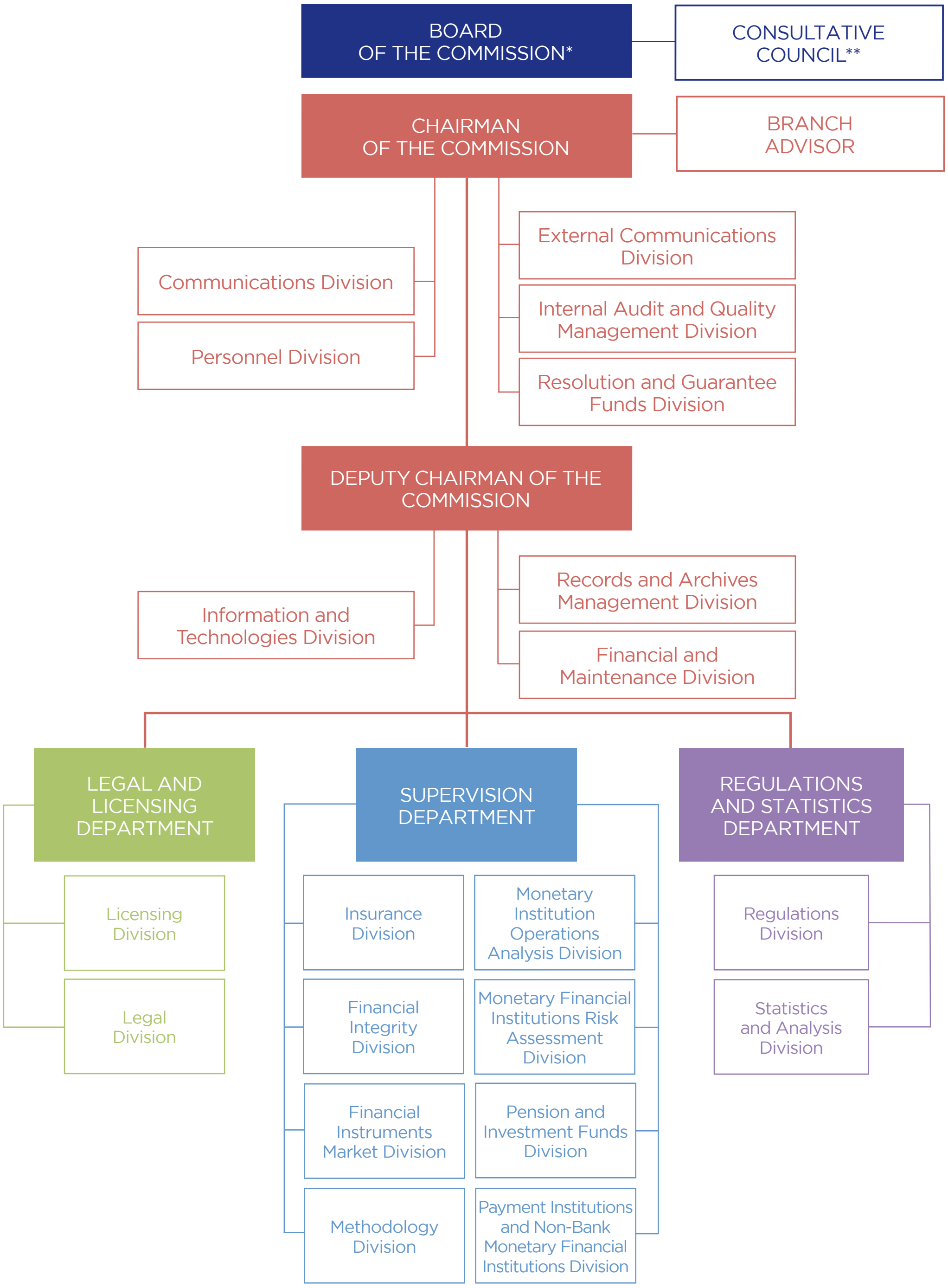
12.5. Improving staff qualifications

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, 95 (66%) 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 the administration and application of laws and regulations, financial analysis, risk management, anti-money laundering, development of the guidelines and key principles of the strategy, electronic payments, procurement management, record keeping, information technologies, presentation and management skills.

To supplement the knowledge in the area of banking risk management, stress testing methodology and practice, capital requirement of the insurance sector *Solvency II*, the bank capital requirement *(Basel III)* and on other matters related to financial supervision, 54 (37%) of the FCMC employees attended seminars abroad.

Within the scope of the European System of Central Banks and the SSM, the FCMC organised three seminars in Riga: *Working in remote and multicultural teams, Risk management and risk-based auditing and Auditing banking supervision under the SSM*, attended by six (4%) FCMC employees.

13. 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 heads of public organisations (professional associations) of the financial and capital market participants.

14. INANCING 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 2015, within the scope of the budget for ensuring the FCMC activities, the FCMC also managed the DGF and the FPI, as well as administered the FSF and single resolution contributions. The DGF and FPI assets are accumulated and used for the purposes of these funds only, and no deductions are made from the DGF and FPI assets 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 FSF, either. The FSF is remitted to the State budget.

Table 7.
Financing of the activities of the FCMC, 2014–2015, in EUR

	ACTUAL PERFORMANCE IN 2014[18]	ACTUAL PERFORMANCE IN 2015[18]	BUDGET FOR THE REPORTING YEAR	BUDGET PERFORMANCE FOR THE REPORTING YEAR,%	SHARE OF THE ACTUAL PERFORMANCE IN TOTAL, %
REVENUE (+)	**6 428 323**	**8 077 784**	**7 398 000**	**109**	**100**
PAYMENTS BY PARTICIPANTS OF THE FINANCIAL AND CAPITAL MARKET	6 419 633	8 057 039	7 380 095	109	100
REVENUE RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	4 743 541	6 078 714	5 540 950	110	75
Payments by credit institutions	4 663 670	5 860 609	5 481 620		
Payments by credit unions	29 169	31 889	31 830		
Payments by payment institutions	14 955	42 231	15 335		
Payments by electronic money institutions	35 747	143 985	12 165		
REVENUE RELATED TO THE SUPERVISION OF FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	512 633	762 161	586 340	130	9
Payments by participants of the financial instruments market	341 685	491 997	401 685		
Payments by private pension funds	170 948	270 164	184 655		
REVENUE RELATED TO THE SUPERVISION OF INSURANCE	1 163 459	1 216 164	1 252 805	97	15
Payments by life insurance companies	219 765	260 602	229 790		
Payments by other insurance companies	943 694	955 562	1 023 015		
OTHER REVENUE	8 690	20 745	17 905	116	0.3

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

	ACTUAL PERFORMANCE IN 2014[18]	ACTUAL PERFORMANCE IN 2015[18]	BUDGET FOR THE REPORTING YEAR	BUDGET PERFORMANCE FOR THE REPORTING YEAR,%	SHARE OF THE ACTUAL PERFORMANCE IN TOTAL, %
EXPENSES (-)	**6 899 390**	**7 438 131**	**8 182 865**	**91**	**100**
Work remuneration, other payments to employees, and mandatory state social insurance contributions	4 883 630	5 366 083	5 859 500	92	72
Employee insurance	28 151	36 857	32 645	113	0.5
Raising professional qualification of the staff	117 454	94 024	136 980	69	1.3
Telecommunications, liaison and information	147 280	153 077	177 955	86	2
Information to the general public, internal and external communication	63 782	68 339	86 025	79	1
Maintenance and operational expenses	633 513	676 535	653 485	103	9
Services for the provision of supervision	18 965	11 312	34 575	31	0.1
International cooperation	885 071	891 929	1 036 800	86	12
Amortisation/depreciation of capital investments	121 544	139 975	164 900	85	2
RESULT	**-471 067**	**639 653**	**-784 865**		

To ensure the financing for the provision of the activities of the FCMC in 2015, the increase whereof was 15%, compared to the forecasts of 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 by the FCMC from the accumulated funds carried forward from the previous reporting years. In light of the necessary amendments to the FCMC budget of 2016 and the fact that the insurance sector did not achieve the volume determined for the financing of the FCMC, the FCMC Board decided to recognise the share of refinancing for 2015 in the revenue of the FCMC in 2015 and does not determine it as advance payments in 2016.

In 2015, the total expenses of the FCMC amounted to 7, 473.4 thousand EUR. In 2015, the FCMC expenses, excluding provisions for annual leave as provided for in the FCMC budget amounted to 7, 438.1 thousand EUR, which was 9% lower than budgeted (8, 182.9 thousand EUR). The resources of 2015 for ensuring the FCMC activities were planned through the application of the 818.3 thousand EUR of accumulated result of the FCMC, however, in light of the decision of the FCMC not to include the share of refinancing of the payments by financial and capital market participants for 2015 into the FCMC revenue for 2015 and the fact that the FCMC was able to save on separate expenses items, it ended the financial year in a budget surplus of 639.6 thousand EUR. In 2015, the excess of expenditure over income, including provisions for annual leave and bonuses amounted to 604.4 thousand EUR, which increased 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, and the amount of the expenses required for ensuring the activities of the FCMC, taking into account the cost of supervision of the relevant market segments.

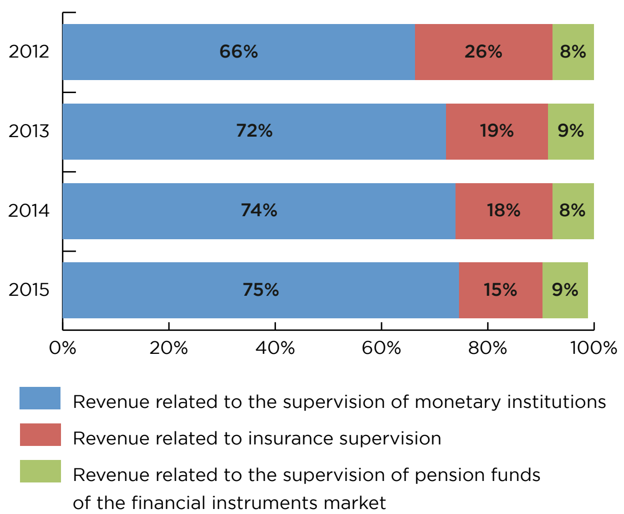
Table 8.
Changes in the FCMC financing structure, 2013–2015, %

FINANCIAL AND CAPITAL MARKET SEGMENT	SHARE OF BUDGETED REVENUE, 2013	SHARE OF BUDGETED REVENUE, 2014	SHARE OF BUDGETED REVENUE, 2015
Supervision of monetary financial institutions, financial instruments market and pension funds	81 %	82 %	83 %
Supervision of the insurance market	19 %	18 %	17 %

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 also been gradually reduced in the overall budget of the FCMC, but, as a result, the financing from the monetary financial institutions has increased.

The revenue and expenditure budget of the FCMC for 2014 and 2015 has been planned having regard to the needs of ensuring the activities of the FCMC.

Figure 33.
Breakdown of the FCMC financing, 2012 – 2015, share



In 2015, staff remuneration costs accounted for the largest share (72%) 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 by legal acts for the employees of public administration institutions.

Table 9.
Breakdown of FCMC staff remuneration, 2015, in EUR

Remuneration	**5 438 161**
Salaries and similar payments	**4 409 668**
including bonuses	175 940
including supplements	64 896
including remuneration to the FCMC Board	352 733
Mandatory state social insurance contributions	**991 636**
including mandatory state social insurance contributions performed on the remuneration of the FCMC Board	54 324
Staff health insurance	**36 857**

In the first half of 2015, the FCMC employees were actively engaged in the process of ensuring the Latvian Presidency of the EU council, participating in events of the corresponding competence. Overall, nine employees were involved in the Presidency events, who took part in the legislative working groups in the European Parliament regarding topics such as combating money laundering operations, improving the flexibility and resilience of the banking system, securities transactions, international payment systems, etc. To ensure these activities, it was necessary to cover the business trips expenses for repeated trips to Brussels from the FCMC budget and to ensure supplements for the fulfilment of additional duties. The sum of expenses related to the Latvian Presidency of the EU Council for ensuring the trips comprised more than 104 thousand EUR, which was later reimbursed by the Ministry of Finance and the Ministry of Justice. The supplement for intensive work was added to the remuneration of the employees involved in the processes of the Latvian Presidency of the EU Council, which is defined by the Cabinet of Ministers of the Republic of Latvia and which had to be ensured in this process, disbursing 15 thousand EUR in total.

The FCMC continued to invest resources into the technical supply necessary for its everyday activities, for ensuring its information exchange with the ECB, as well as with other involved entities, however the total amount of long-term investments was not increased in 2015.

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.

Table 10.
Membership fees paid by the FCMC to the EU and global organisations, 2014–2015

	2014, IN EUR	2015, IN EUR	CHANGES IN 2015/2014
Payments to EU organisations	439 951	462 611	5.1%
Payments to global organisations	34 593	35 534	2.7%
Total	**474 544**	**498 145**	**5%**

During 2015, the FCMC continued active participation in the practical implementation and refining of significant Eurozone projects, such as the SSM and the single resolution mechanism. These tasks required active and direct involvement of the FCMC employees in the events organised by the ECB and the bodies thereof, visiting the ECB headquarters in Frankfurt. The FCMC also continued working in a number of other international organisations with respect to the development of the EU legal acts and methodologies of supervisory institutions and practical information exchange regarding the issues under FCMC competence. Due to the above, the business trip expenses of the FCMC were increasingly growing, however, in light of the reimbursement of the expenses of the trips in an amount of 122.7 thousand EUR, the total actual amount of the business trips expenses in 2015 reduced by 10% (in 2015, the total number of business trips exceeded 600).

Table 11.
Breakdown of the FCMC business trips expenses, 2014 – 2015, in EUR

	2015	2014
Training related business trips	76 524	87 203
Job related business trips	371 730	411 604
including business trips for ensuring the supervisory process	5 621	429
including business trips related to representation in EU institutions	295 309	365 438
Total	**448 254**	**498 807**

With respect to the growing workload of the FCMC, within the scope of the SSM, and the related increase in the number of employees, in 2015, the FCMC leased additional office premises, comprising in total 1, 858 m^2. In 2015, the expenses for the lease of office premises of the FCMC totalled 315.6 thousand EUR, with the maintenance costs thereof being 89.2 thousand EUR.

In 2015, the job position o Branch Advisor was opened in the FCMC. In September 2015, the Branch Advisor was posted to work in the Embassy of Latvia in the USA and for ensuring his activities in the USA 30.5 thousand EUR were expended in addition to the work remuneration, benefits for service abroad and business trip expenses.

The financial statements of the FCMC for 2015 and financial statements of the DGF and FPI for 2015, which are subordinated to the FCMC, as well as independent auditor reports on them are available on the FCMC www.fktk.lv.

15. INTERNAL AUDIT AND QUALITY MANAGEMENT

In 2015, the Internal Audit and Quality Management Division, objectively verifying the functions and processes of the FCMC, provided the 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. The findings of each internal audit are reported to the FCMC Board.

> The FCMC quality management and internal control systems are functioning sufficiently effectively and are constantly refined.

In the reporting year, three internal audit reviews were completed and two scheduled internal audit reviews were started, during which the deficiencies in control were discovered in the following areas:

- organisation of processing and protection of personal data;
- planning of the supervisory measures applied to the financial and capital market participants;
- documenting of the recruitment process and storage of documents;
- granting, calculation and disbursement of work remuneration;
- preparation of the opinion on the draft laws and regulations prepared by the EU supervisory authorities.

According to the findings of the performed internal audit reviews, it was concluded that in the audited areas, the quality management and internal control systems have been established and are functioning in all material aspects, however, there is some room for improvements, and the assessed control is generally adequate, sufficient and efficient, which provides sufficient assurance that the FCMC risks are being managed and the objectives of the institution are achieved.

Aimed at the improvement of the functioning of the quality management and internal control systems and the mitigation of potential risks and adverse effects, during the reporting year, the auditors having carried out the internal audit reviews, had made 31 recommendations aimed at the improvement and enhancing of the internal control system of the FCMC, of which five or 16% were rated as high priority, 25 or 81% were rated as moderate priority, and one or 3% were rated as low priority areas.

During the reporting year, the structural units, which were in charge of the prevention of discovered deficiencies, had implemented a number of measures to improve the effectiveness of the processes and mitigate the identified risks. The work on implementation of the internal audit recommendations will also continue in 2016, in line with the set time schedules for implementation of the internal audit recommendations.

In the reporting year, four consulting projects were completed in the areas which were related to the planning of the activities of the FCMC, its risk management and improvement of the processes thereof.

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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