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ANNUAL REPORT AND
ACTIVITY REPORT OF THE
**FINANCIAL AND CAPITAL
MARKET COMMISSION**
FOR 2019



FINANȘU UN
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KOMISIJA

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INTRODUCTION



ABBREVIATIONS USED IN THE ANNUAL REPORT

FPI – Fund for the Protection of the Insured

AIF – Alternative Investment Funds

AIFM – Alternative Investment Fund Managers

USA – the United States of America

BRRD – Bank Recovery and Resolution Directive

CET1 – Common Equity Tier 1 Capital Ratio

CIR – Cost-to-Income Ratio

CRR/CRD – Capital Requirements Regulation/
Capital Requirements Directive

O-SII – Other Systemically Important Institution

O-SIICB – capital buffer of another systemically important institution

EIOPA – European Insurance and Occupational Pensions Authority

EBA – European Banking Authority

ECB – European Central Bank

EEA – European Economic Area

EC – European Commission

EU – European Union

ESRB – European Systemic Risk Board

ESMA – European Securities and Markets Authority

FATF – Financial Action Task Force

FinTech – information technology-based financial services innovations

FIML – Financial Instruments Market Law

FCMC – Financial and Capital Market Commission

FSF – Financial Stability Fee

GC – Guaranteed Compensation

ICAAP – Internal Capital Adequacy Assessment Process

ILAAP – Internal Liquidity Adequacy Assessment Process

NPL – Non-performing Loans

InsurTech – Information technology-based insurance services innovations

IT – Information Technologies

MiFID II – Markets in Financial Instruments Directive II

MiFIR – Market in Financial Instruments Regulation

Moneyval – Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures

LPSEM – Law on Payment Services and Electronic Money

DGF – Deposit Guarantee Fund

MLTPF – money laundering and terrorism and proliferation financing

AML/CTPF – anti-money laundering and combating terrorism and proliferation financing

AML/CTPF Law – Law On the Prevention of Money Laundering and Terrorism and Proliferation Financing

CIS – Commonwealth of Independent States

CTPLI – Compulsory Third-party Liability Insurance of the Owners of Motor Vehicles

OECD – Organisation for Economic Cooperation and Development

OFAC – USA Office of Foreign Assets Control

CCyB – Counter-cyclical Capital Buffer

PSD II – Payment Services Directive

CRPC – Consumer Rights Protection Centre

ROE – Return on Equity

IFRS – International Financial Reporting Standards

IMF – International Monetary Fund

SREP – Supervisory Review and Evaluation Process

SFPS – State-Funded Pension Scheme

SRF – Single Resolution Fund

SRB – Single Resolution Board

SSM – Single Supervisory Mechanism

VISION, MISSION, VALUES

FCMC VISION

Our vision is to be a financial sector supervisor and regulator exercising its powers in a consistent, commensurate, clear, and explicit manner.

FCMC MISSION

Our mission is to take care of the public interest by regulating and supervising the activities of the financial and capital market participants; promoting the protection of the interests of investors, depositors, and insured persons, including financial literacy; and promoting the development and stability of the financial and capital market.

FCMC VALUES

ACCOUNTABILITY – we are accountable for our conduct and decisions. Decisions we take are well-reasoned and correspond to the public interest. We are reliable.

PROFESSIONALISM – we are industry experts constantly enhancing our professional knowledge and skills, demonstrating initiative, decisiveness, and a results-oriented conduct.

DEVELOPMENT – we are open to new ideas and technologies. We respond in a timely and accurate manner to the entry of new technologies into the financial sector and promote the development of the financial sector; we are developing as an organisation, becoming more effective, introducing innovative governance and processes rooted in modern technologies.

CHAIRPERSON'S FOREWORD



THE LATVIAN FINANCIAL SECTOR HAS RESTORED ITS REPUTATION; NOW WE SHOULD SEEK WAYS TO DEVELOP

We live in a changing world, and the events in the first half of 2020 with respect to the quick spread of the COVID-19 disease caused by the new coronavirus clearly show that challenges come in a row - thus, fast response to changes and the ability to adapt thereto, or even use these changes for development, characterises the quality which is the key to success nowadays.

The year 2019 in the Latvian financial sector passed with the implementation of *Moneyval* and FATF recommendations. The supervisor, other institutions, and the financial market participants themselves put in much effort to this effect.

I am satisfied that, by the joint effort of Latvian institutions, we have achieved the result we have been hoping for - but it is quite clear that there is still much work to be done in the field of combating financial crimes. We should elaborate on the nuances of perspective, trying to achieve possibly more uniform understanding regarding the application of laws and regulations. The core principles of the risk assessment-based approach should be consolidated in the viewpoints of the financial sector professionals, but a prerequisite for successful implementation of such approach is the ability of all parties to assume responsibility.

June 2019, the *Saeima* (Parliament) of the Republic of Latvia approved in the final reading the amendments to the Law on the Financial and Capital Market Commission, providing for significant changes in the governance model of the FCMC. On 30 March 2020, the new FCMC Board started working in the composition of three members, fully introducing the changes stipulated by the amendments to the Law on the Financial and Capital Market Commission.

A significant milestone is the discussion about the possibility of merger of the FCMC and the Bank of Latvia launched in the second half of 2019. We are currently in the assessment stage, and this process proceeds in a gradual and structured way, initially aggregating all pros and cons of such decision.

Upon taking office of the FCMC Chairwoman, one of my first goals was to look into the situation in detail, setting as one of my priorities the formation of strategic dialogue with both market participants and the recipients of the services of financial market participants, especially foreign investors and entrepreneurs. Numerous meetings where sectoral topicalities were discussed brought to light the issues that were included in the worklist to be done by the FCMC, emphasising the need to seek balance and find an approach and solutions acceptable to all parties. At the same time, speaking about prevention of financial crimes, I have emphasised that there is no reason to be nostalgic about the past. Such times and such approaches will not return to the Latvian financial sector. Transparency and a clear origin of finance - these are the keywords that both the financial sector participants and the recipients of financial services must choose as the basis for their activities.

The other priority of my work, in its turn, pertains to a forward-looking perspective. I see the year 2019 as the closing stage of the large changes; this is also confirmed by the key indicators of the banking sector. Now it is time to move towards development. The results of the survey performed by the FCMC regarding the use of *FinTech* solutions in the financial sector show that this is the course of action that might speed up the progress of Latvia. It is equally important to strengthen the potential of the Latvian capital market. We have a lot of work to do, so we will jointly seek to accomplish it all step by step.

During the reporting year, the FCMC itself went through significant changes, as well. On 13

Santa Purgaile
FCMC Chairwoman

REPORT OF THE BOARD

The FCMC has been operating as an autonomous public institution since 1 July 2001, regulating and monitoring 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, which up until 15 July 2019, consisted of five members: Chairman of the FCMC, his deputy, and three members of the Board, who concurrently were the directors of the departments.

On 13 June 2019, the *Saeima* (Parliament) of the Republic of Latvia adopted in the final reading the amendments to the Law on the Financial and Capital Market Commission, providing for gradual replacement of the management and change of the governance model of the FCMC.

Changes to the law provide that, instead of the previous five Board members, the FCMC Board will henceforth consist of three members - the Chairperson and two Board members. The Chairperson, upon the proposal of the Cabinet, and the Board members, upon the proposal of the Chairperson, are approved in the office by the Saeima of the Republic of Latvia.

In light of the above, in 2019, the composition of the Board changed – until 15 June 2019, the FCMC Chairman was Pēters Putniņš and the Deputy Chairwoman, Gunta Razāne. The Director of the Supervision Department, Nora Dambure, Director of the Legal and Licensing Department, Gvido Romeiko, and Director of the Regulations and Statistics Department, Ludmila Vojevoda, were also the members of the Board, and they continued working also after 15 July 2019, when the Head of the Monetary Financial Institutions Operations Analysis

Division of the FCMC Supervision Department, Kristīne Černaja-Mežmale, was approved as the temporary FCMC Chairwoman. While on 24 October 2019, the Saeima of the Republic of Latvia approved Santa Purgailis in the office of the Chairwoman of the FCMC, and on 7 November 2019, Kristīne Černaja-Mežmale was approved in the office of the Board Member of the FCMC.

Once a week, the Chairwoman of the FCMC convenes and chairs the meetings of the Board aimed at reviewing the most important matters and decision-making. In 2019, 61 meetings of the FCMC Board were held, during which 199 decisions were adopted (in 2018 - 56 meetings with 200 decisions adopted, respectively).

To promote the efficient monitoring of the financial and capital market, ensuring the cooperation of the FCMC with the professional associations of the financial sector, meetings of the Consultative Council of the financial and capital market are also convened on a regular basis. In 2019, 12 such meetings were held during which 30 draft laws and regulations binding on the financial and capital market were reviewed (in 2018 - 38 draft laws, respectively).

4 November 2019 marked five years since the commencement of the SSM established by the ECB, and in the field of supervision of Latvian systemically important banks, also during the reporting year, the employees of the FCMC continued to participate in the work of the SSM joint supervisory work teams and in the establishment of supervision practice. In the reporting year the prudential supervision of significant Latvian banks - AS *Swedbank* and AS *SEB banka* - was implemented by the ECB in close cooperation with the FCMC. In March 2019, the ECB, taking into consideration the proposal of the FCMC, took a decision to undertake direct supervision over AS *PNB Banka*; thus, three Latvian commercial banks were under the direct supervision of the ECB within the scope of the SSM. When undertaking direct supervision over AS *PNB Banka*, the ECB classified the bank as significant in accordance with Article 6(4) of Regulation No 1024/2013. The ECB's decision was taken following the request of the FCMC, which, in its turn, was related to the international litigation against the Latvian state (*AS PNB Banka and others v. Republic of Latvia* (ICSID Case the Head of the Monetary Financial Institutions Operations Analysis Division of the FCMC Supervision Department,

Kristīne Černaja-Mežmale No ARB/17/47)).

During the reporting period, the FCMC ensured the prudential supervision of less important banks, whereas the ECB continued to prescribe a uniform framework and guidelines for supervising such banks.

The FCMC, ensuring continuous monitoring of market participants, carried out the evaluation of the performance results of market participants, the analysis of the financial statements and activity inspections thereof, *inter alia*, on-site inspections.

In 2019, the FCMC carried out 21 on-site inspections, including six on-site inspections of banks, one - in an insurance company, four on-site inspections of insurance brokers, four on-site inspections of cooperative credit unions, one - in a payment institution, two on-site inspections in private pension funds and two on-site inspections of the investment service providers (one - in a credit institution and one - in an investment brokerage company (investment firm)). The FCMC also carried out the one-site inspection of the Central Securities Depository. In 2019, the FCMC carried out on-site information system inspections in three banks, two insurance companies, the Central Securities Depository, as well as in three credit unions, one payment institution, and one electronic money institution.

On 15 August 2019, the ECB, as the direct supervisor of AS *PNB Banka*, resolved to recognise it as the financial institution failing or likely to fail. The European Single Resolution Board, in its turn, adopted the decision not to carry out the resolution of AS *PNB Banka*, namely, not to take measures to stabilise the operation of the bank. Considering the above mentioned and taking care of the protection of deposits of the bank clients, the FCMC Board, in an extraordinary meeting, took the decision to suspend the provision of financial services for AS *PNB Banka* and resolved on the unavailability of deposits. The ECB, as the direct supervisor of AS *PNB Banka* under Regulation No 806/2014 adopted such decision, having detected that the bank has failed to comply with regulatory requirements and having assessed the financial situation of the bank.

Whereas on 22 August 2019, the FCMC filed an application to the Riga City Vidzeme District Court on the commencement of the insolvency proceedings of AS *PNB Banka*, and, on 12 September 2019, the court declared the bank insolvent.

In the extraordinary meeting held on 6 March 2019, the FCMC adopted the decision to approve the creditor verification methodology submitted by the liquidators of *ABLV Bank AS* in liquidation; therewith the self-liquidation process of the bank, under the control of the FCMC, could proceed, by starting to apply the methodology and to introduce the disbursement mechanism. The development of the methodology was coordinated with the Office for Prevention of Laundering of Proceeds Derived from Criminal Activity (currently - the Financial Intelligence Unit of Latvia).

In 2019, the FCMC also ensured regular supervision in the field of financial crime prevention. Four banks - *Rigensis Bank AS*, *AS PrivatBank*, *AS Baltic International Bank* and *AS SEB banka* – had a fine imposed due to non-observance of the AML/CTPF Law requirements in the sum total of EUR 5,398,039, along with operational restrictions, as well as a set of duties to be fulfilled, in order to arrange and enhance internal control system of the banks. The FCMC carried out the follow-up supervision of the fulfilment of these obligations. In addition, in one instance, a warning was expressed to the Board member in charge of the AML/CTPF. In turn, in 2019, in the non-bank sector one payment institution and one investment management company had fines imposed due to non-observance of the AML/CTPF Law requirements in the sum total of EUR 18,188. In addition, on one occasion, a warning was expressed to the persons in charge of the AML/CTPF.

In 2019, the process of transformation of the banking sector continued – 12 banks, whose operations had previously been focused on servicing foreign clients, continued introducing new business models under the supervision of the FCMC. During the reporting year, the share of foreign deposits in total deposits continued decreasing, and in December 2019 it comprised 18.8% (at the end of 2018 – 20.3%). In Latvian banks, domestic and EU country deposits dominate; these have reached 94% of the total deposit amount – 81% were the financial resources of domestic clients, but 13% the resources of EU country clients.

In 2019, concerning the issues of anti-money laundering, the FCMC representatives participated in the work of *Moneyval*, as well as participated in the execution of the tasks set by the plan “Action Plan for the Prevention of Money Laundering and Terrorist Financing for the Time Period until 31 December 2019” approved by the Cabinet of Ministers. Additionally, the FCMC closely cooperated with the super-

visory authorities of the Baltic States and Sweden, setting up a special supervisory task force for the prevention of financial crimes.

In the reporting year, the FCMC Board approved a new FCMC Operational Strategy for 2019 - 2023, setting five priority areas:

- to ensure consistent and professional supervision of the financial sector by developing an appropriate and proportionate regulatory environment of the financial sector, promoting a high level of compliance of the financial sector, and mitigating the risks, *inter alia*, in the AML/CTPF field, as well as by raising effectiveness of the financial sector supervisory and control measures and facilitating deeper integration in the SSM;

- to continue developing as a professional and responsible organisation with effective corporate management and processes by improving corporate culture and developing professional knowledge and skills of the staff, as well as the IT used on an everyday basis, in light of the

development trends thereof and the needs of the users;

- to actively involve in the dialogue with the representatives of the financial sector, implement clear and understandable strategic communication with the public, and to continue enhancing financial literacy of the population;

- to facilitate a business environment favourable for innovative and reliable financial services and to proactively follow up the development of financial innovations, to actively be involved in the dialogue with the participants of the financial sector regarding risks caused by innovations, and to ensure the timely response and adaptation of the supervisory approach;

- to continue stronger integration in the Single Resolution Mechanism and the Single Deposit Insurance Mechanism, to improve the effectiveness of the crisis management mechanism of Latvian financial sector, and to ensure the resolution solution corresponding to the public interest.

FCMC ACTIVITIES IN 2019



SUPERVISION

SUPERVISORY PRINCIPLES

The FCMC regulates and oversees the sector of the Latvian commercial banks in close co-operation with the ECB within the scope of the SSM and with the European Supervisory Authorities, as well as pursuant to the best international credit institution supervisory practices and operational frameworks.

The main principle of supervision is to identify, as soon as practicable, any problems in the financial market or in the activity of an individual market participant in order to immediately issue the supervisor's opinion and recommendations or to require the elimination or minimisation of the problems.

Supervision is one of the key pillars of a sound financial system, which complements the self-regulation of financial markets and the internal control mechanisms of each financial institution. The main objective of supervision is to ensure that each supervised institution is managed professionally and prudently in accordance with the nature of its activities and exposure to risks.

To promote the protection of the interests of investors, depositors and the insured, as well as the stability of the financial and capital market, the FCMC shall carry out continuous and comprehensive supervision over market participants by:

- determining the priorities of the supervision of each financial sector for the coming year, based on risk assessment and trends in the financial market;

- developing supervisory programmes for each sector as well as for each market participant, based on the defined priorities;

- maintaining a constant dialogue with market participants and professional associations regarding the new requirements and the trends in the relevant market sectors, and the risks and problematic issues pertaining thereto;

- ensuring that new market participants with a sound capital base and clear and viable strategy enter the market;

- carrying out off-site analysis of the indicators characterising the activities of market participants, risks and risk management systems, continuously focussing on the qualitative and quantitative changes of the financial indicators as well as compliance with regulatory requirements and the effectiveness of corporate governance;

- ensuring, within the scope of its competence, the disclosure of true and fair information about the activity of market participants;

- carrying out on-site inspections and horizontal off-site inspections;

- assessing the quality of financial services and ensuring consumer protection within the scope of its competence;

- in cases of non-compliance with regulatory requirements, imposing preventive and corrective measures on the market participants in a timely manner.

The FCMC has been continuously improving the methods applied in the supervision of all market participants.

BANKING SECTOR

In 2019, the FCMC continued to consolidate the framework of intensive banking supervision, the purpose of which is to take risk-based and result-orientated supervisory measures and enable the FCMC to get involved in the activities of the banks and take the necessary measures to resolve potential and existing problems or reduce losses in a timely manner.

At the beginning of 2019, based on the assessment of the operational risks of credit institutions and of the trends of the financial system, the FCMC set the supervisory priorities.

CREDIT INSTITUTION SUPERVISORY PRIORITIES SET IN 2019:

- supervision of the process of successful implementation of strategies and new business models and the result thereof, as well as the assessment of the earning capacity, focussing on further viability and sustainability of the business models of the banks;
- evaluation of internal governance, operational compliance, and reputational risk, focussing on effective operation of internal control systems of the banks and evaluation of the risk appetite of the banks, as well as the changes in the risk tolerance of the banks, especially, considering the aspect of the change of business models of the banks;
- credit risk supervision, concentrating on the NPL and ensuring the development of the NPL strategies, as well as risk management as a whole. In parallel, the supervisors still focus on introduction of IFRS 9.

Based on the priorities, the minimum amount of supervisory measures was identified and, considering the existing resources, the supervisory measure plan was drawn up for 2019, which comprised both on-site and off-site supervisory measures.

Supervision of banks in 2019 was constantly based on interrelated methods — the off-site monitoring of the performance of banks, based on the analysis of their financial statements and other operational information at the disposal of the FCMC, as well as on-site inspections.

For the purposes of evaluating the strategy, business model, and earning capacity, the supervisory focus in 2019 was on active following up on how the new bank strategies and business models are introduced. Regular on-site meetings were organised with the management of each less-important bank, during which the banks presented to what extent they

have implemented the new strategies previously presented to the supervisors. The supervisors compared in detail the performance of the banks with the banks previously forecasted and presented to the supervisors before starting the business model change. During these quarterly dialogues, the FCMC listened to the banks, gathering information and identifying possible barriers to successful introduction of new strategies, as well as continuing to carry out the verifications of the financial forecasts of the banks, to ascertain that the new business models would be able to demonstrate their viability also in the long term, ensuring stable indicators of the earning capacity of the banks.

A number of off-site measures were taken for the assessment, analysing the reports submitted by the banks, performance indicators, and other information at the disposal of the supervisors; the material risks inherent to the banking business were also assessed. Within the scope of assessment of the business models and earning capacity, indicators such as return on equity (ROE), cost-to-income ratio (CIR), income stability, planned target market and possible changes in the number of customers, interest and tariff policy, etc. were assessed. Both the information obtained during regular meetings with the banks and the data from the reports submitted by the banks were used in the SREP, determining the personal funds requirements for covering risks inherent to the activities of the banks and probable risks and special liquidity requirements, as well as applying other supervisory measures.

In 2019, the supervisors continued to focus on the assessment of **internal governance, compliance, and reputational risk** in the banks, putting special emphasis in these fields on successful introduction of the change of business models and ascertaining of ensuring appropriate governance structures, effective operation of the internal control systems of the bank, as well as appropriate risk appetite level.

In 2019, special emphasis was still put on constant improvement of the ICAAP, ILAAP, and recovery plans, as well as the quality of data of such reports as COREP and FINREP. Besides, the supervisory process of successful elimination of drawbacks discovered during the previous horizontal inspections continued in 2019.

Assessment of the credit risk and adequacy of provisions, focussing on NPL and risk governance as a whole, remained the supervisory priority also in 2019. The FCMC focussed on the credit risk both in the context of the change of banking business models and in regular

supervisory activities of the FCMC, namely, within the scope of on-site inspections and continuing the supervisory process of elimination of drawbacks discovered during the previous horizontal inspections also in 2019. The supervisors also still focussed on the introduction of IFRS 9.

Requirements were set for the banks with high share of non-performing assets to establish strategies for work with non-performing assets, incl. strategy implementation plan and evaluation of operational environment according to the size, nature, and complexity of activities of each bank, as well as the amount, concentration, and specifics of the non-performing assets. The FCMC assessed the strategies developed by the banks, their quality and credibility, and informed the banks about the directions of improvement. In addition, the FCMC, for the supervisory purposes, asked the banks to regularly submit information on indicators of the non-performing assets and achievement of the goals set in the strategies. The FCMC will also henceforth promote a proactive approach of the banks to effective management and development of the non-performing assets.

CHANGE OF BANKING BUSINESS MODELS

In 2019, the FCMC maintained an intensive dialogue with all banks implementing the business model change by meeting on a regular basis and receiving focussed information from the banks regarding the progress reached and the results achieved on an individualised level of detail. Dialogues focussed on the goals already achieved by the banks, as well as specific challenges the banks face or might face in the nearest future, discussing in more detail the solutions found by the banks, providing feedback on them from the perspective of the supervisors, and achieving uniform understanding with respect thereto.

Changes in the banking business model are to be assessed as comprehensive transformations, and they also affect the balance structure of banks and the bank risk profile, etc.; therefore, in 2019, the FCMC, in addition to business model analysis, carried out a comprehensive assessment of all the existing and potential risks concerning the banking operations and those related to the banking operations. With respect to the previously set strict requirements regarding capital and liquidity, in general, the banks demonstrated to the supervisors the ability to adapt to new circumstances, even given that during the process of the business model change they have considerably reduced their

client base, preserving the cooperation with those clients whose inherent risks the banks are able to manage.

The FCMC has carried out the assessment of banking business models, continuing to pay particular attention to the viability and sustainability criteria, provision of regulatory requirements, implementation of the change of target markets and target clients, and revised financing structure. The FCMC has integrated the assessment results into the SREP. The main directions of assessment were the effectiveness of change management of the banks, role of shareholders, governance model, risk appetite, verifications of financial forecasts, structure of income and expenses. The FCMC also focussed on the changes in the assessment of services, interest and tariff policy, client attraction dynamics, stability of counterparties (cooperation partners), availability of distribution channels, and existence of innovative solutions.

The implementation of the change of business model of credit institutions, focussing on ensuring stable viability and sustainability, is still constantly and scrupulously supervised, and it remains the main target in 2020.

SUPERVISORY REVIEW AND EVALUATION PROCESS

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, is constantly assessing the performance of banks, the level of risks and the quality of their management; and based on the results of the monitoring of these risks, plans the necessary supervisory measures, including on-site inspections.

In 2019, the FCMC continued the SREP according to the SREP guidelines developed by the EBA, as well as the ECB guidelines regarding the SREP of less-important banks, with the process taking place within the scope of supervisory dialogues on the SREP results.

Also in 2020, a significant focus of the SREP is pointed towards the revised banking business models and assessment thereof, paying special attention to the earning capacity, viability, and sustainability of banks, as well as the risks connected with the change of the business model.

Risk assessment, within the scope of the SREP, is being carried out biannually, and it takes into account both the risk level characterising quantitative indices and their thresholds in accordance with the ECB methodology, as well as information on risk management arising out of the on-site inspections, thematic and horizontal inspections, information at the disposal of the FCMC on the observance of the regulatory requirements in the credit institutions, detected internal control system flaws, quality of the capital and liquidity adequacy assessment processes, and the recovery plan assessment.

In 2019, the FCMC carried out intensive off-site monitoring of banking activities, which was based on ICAAP and ILAAP reports, 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:

- a daily report about the dynamics of deposits;
- reports about liabilities to related-party financial institutions;
- minutes of the meetings of bank credit committees, of the management board and supervisory board as well as internal audit reports of banks on the reviews;
- reports on the results of risks and stress tests.

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

Risk assessment of the important banks being under direct supervision of the ECB is carried out annually, by means of the methodology prescribed by the ECB.

Risk assessment, within the scope of the SREP, is carried out on a rating scale from “1” to “4”; in 2019, the following risk ratings were assigned to banks in Latvia:

Risk assessment	Number of banks ¹
1.0 – 1.7 (low risk)	0
1.8 – 2.5 (moderately low risk)	6
2.6 – 3.3 (moderately high risk)	6
3.4 – 4.0 (high risk)	2

¹ Including the banks under the direct supervision of the ECB.

The planning of the supervision of a bank is performed based on the risk rating assigned to it – the required supervisory measures applied to a bank that has been assigned the lowest rating (the institution's activities have a low inherent risk and its risk management is sufficient) are minimal, whereas an institution with the highest risk rating (the institution's activities have a high inherent risk and its risk management is weak) attracts continuous and enhanced supervision.

The SREP results were taken into account when determining own fund requirements for covering the risks inherent to the activities of the banks and probable risks, and for ensuring special liquidity requirements, as well as by applying other supervisory measures (for example, by imposing an obligation to submit reports more frequently, to develop a capital strengthening plan, to develop measures for the reduction of non-performing assets, to improve the internal control system, etc.).

SANCTIONS AND CORRECTIVE MEASURES

Having implemented banking supervision, in 2019, the Board of the FCMC adopted a decision regarding the imposition of sanctions on several banks, as they, by the term laid down in the Credit Institution Law, namely, by 1 April 2019, have failed to prepare and submit the FCMC the annual statement of 2018 together with the certified auditor's report, and the statements had not been timely made public, either. **Thus, the Board of the FCMC imposed various sanctions on eight banks - issuing a warning as well as imposing a fine, being determined in the amount ranging from EUR 4,260 up to EUR 13,490.**

The FCMC imposed a penal sanction on one bank - a warning that it had failed to ensure the limits to large exposures, namely, 25% of the bank's eligible capital, thus failing to comply with the requirement of Article 395(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

GROUP SUPERVISION

In 2019, the FCMC cooperated with the supervisory authorities of the credit institutions of the Member States, which pursuant to the require-

ments of the laws and regulations implement the supervision of groups of credit institutions. In 2019, FCMC staff took part in the work of the four supervisory colleges of the EU Member States' credit institutions.

In 2019, the most significant directions in the agendas of the boards comprised the coordination of supervisory measures, the assessment of the evaluation process of internal capital and liquidity adequacy processes by banks, and the risk profile at the group level, as well as the assessment of the recovery activity plans developed by banks.

ON-SITE INSPECTIONS IN CREDIT INSTITUTIONS

During the reporting year, the FCMC carried out six on-site inspections in banks, paying particular attention to the lending process, including work with problematic assets, as well as risk management functions – management of credit risk, strategy, and business risk. 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 implementation of the action plan in the field of the prevention of deficiencies.

The representatives of the FCMC also participated in the controls initiated by the ECB that were carried out in systemically important credit institutions aiming to assess the quality and compliance of internal models for the calculation of credit risk capital requirements in the banks, as well as the internal governance issues.

CAPITAL ADEQUACY

In 2019, the level of the capitalisation of banks remained high. 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 Tier 1 capital in the case of Latvian banks.

In 2019, eight banks used the possibility to consolidate their capital base in the sum total of EUR 122.8 million, deciding not to divide the audited profit of 2018 or a part of it and leave it at the disposal of the bank. Two banks disbursed the dividend from the audited profit of the previous years.

Within the scope of the supervisory process, the FCMC paid attention to and assessed the

adequacy of capitalisation of the banks with high NPL share.

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 considered when assessing the capital adequacy ratio of banks.

The banks have assessed their internal capital adequacy ratio each year 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 in the current and planned activities of the bank, as well as for covering probable risks, and that a sufficient capital buffer is ensured in the case of the occurrence of potential significantly adverse circumstances affecting their operations. The results of the inspections carried out by the FCMC revealed the areas, in which the banks needed improvements.

During the assessment of bank capital adequacy ratios, 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.

Within the scope of the SREP, in 2019, the FCMC evaluated the level and management of banking risks mentioned in Article 92 of Regulation No 575/2013 (Tier 1 risks) and other risks inherent to the activities of the credit institutions and probable risks (Tier 2 risks), and in accordance with the rights provided for by the Credit Institution Law set the requirements to all banks to maintain the highest fund levels for covering such risks inherent to the activities of the credit institutions and probable risks which are not covered by the fund-level requirements set by Regulation No 575/2013.

LIQUIDITY

Sufficient liquidity of the credit institutions ensures the ability to withstand the potential reduction of the deposit base under the influence of external macroeconomic environment risks, and, for the purposes of ensuring adequate liquidity, the FCMC is entitled to set special liquidity requirements to the credit institutions. The FCMC assesses the risks inherent to the activities of the credit institution and probable risks, taking into account the business model thereof, risk management principles and pos-

sible systemic liquidity risk that might endanger the stability of the financial market of Latvia.

Also in 2019, the FCMC evaluated whether the strategy, procedures, and measures taken by the credit institutions ensure sufficient risk management, whether the amount of liquidity reserves of the credit institutions is sufficient for covering the liquidity and financing risks inherent to its activities and corresponds to the business models. The FCMC evaluated the reports of the credit institutions regarding the process of the liquidity adequacy assessment, and, in 2019, prescribed the special liquidity requirement to 11 banks, the activities whereof were mainly focussed on servicing foreign customers.

RISK MANAGEMENT FUNCTION

In providing financial services, banks need to ensure not only the effectiveness of their operation, but also, in line with the size, nature, and complexity of operations of the bank, to ensure the establishment and efficient implementation of overall risk management function, which is important for their activities.

In 2019, the FCMC, carrying out the inspections of banking activities, continued to focus closely on the quality of management of each key risk, especially on the effective operation of the internal control system of the banks, evaluation of the risk appetite defined by the banks, risk tolerance, and capacity to manage them, specifically evaluating these issues within the context of the change of business models and the MLTPF risk prevention. 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 management in identifying, measuring, and managing each relevant risk, were considered in the assessment of each risk management function. Particular attention was paid to whether the bank manages the material risks inherent to its activities. If necessary, the banks were requested to carry out improvements.

SINGLE SUPERVISORY MECHANISM

4 November 2019 marked five years since the establishment of the SSM. It has three key objectives:

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

Together with the ECB, competent authorities from EU Member States operate within the scope of the SSM (European System central banks and national supervisory authorities). In 2019, under direct supervision of the ECB there were 117 important banks, whereas under the supervision of national competent institutions there were 2,369 less-important banks.

In 2019, three Latvian banks – Swedbank AS, AS *SEB banka* and AS *PNB Banka* (from April of 2019 until withdrawal of the licence on 18 February 2020) - were supervised by the ECB.

These banks are supervised, with the ECB and FCMC staff participating in the joint supervisory work teams, which form the basis of the everyday supervision of important banks.

The FCMC continued to supervise less important banks and, at the same time, in cooperation with the ECB and other national competent authorities, to enhance and adjust the single guidance and guidelines for the supervision of such banks. The FCMC took active part in enhancing single supervisory standards by improving one of the main banking supervision tools - SREP - and promoting consistent application of high-quality supervisory standards to less-important banks.

Due to the representative of the FCMC Board being a member of the Supervisory Board of the ECB, the FCMC was also involved in the process of adopting the SSM decisions on both all of the significant 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 2019, the Supervisory Board of the ECB adopted 2,356 decisions (the most decisions were taken on the following matters - 1,114 licensing decisions, 176 decisions on internal models, 169 decisions on its own capital matters, and 202 decisions in regard to SREP), 18 Board meetings were held, and draft decisions were coordinated and approved in 1,509 written procedures. FCMC experts assessed and provided their view on the issues to be reviewed at the Board meetings as well as on the documents examined 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, FCMC experts constantly took part in the committees and work groups set up by the ECB, contributing to the development and enhancement of the ECB's single supervision methodology, as

well as further coordination of the statutory regulation within the framework of the European Banking Union.

BANKING SECTOR PERFORMANCE IN 2019

At the end of 2019, 13 banks and five branches of banks from the EU Member States were operating in the Republic of Latvia. At the beginning of the year, the merger of DNB Bank ASA and Nordea Bank AB that had been implemented in the Baltic states since autumn of 2017 was completed, resulting in the united bank *Luminor Bank* AB in Latvia and Lithuania continuing to operate as a branch of Estonian *Luminor Bank* AS. During the reporting year, the strategic decision of Danske Bank Group on dissolution of business activities in the Baltic States was also implemented, in light of terminating the operation of Danske Bank Branch in Latvia in the first quarter of 2020. Both referred-to credit institutions, according to the adopted strategic decisions during the reporting year, also implemented gradual reduction of the amount of their loan portfolio. In the third quarter of 2019, the operation of AS *PNB Banka* was suspended and, even though the process of withdrawing the banking licence on the part of the ECB had not yet been completed by the end of the year, the referred-to bank was not actually operating; therefore, its indicators are excluded from the total banking sector indicators in the overview, in order to assess the operation of active banks. In turn, in the last quarter of the year (8 November 2019), the licence for operations of a credit institution was also withdrawn for Scania Finans Aktiebolag Branch in Latvia, which will continue operating in Latvia as a leasing company.

BANKING SECTOR PERFORMANCE INDICATORS²

In 2019, the total amount of the Latvian banking sector assets did not significantly change (decreased by 0.2%). Excluding the impact from termination of the operation of separate credit institutions, as well as the strategic decisions implemented by two credit institutions oriented towards servicing domestic

clients by consistently reducing domestic market operations exposures and liabilities towards affiliated and associated credit institutions over the period of the reporting year (namely, by EUR 849 million or 55%), the amount of assets of other banks grew by 5.6%.

Figure 1. Assets (billion EUR)

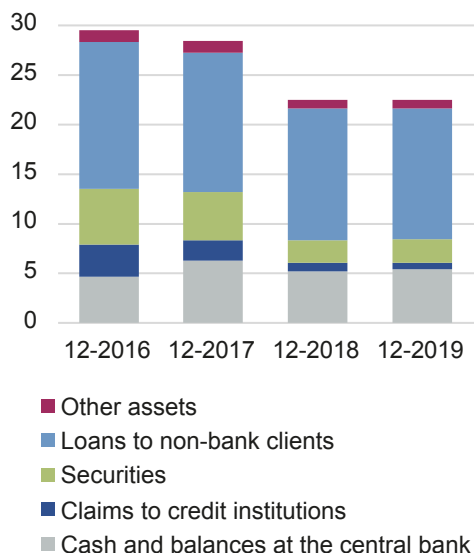
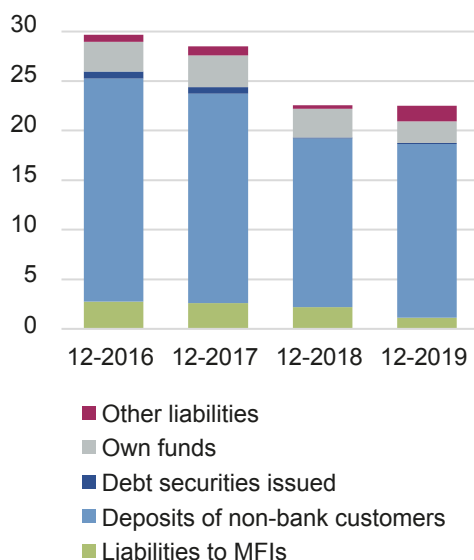


Figure 2. Liabilities (billion EUR)



² As of 2018, in the publications by the FCMC the FINREP and COREP data provided by the banking sector are mainly used – the consolidated data of the banks under the consolidated supervision (i.e., the data on banks and their financial subsidiaries), as well as the data on other banks and foreign bank branches on an individual level.

Capital and liquidity ratios of active banks remained at a high level.

At the end of the reporting year, the total amount of own funds of active banks was by EUR 117.5 million, or by 5.5%, smaller than the year before. This was determined by the drop in the amount of both Tier 1 and Tier 2 capital instruments (correspondingly, by EUR 19.2 million, or 1.0%, and by EUR 98.4 million, or 44.8%). In general, the changes had a positive effect on the capital structure of the banking sector - during the reporting year, the share of Tier 2 capital reduced from 10% to 6%. Without significant changes in the amount of structure of the assets of the sector, the changes in the risk weighted assets were also insignificant (increasing by 0.9% over the year). Even under the impact of changes in the capital and its structure, capital ratios as a whole decreased over the year (CET1 ratio – from 21.8% to 21.3%, total capital ratio – from 24.6% to 22.7%); overall they remained at a high level, ensuring sufficient reserves for shock absorption capacity and exceeding the average EU ratios³ (CET1 – 14.6%, total capital ratio – 18.9%). Average EU harmonised liquidity coverage ratio of the banking sector did not change significantly and remained high (304.6%); for individual banks it ranged from 157% to 753% (as of 1 January 2018, the minimum requirement of the LCR is determined in the amount of 100%).

Figure 3. Liquidity coverage ratio (%)

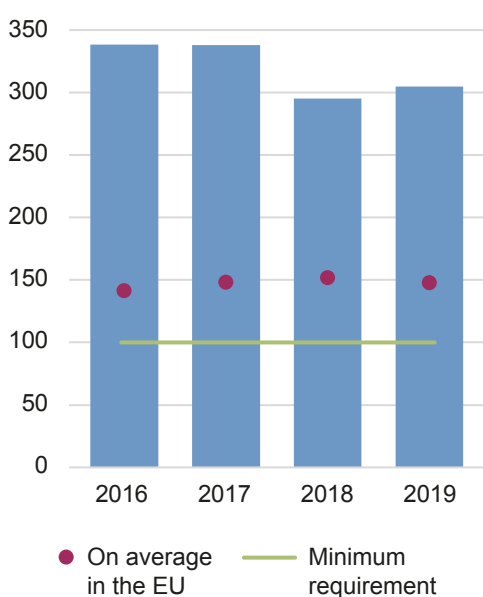
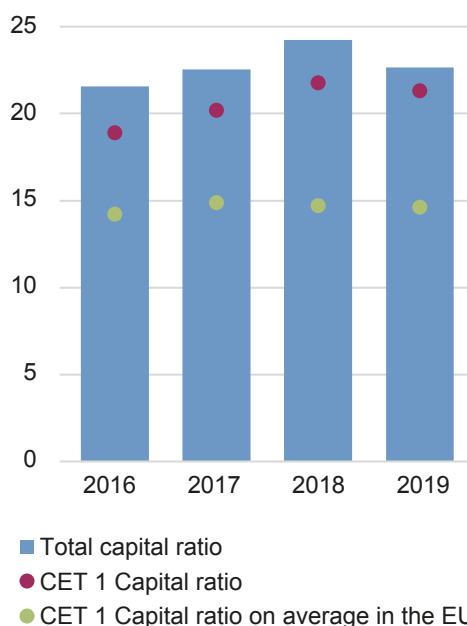


Figure 4. Liquidity coverage ratio (%)



Profitability of the banking sector, in general, deteriorated.

In 2019, overall, the Latvian banking sector performance involved a profit in the amount of EUR 228.9 million, which is by 20.2% less than the year before. The combined ROE of the sector decreased from 10.3% to 9.6%, but nevertheless remained higher than the average EU level (6.6%). Most banks performed with profit, and their ROE ranged from 6.0% to 22.0%, while four of the banks implementing the change of the business model, as well as two branches of foreign banks (the total market share whereof made up <5%) ended the year in losses.

Operating income of the banks whose operations are focussed on the servicing of domestic customers remained stable (increased by 1.4%). Nevertheless, the referred-to reorganisation process of the banks, as well as growing expenses of separate banks for the intragroup services, determined a significant growth of administrative expenses (by 10%) and, correspondingly, CIR of this group of banks deteriorated, namely, grew from 54% to 60% (in the EU on average - 63.2%). ROE of this group of banks still remained considerably higher than in the EU on average, reaching 11.9% at the end of December (in the EU on average - 6.6%).

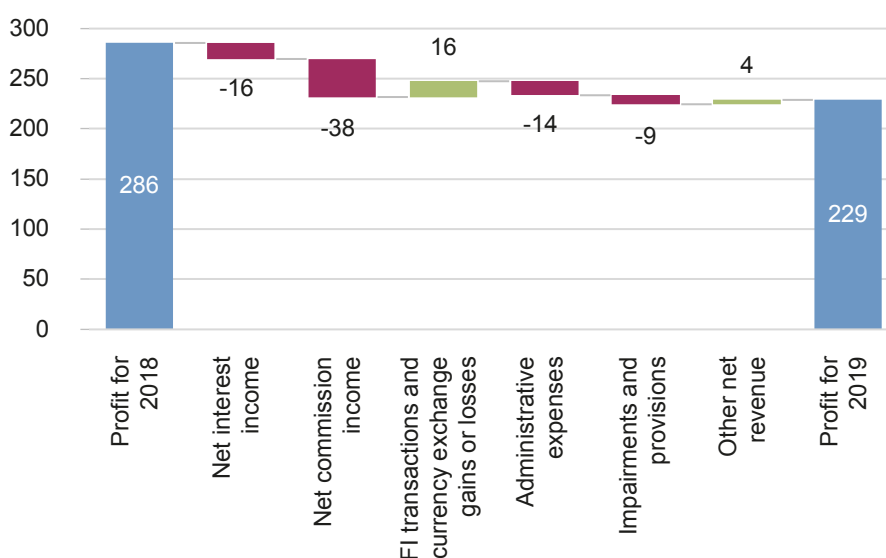
³ Hereinafter data source for the average ratios of the banking sector in the EU – EBA Risk Dashboard Q3 2019.

Operating income of the banks implementing the change of business model decreased over the year (by 20%), nevertheless in the second half of the reporting year the drop rate gradually reduced. The growth of administrative expenses in the second half of the year determined the deterioration of the CIR of these banks, reaching 73% at the end of the year, thus exceeding both the average ratios of the Latvian banking sector and those of the EU (respectively, 62.4% and 64.1%).

Figure 5. Operating income and expenses (EUR million)



Figure 6. Impact of revenue and expenditure on changes in the profit (EUR million)



Following the reduction for several years, the total amount of non-bank client deposits stabilised, showing moderate growth (by EUR 477 million, or 2.8%). The balance of domestic deposits significantly increased, namely, by EUR 983 million, or 7.6% (incl. of non-financial corporations – by EUR 284 million, or 6.3%, of households – by EUR 521 million, or 7.4%, of general governments – by EUR 5 million, or 0.6% and, of other financial corporations – by EUR 172 million, or 29.5%). Along with the stable wage growth, the main driver in domestic deposits over the period of the last five years has been the rise in household deposits by 8% per year on average. At the same time, the amount of foreign client deposits continued reducing to decline (by 12.6%, or EUR 505 million), incl. in the main drop observed in the deposits of non-financial corporations, while the amount of deposits of households from the EU countries increased. The geographic structure of deposits continued changing in favour of deposits from the EU countries, and the share of the client deposits from the non-EU countries in the total deposits continued reducing (from 9.9% to 6.8%). The risk mitigation process commenced in previous years continued also in the reporting year, and the banks were still responsibly assessing their client base according to a much more prudent business approach and replaced the non-EU country deposits with domestic deposits and deposits of EU country households, making active use of the deposit platforms as well.

Figure 7. Non-bank client deposits (EUR billion)

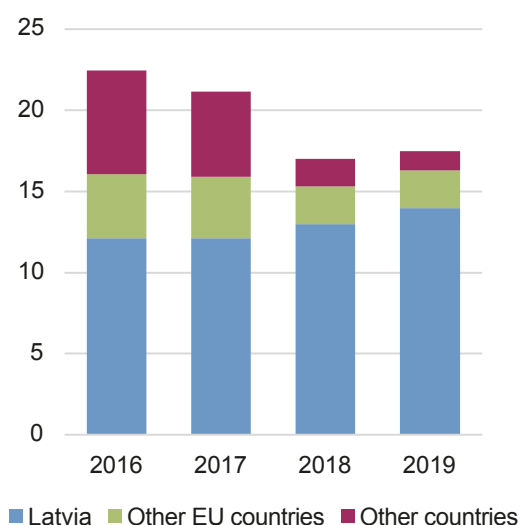
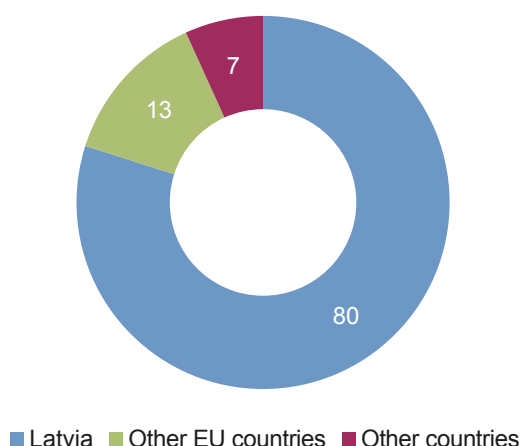


Figure 8. Structure of non-bank client deposits at the end of the reporting year (%)



Over the year, the total amount of loans issued in Latvian banking sector to non-bank clients decreased by EUR 279 million, or 2.0%, incl. domestic clients - by 1.0%. Decrease in the total amount of loans issued to non-bank clients was mainly affected by the structural changes in the Latvian banking sector - termination of activities of separate credit institutions, as well as implementation of strategic decisions of two foreign bank branches, by consistently reducing the amount of their loan portfolio. Excluding the impact of the structural changes of the banking sector, the amount of the loan portfolio of non-bank clients grew by 4.7% in the reporting year, which was fully determined by the growth in domestic loan portfolio (by 6.5%). Equally high growth rates of the amount of issued loans were observed both with regard to domestic households (by 6.4%) and domestic non-financial corporations (by 6.7%). In the reporting year, the loan portfolio of foreign clients continued dropping, incl. the amount of loans issued to non-EU country clients dropped overall by 24%; besides this, the write-off of the long past-due and bad (uncollectable) loans implemented by separate banks triggered an expressly steep decrease of balance of those loans in the final quarter of the years, i.e., by 14.7%. At the same time, the amount of loans issued to the EU clients grew slightly (by 6.1%). The share of foreign clients in the total loan portfolio continued to decrease, reaching 12.2% at the end of December (which was fully determined by the drop in loans issued to non-EU country clients).

The quality of loans issued to non-bank clients continued to improve, with the share of the NPL reducing to 5.6% at the end of December. In the reporting year, changes were observed in the NPL structure, especially in the last quarter of the year, when some banks carried out the write off of the long past-due and bad (uncollectable) loans, while separate large-scale loans migrated from the category of doubtful loans (unlikely to pay) to the group of loans past-due more than 90 days. Therewith, the share of long past-due (more than one year) loans in the NPL structure decreased, while the share of loans past-due more than 90 days increased, amounting to, correspondingly, 2% and 0.9% at the end of December. Overall, the referred-to processes had a positive impact on the loan portfolio quality indicators and, in the last quarter of the year, the NPL share reduced considerably for loans issued both to domestic non-financial corporations and foreign clients, amounting to, correspondingly, 5.5% and 14.8% at the end of December. Domestic household loan portfolio quality indicators also continued to demonstrate a steady positive trend over the entire year, with the NPL share therein reducing to 3.5% at the end of December (3.4% in housing loan portfolio; 3.8% in other household loans).

Figure 9. NPL structure (%)

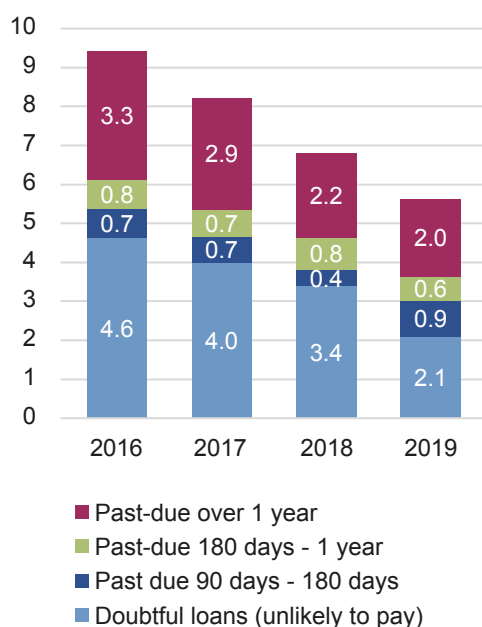
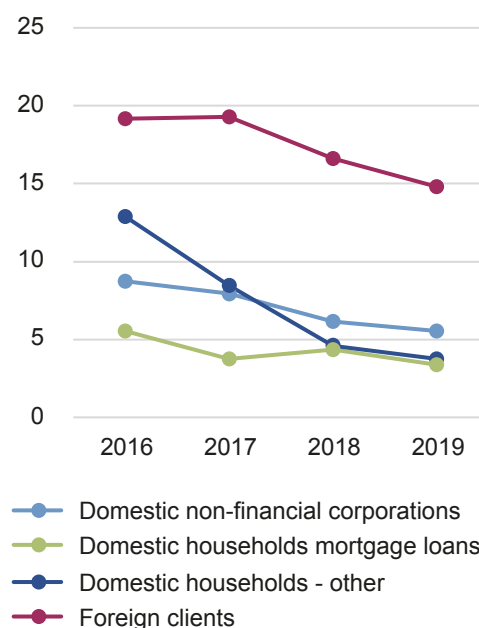


Figure 10. NPL of the respective portfolio (%)



Overall, in the banking sector the provisions to the NPL ratio decreased to 30.0% at the end of December; a steeper drop was observed in the last quarter of the reporting year (from 31.6% to 30.0%), when several credit institutions implemented the write off of the long past-due and bad (uncollectable) loans. Considering that the coverage of such loans with the formed provisions is traditionally considerably higher, their write-off reduced the average provisions to the NPL ratio in the sector.

INSURANCE SECTOR

In 2019, the priority in the process of supervision of the insurance companies was to continue actual supervision in accordance with the requirements laid down by the Insurance and Reinsurance Law by verifying the conformity of the documents and reports filed by the insurers to the requirements laid down by laws and regulations, carrying out off-site and on-site inspections to ascertain the ability to ensure the compliance of operation with the requirements laid down by laws and regulations, and by correspondingly updating supervision handbooks.

In 2019, the FCMC carried out full on-site inspection of the activities of one insurance company. The FCMC carried out on-site supervision and monitoring, based on the analysis of the reports and other information submitted by insurance companies, as well as the insurance companies were invited to present their approved operational strategies to the FCMC, thus facilitating mutual dialogue between the FCMC and insurance companies.

Based on the results of the analysis of the activities of insurance companies, the FCMC carried out the annual risk assessment of insurance companies, assigning a risk grade to each insurance company depending on the level of its risks and the quality of the management thereof, as well as pursuant to the impact of the insurance company on the insurance market.

The risk assessment and risk grading processes form a part of a supervisory review process, which is based on an assessment of the impact of risks, and is one of its stages. This is a method used by the FCMC to identify, analyse and assess risks inherent to the activities of insurance companies and to assess the quality, adequacy and appropriateness of the risk management methods applied by them in terms of the nature, volume, and complexity of the operations thereof.

The key objectives of the risk assessment and risk grading process are:

- to assess the risks inherent to the activities of the insurance company, as well as its risk management system;
- 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 risk rating to each insurance company);
- to ensure efficient and targeted planning of

supervision;

- to ensure the continuity and transparency of the supervisory process;
- to promote the introduction of more advanced risk management approaches in insurance companies;
- to promote communication and dialogue with insurance companies.

Once a year, after receiving the annual quantitative report and the periodic supervisory report and the evaluation of the information reflected therein, the FCMC assigns, for supervisory needs, a risk grade to each insurance company on a scale from “1” to “4”, in which “1” stands for the highest rating, and “4” stands for the lowest rating.

According to the methodology approved by the FCMC, the risk level assigned to the insurance company is reviewed after completing a fully-fledged on-site inspection and on obtaining essential information about the activity of the insurance company, which might affect the previously assigned risk level.

The FCMC uses the risk grades of insurance companies obtained as a result of risk assessment and the risk grade determining process to carry out effective supervision of insurance companies, by setting priorities and intensities for the off-site and on-site supervisory measures to be taken. According to the risk grade assigned to the insurance company, the supervision of the activity thereof is planned – for an insurance company with the highest rating (i.e., low risk activity), the necessary supervision measures are minimal, whereas for an insurance company with the lowest rating (i.e., high risk activity), continuous and enhanced supervision and control of the activity is required. The “Procedure for minimum frequency for the regular review of elements laid down in Section 44 of Insurance and actions for performing inspections” approved by the FCMC is available on the FCMC website under the section “Legislation”: <https://www.fktk.lv/tiesibu-akti/apdrosinasana/informacijas-atklasana-atbilstosi-regulas-es-2015-2451-prasibam/uzraudzibas-parbaudes-process/>.

In 2019, as a result of the risk assessment carried out by the FCMC and determining of the risk grade, the following risk grades were assigned to insurance companies:

- risk grade “1” is not assigned to any company (the activity is characterised by a low level of risk and the methods used to manage the

risks are sufficient);

- risk grade “2” was assigned to two companies (the activity is characterised by a moderate level of risks and/or the methods used to manage the risks are satisfactory; however, there is room for improvement);

- risk grade “3” is assigned to four companies (the activity is characterised by an increased level of risks and/or the methods used to manage the risks are not satisfactory, because there are significant deficiencies);

- risk grade “4” is not assigned to any company (the activity is characterised by a high level of risks and the methods used to manage risks are not sufficient, i.e., inconsistent with the risks, scale of activity, and complexity inherent to its activity).

In 2019, as compared to 2018, the assigned risk grade was not changed to any insurance company.

In 2019, the FCMC carried out the thematic off-site inspection of the activity of all the insurers to assess the compliance of their activity with the requirements laid down in Clause 1 Paragraph 2, Section 37.⁵ of the Law on Audit Services.

During the supervision process carried out in 2019, no substantial violations of the requirements laid down in the Insurance and Reinsurance Law or other binding laws and regulations were identified.

In 2019, the FCMC cooperated with the supervisory authorities of insurance and reinsurance companies of EU Member States, which are implementing the supervision of the insurance groups and reinsurance groups whose members were insurance companies licensed in Latvia. In 2019, FCMC staff ensured the participation in three colleges of insurance and reinsurance supervisors of three EU Member States and ensured the preparation and provision of information in accordance with the requests of group supervisory authorities.

In 2019, the FCMC participated in the work of the 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, Costs and Past Performance Report, Follow-up on past Peer Reviews, 2020

Solvency II review, LTG 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.

GUARANTEE FUND OF THE COMPULSORY THIRD-PARTY LIABILITY INSURANCE OF THE OWNERS OF MOTOR VEHICLES

In 2019, under Section 51 of the Compulsory Civil Liability Insurance of Owners of Motor Vehicles Law and Clause 19 of Cabinet Regulation No 195, On the Procedure for Establishing the Guarantee Fund of 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, the FCMC carried out a compliance inspection of the establishing, provisioning, and administration procedures of the guarantee fund of the compulsory third-party liability of the owners of motor vehicles administered by the association Motor Insurers' Bureau of Latvia and notified the Ministry of Finance and the association Motor Insurers' Bureau of Latvia of the findings of the inspection.

INSURANCE AND REINSURANCE INTERMEDIARIES

In 2019, the FCMC carried out off-site supervision of insurance brokers and of the Latvian branches of the insurance broker firms of EU Member States registered in the Register of insurance and reinsurance intermediaries maintained by the FCMC, which is based on the analysis of the submitted reports and other submitted information.

In 2019, the FCMC conducted thematic on-site inspections of the activity of two insurance brokers, assessing the compliance of provision of their insurance intermediation services and preparation of reports for supervisory needs with the requirements laid down in laws and regulations.

In 2019, the FCMC conducted thematic off-site inspection of the activities of all insurance brokers, in order to assess their ability to ensure the fulfilment of the requirements laid down in the Insurance and Reinsurance Distribution Law, which came into force on 23 May 2019.

In the supervisory process carried out in 2019, no material violations of the requirements determined in the Activities of Insurance and Reinsurance Intermediaries Law (in force till 23

May 2019) or the Insurance and Reinsurance Distribution Law (in force from 23 May 2019) were identified, for which the sanctions would be applied foreseen in the aforementioned laws.

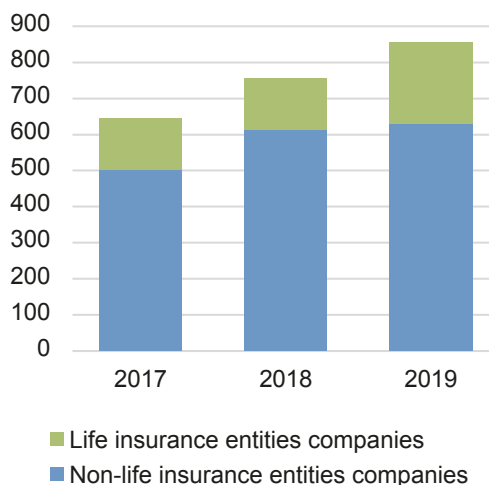
INSURANCE SECTOR PERFORMANCE INDICATORS

At the beginning of 2019, a licence was issued to the EU Member State non-life insurer's branch (*Telia Forsakring AB* Branch in Latvia), whereas at the end of the year the consolidation of SEB Group life insurance companies operating in the Baltic States into a single enterprise *SEB Life and Pension Baltic SE* was completed; as a result the head office of the new enterprise operates in Latvia, but its branches - in Estonia and Lithuania. The referred-to transaction in the reporting year had a positive influence on the insurance sector performance indicators as a whole.

Premiums written in the activities of insurers preserved a considerable growth in 2019, and the total gross premiums written grew by 13.4% over the year, reaching EUR 856.7 million. Along with the reorganisation of the life insurance company, a steep growth of the activities of insurers in other EEA countries was observed, where the amount of premiums written grew by 26% (mainly in Lithuania, Poland, and Estonia). The growth of premiums written in Latvia, in its turn, was more moderate

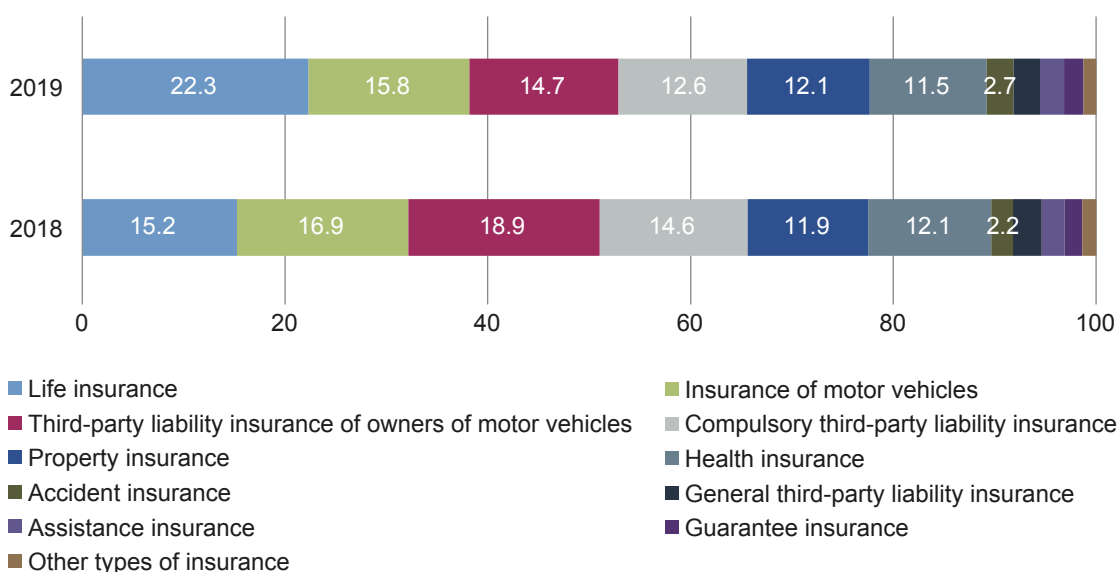
(by 7.5%), and the share thereof in the total portfolio of premiums written comprised 65%. Premiums written in Latvia per capita reached EUR 291.

Figure 11. Premiums written by insurers, in EUR million



In the total portfolio of premiums written, premiums of transport insurance still comprised the largest part (43.2%), reaching EUR 370.3 million; almost all motor vehicle owner third-party liability insurance premiums were written in other EEA member states. In turn, the most significant insurance types in Latvia were life insurance (23%), CTPLI (19%), health insurance (17%), and motor vehicle insurance (16%).

Figure 12. Gross written premiums by type of insurance at the end of the reporting year (%)



Earning capacity - the earning capacity of insurance companies improved, and, during the reporting year, they earned EUR 33.6 million in total, namely, almost three times more than the year before. The profit of life insurance companies (EUR 7.9 million) was promoted by successful investment activities, while the profit of non-life insurance companies (EUR 25.8 million) was mainly ensured by income from core insurance activity.

Combined ratio⁴ slightly improved during the reporting year, reaching 95.3% at the end of December, and for all non-life insurance companies it was below 100% (except for one company, whose ratio reached 106% and which is mainly operating in other EEA Member States). Slight improvement of the combined ratio was mainly determined by the reduction of the approved indemnity claims.

Figure 13. Combined ratio

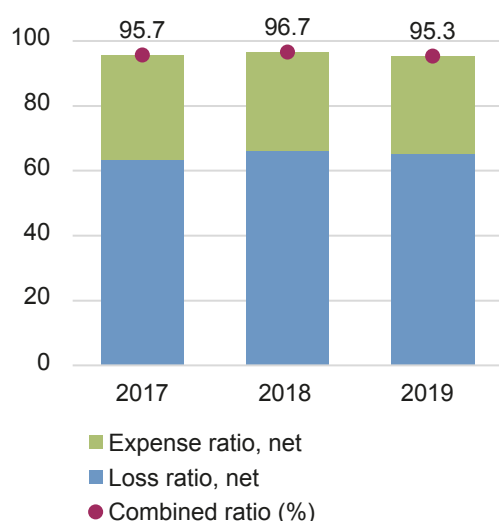
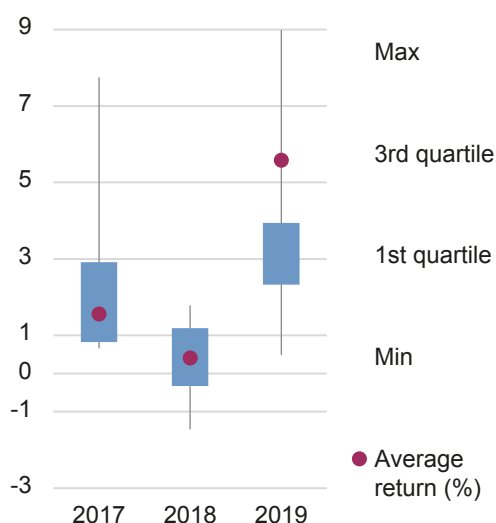


Figure 14. Return on investments



Favourable trends in financial markets considerably improved the return on investments and it was positive for all insurance companies (i.e., it ranged from 0.5% to 13.8%). Higher return (12.6%) was ensured by a more risky investment policy implemented by life insurance companies (two thirds of investments were made into investments funds, *inter alia*, the majority into stock and alternative investment funds), while the conservative investment policy of non-life insurance companies (more than one half of investments were made into debt securities) determined a lower return (2.0%).

Solvency - the solvency ratio (the adequacy of own capital to the solvency capital requirement, which, under the Solvency II supervisory regime, is being determined, on the basis of risk assessment) of insurance companies remained stable above the minimum requirements and reached 160% at the end of December (the minimum requirement lowest allowable limit of the indicator is 100%), including 214.8% for life insurance companies and 136.8% for non-life insurance companies.

⁴ The rise of the ratio above 100% indicates the losses from the non-life insurance activities, not including the investment income.

COOPERATIVE CREDIT UNIONS

In 2019, 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 and the covering of losses, as well as by carrying out on-site inspections. During the reporting year, FCMC experts carried out four on-site inspections 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 with the requirements of laws and regulations.

When implementing the supervision of cooperative credit union activities, a licence for the activities of a credit union was issued to one union in 2019.

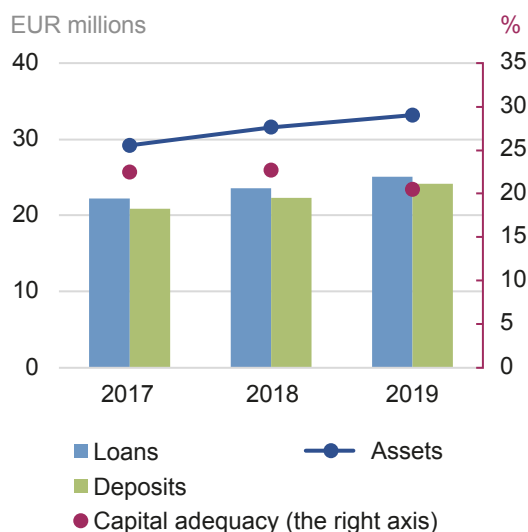
PERFORMANCE INDICATORS OF COOPERATIVE CREDIT UNIONS

At the beginning of 2019, a licence for a credit union's operation was issued to cooperative credit union *Ziemeļvidzeme*, which was established according to the territorial principle and started its economic operation in the second half of the year.

At the end of the reporting year, there were 35 cooperative credit unions in Latvia; their total asset increase preserved a stable growing trend – over the year the total asset volume of cooperative credit unions increased by 5% or EUR 1.6 million, reaching EUR 33.2 million at the end of December. The increase in assets was mainly ensured by the contributions by members – the amount thereof increased by 8.4% during six months of the year and reached EUR 24.2 million at the end of December. A majority, or 89%, were deposits by households. Contributions by members constituted the major source of the assets attracted by credit unions (99%).

Though the capital adequacy ratio of credit unions slightly decreased over the year (by 2.2 percentage points), nevertheless they all worked with the capital adequacy ratio above the minimum capital adequacy requirement (10%), and the total owned funds of credit unions in relation to the sum total of the assets and off-balance items ratio, i.e., the capital adequacy ratio, was 20.6% at the end of December.

Figure 15. Assets, loans, deposits and capital adequacy of credit unions



The amount of loans granted to members continued to increase – it increased by EUR 1.5 million, or 6.5%, during the reporting year, reaching EUR 25.1 million at the end of December. The growth of the loan portfolio was driven by consumer lending and lending for house acquisition loans, i.e., the key types in the loan portfolio (correspondingly, 40.8% and 47.9% of the total loan portfolio). About 99% of the loan portfolio was granted to households.

Loan portfolio quality did not show positive trends in the reporting year. The rise in the share of standard loans was ensured by newly issued loans, while part of the loans from close-watch supervised loans category was reclassified in a lower-quality loan category (ensured by the activities of one market participant), namely, with the share of NPL of such loans in the total loan portfolio reaching 14.5% at the end of December. According to the growing NPL share the credit unions, overall, increased the amount of provisions formed for doubtful loans, which, at the end of December, amounted to 6.8% of the total loan portfolio of credit unions (or 47.7% of NPL).

Overall, the earning capacity of credit union sector reduced. Income from reduction of the previously formed provisions dropped significantly (by 65.4%), while the constantly growing NPL share in the loan portfolio triggered small operating income (by 14.2%); therewith the profit obtained by credit unions during the reporting year, namely, EUR 331 thousand, was considerably (by 58%) smaller than the year before. As the amount of the obtained profit dropped, the return on equity ratio also reduced, reaching 4.8% at the end of December. 21

out of total 35 credit unions ended the year in profit, earning in total EUR 364 thousand (their market share in total sector assets reached 96%).

PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

In 2019, the FCMC continued to carry out supervisory measures of payment institutions and electronic money institutions, based on the service business model provided by the institutions, the associated risks, and their grade, to which greater attention was paid. In 2019, the supervision of payment institutions and electronic money institutions was carried out, also taking into account the monitoring of the performance of the institutions, which was based on the scope of activity and the trend analysis, as well as the analysis of the submitted financial statements.

In 2019, the FCMC continued paying special attention to the analysis of the client base of payment institutions and electronic money institutions. Payment institutions and electronic money institutions are required to submit a report on customer assets, in which payment institutions present information about payments which were commenced and completed by the institution, specifying the mean average value of the payments performed within the previous 12 months, whereas 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.

Also in 2019, the FCMC focussed on the financial stability of payment institutions and electronic money institutions: information about the amount of equity capital was assessed, reviewing the balance sheet statements and profit and loss accounts not only for the licensed institutions, but also for the registered institutions. In 2019, one on-site inspection was carried out in the payment institution. The goal of inspection was to assess the operational model of the payment institution and compliance of the operations with the requirements of the laws and regulations, especially those laid down in the LPSEM and AML/CTPF Law. In 2019, the registration in the FCMC payment institution register was cancelled for six payment institutions and five electronic money institutions, incl. two licensed electronic money institutions. In 2019, one licence for a payment institution's operation was issued.

Compared to 2018, the number of payment institutions and electronic payment institutions

decreased in 2019 by 33.3% and 38.5%, respectively. The decrease in the number of payment institutions and electronic money institutions continued to be affected by the changes in legal acts in 2018, when the licensing regime for market participants was changed by determining stronger criteria for institutions eligible to work in the status of a registered institution, as well as by stricter requirements of the laws and regulations in the field of AML/CTPF and the supervisory measures implemented by the FCMC.

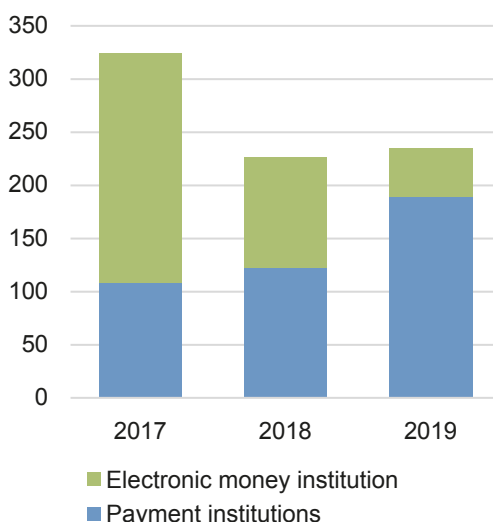
PERFORMANCE INDICATORS OF THE PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

In 2019, the sector of payment institutions and electronic money institutions continued to shrink. Changes in regulatory framework introduced in the previous year continued to affect the operation of the sector. Having assessed their business models and the new requirements in the regulation of existing market participants, 11 market participants adopted a decision to terminate their registration in the register of payment institutions and electronic money institutions maintained by the FCMC. In turn, State JSC Latvijas Pasts, following the receipt of the licence, continued providing payment services already in the status of the licensed payment institution. At the end of the reporting year, 10 payment institutions (including six registered and four licensed payment institutions) and eight electronic money institutions (including seven registered and one licensed electronic money institutions) were operating in Latvia.

In the reporting year, the provision of payment and electronic money services provided the payment institutions and electronic money institutions with gross revenue in the total amount of EUR 10.4 million (i.e., two times less than in the previous year); 51% was comprised of the revenue obtained by electronic money institutions.

The total amount of payments performed by the payment institutions and electronic money institutions in the reporting year grew by 4% and reached EUR 235 million. The amount of liquid assets also increased, reaching EUR 56.8 million (including claims towards the banks for securing payment services – EUR 51.5 million) at the end of December, and it still ensured the covering of the payables owed to the clients (EUR 55.3 million), including the payables owed to the users of payment services (EUR 51.6 million).

Figure 16. Total annual amount of performed payments (EUR million)



The reduction in the number of electronic money institutions determined the drop in the total amount of repurchased electronic money (i.e. the exchange of the issued electronic money to cash) over the period of the reporting year by 22.5%, reaching EUR 22.7 million at the end of December.

INVESTMENT MANAGEMENT COMPANIES AND MANAGERS OF ALTERNATIVE INVESTMENT FUNDS

SUPERVISORY MEASURES APPLIED TO INVESTMENT MANAGEMENT COMPANIES AND INVESTMENT FUNDS

In 2019, the off-site supervision of investment management companies and investment funds was carried out 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, FCMC regulations and guidelines, and other laws and regulations.

In the off-site inspection field, regular reports were received and analysed in 2019: on a monthly, quarterly, and annual basis.

Conformity assessment of key information aimed at investors was carried out, as well as an assessment of whether the synthetic indicators of investment funds set by the investment management funds corresponded to the fluctuation of the profitability of the funds.

Closer attention was paid to off-site analysis of the internal control system and internal audit of investment management companies, as well as the assessment of the key risks to compa-

nies, 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.

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

SUPERVISORY MEASURES APPLIED TO THE MANAGERS OF ALTERNATIVE INVESTMENT FUNDS AND ALTERNATIVE INVESTMENT FUNDS

In 2019, off-site supervision of the AIFM was carried out to assess the structure of investments managed by them, the income and expense structure, and compliance of their activities with the requirements of the laws of the Republic of Latvia, the regulations and guidelines issued by the FCMC, and other laws and regulations.

On 20 June 2019, amendments were made to the Law on Alternative Investment Funds and Managers Thereof, prescribing significant allowances for the supervisory framework of the registered AIFM; therefore, further supervisory measures of the registered and licenced AIFM differ significantly.

In the off-site inspection field, regular reports were received and analysed in 2019: on a monthly, quarterly, and annual basis.

Special attention was paid to the use of licenced AIFM's asset evaluation methods for the determination of the value of the assets.

Follow-up monitoring of the on-site inspections of the licenced AIFM is also carried out within the scope of off-site supervision, by controlling the implementation of the action plan and, where necessary, recommending the necessary adjustments.

Meetings were held also with the representatives of the management of licenced AIFM to monitor the key events in the activities of market participants and the fulfilment of business strategies in between on-site inspections.

In 2019, a large-scale assessment of the risk portfolio of the AIFM and AIF was carried out.

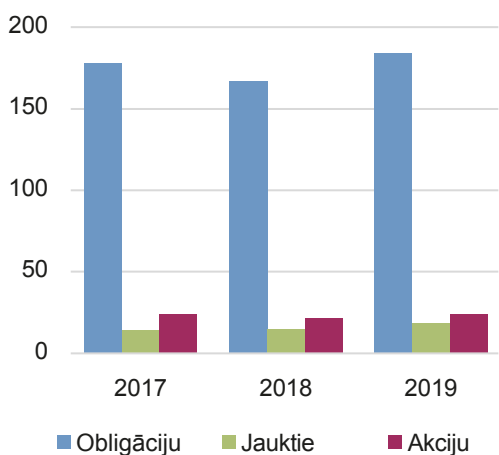
PERFORMANCE INDICATORS OF THE INVESTMENT MANAGEMENT COMPANIES AND MANAGERS OF ALTERNATIVE INVESTMENT FUNDS

At the end of 2019, 11 investment management companies and 20 AIFM (including four investment management companies) were operating in Latvia. At the end of the year, the amount of assets under the management of the investment management companies reached almost EUR 4.7 billion, whereas the amount of assets under the management of the AIFM reached EUR 193 million at the end of December.

PERFORMANCE INDICATORS OF INVESTMENT FUNDS

At the end of 2019, 24 investment funds registered in the FCMC were operating, including 13 bond funds, four mixed funds, and seven stock funds. Total investment fund assets increased by 11.7% over the reporting year, reaching EUR 226.9 million at the end of December. Asset growth rate reached, correspondingly, 10.5% for bond funds, 25.6% - for mixed funds and 11.6% - for stock funds. Thereby, at the end of the reporting year, the amount of their assets comprised EUR 184.5 million, EUR 18.3 million and EUR 24.1 million, respectively.

Figure 17. Investment fund assets (EUR million)

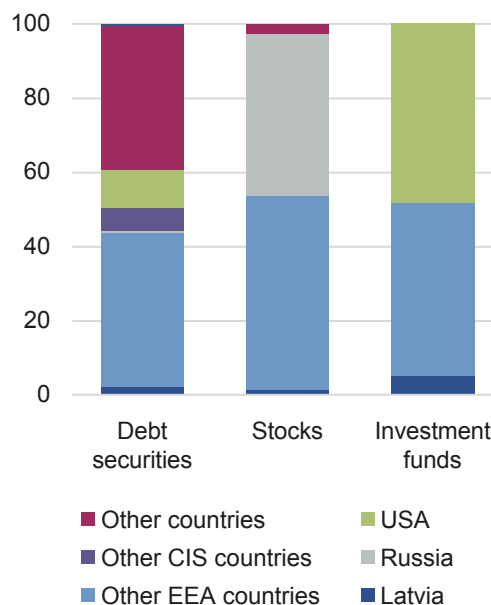


Debt securities accounted for the majority share of the overall securities portfolio of the investment funds (84%). Investments in debt securities are focussing on a high-yield and high-risk segment, i.e., 69% of debt securities had a credit rating below the investment level (below BBB-), or were unrated. In turn, investment fund investment certificates (the majority whereof were focussed on capital securities), as well as stocks and other variable-yield securities, accounted for 13% and 2.8%, respectively, in the overall portfolio.

Even though the share of investments in the EEA Member State and the CIS countries

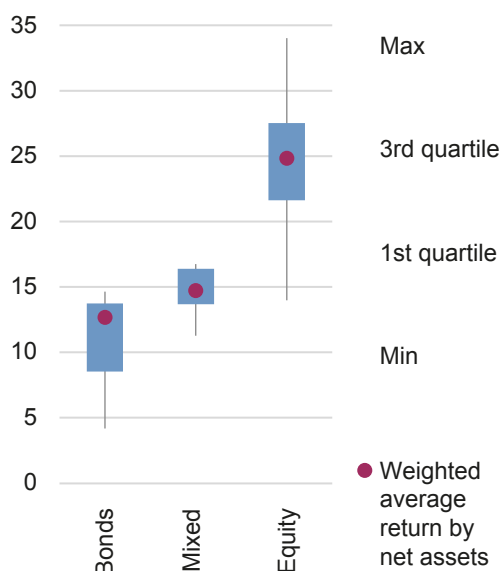
slightly decreased in the reporting year, reaching, respectively, 45% and 6.9% of total investments at the end of December, but the share of investments in other countries slightly increased, the majority share of all asset classes still consisted of investments in securities issued by EEA-based issuers.

Figure 18. Securities portfolio of investment funds by type of financial instruments and by group of countries (by the country of registration of the issuer) at the end of the reporting year (%)



All investment funds ended the year with positive return. The annual return of the bond funds ranged from 4.2% to 14.7%, mixed funds - from 11.3% to 16.7%, and stock funds - from 14% to 34%. Better performance was shown by the funds whose investment core currency was the US dollar, as the value whereof to EUR grew over the year.

Figure 19. Annual return of investment funds in 2019 (%)



PERFORMANCE INDICATORS OF ALTERNATIVE INVESTMENT FUNDS

At the end of the reporting year, 30 AIF were operating in Latvia. In the reporting year, the assets thereof continued to increase, reaching EUR 193.3 million at the end of the year. The assets of private capital investment strategy funds, along with new investments in companies, grew by 29%, reaching EUR 152.6 million at the end of December. In turn, along with two fund managers fully exercising all investments and performing the repayment to the investors, the total assets of real estate investment strategy funds decreased by 27%, reaching EUR 40.7 million at the end of the reporting period. AIF were mainly making investments in capital shares of the companies (EUR 162 million). AIF focussed on investments in the local market; nevertheless, the share thereof had a downward trend in the reporting year, which was mainly determined by the fact that several real estate investment strategy funds were liquidated, as a result of fund managers fully exercising all investments and performing the repayment to the investors. New investments were also mainly made outside Latvia, namely, in Estonia. At the end of the reporting year, 59% of the assets of AIF were invested in Latvia, 30% in Estonia, and 12% in Lithuania (at the end of 2018 - 72%, 14%, and 14%, respectively).

Figure 20. Assets of alternative investment funds (EUR million)

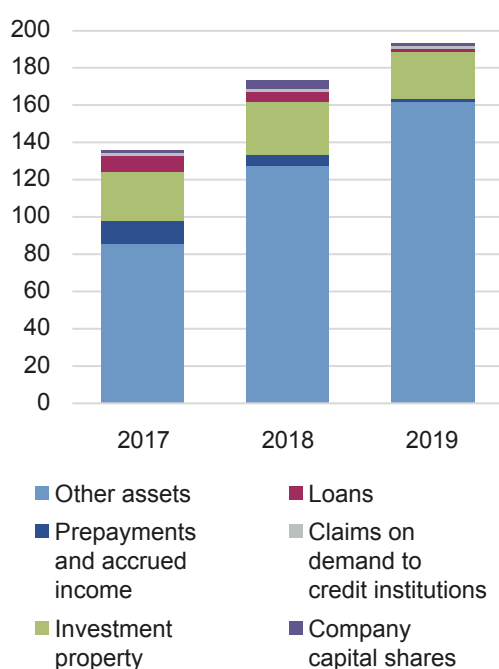
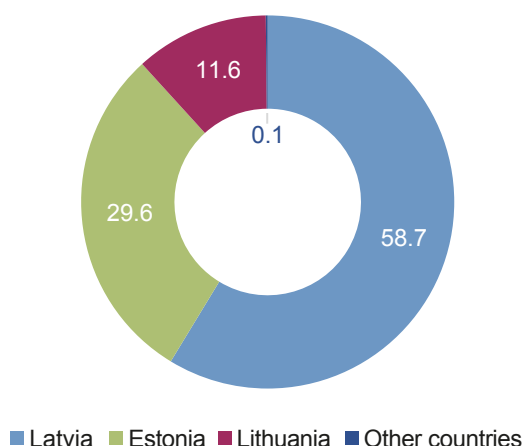


Figure 21. Assets by countries at the end of the reporting year (%)



STATE-FUNDED PENSION SCHEME

SUPERVISORY MEASURES APPLIED TO MANAGERS OF THE ASSETS OF THE STATE-FUNDED PENSION SCHEME AND INVESTMENT PLANS

In 2019, the FCMC carried out off-site supervision of the asset managers of the SFPS to assess the quality of assets of investment plans managed by them, the income and expense structure, and compliance of their activities with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, and other laws and regulations.

In the off-site inspection field, regular reports were received and analysed in 2019: on a monthly, quarterly, and annual basis.

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 in were evaluated.

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. Meetings were also held with the management representatives 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 2019, the large-scale assessment of the risk portfolio of the SFPS investment plans was carried out. Also:

- the key information aimed at the members

of all SFPS investment plans was received and reviewed in accordance with FCMC's Regulations on the Preparation of the Key Information to the Members of the State-Funded Pension Scheme;

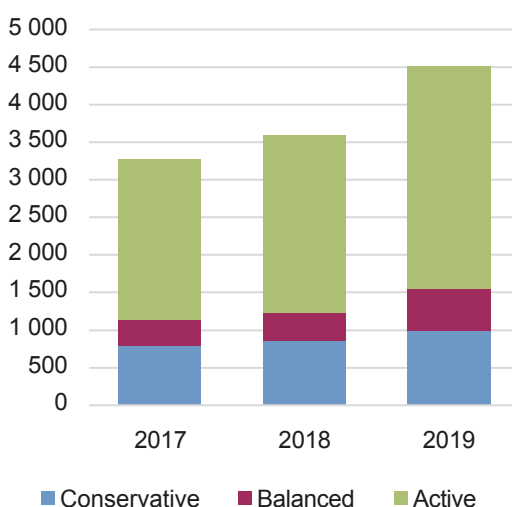
- investment plan expenses were assessed, and in-depth analysis of their structure was carried out, taking into consideration changes in legal acts;
- the monitoring of the capital increase process of the asset managers of the SFPS was carried out, in order to verify compliance with the new capital requirements.

Meetings were also held with the management representatives of the SFPS asset managers to monitor the key events in the activities of market participants and the fulfilment of business strategies in between on-site inspections.

PERFORMANCE INDICATORS OF THE STATE-FUNDED PENSION SCHEME INVESTMENT PLANS

At the end of 2019, 31 investment plans of the SFPS were operating in Latvia, including nine conservative plans, five balanced plans, and 17 active plans. Along with the steep rise in financial markets and growth in the number of participants, the accrued pension capital continued to grow steeply. In 2019, the pension capital accrued in the investment plans grew by 25.5% or EUR 915.4 million, totalling EUR 4.5 billion at the end of December. Net assets grew for all types of investment plans.

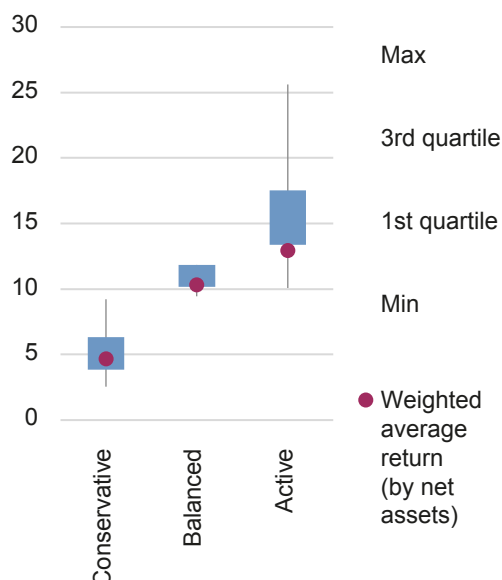
Figure 22. Accrued pension capital by type of investment plan (EUR million)



In the reporting year, all investment plans worked with positive return, and the results thereof reflected financial market trends, which were

favourable both to stock and bond markets. Financial markets had a positive reaction to the progress in the trade negotiations between the USA and China and, especially to the agreement reached at the end of the year between the USA and China on gradual lifting of trade tariffs, as well as the announcement of central banks on measures stimulating the economy. European, USA, and global stock indices ended the year with a considerable growth (above 20%). In the reporting year, the return of conservative investment plans ranged from 2.5% to 9.2%, for balanced plans it ranged from 9.4% to 11.8%, and for active plans – from 10.1% to 25.6%.

Figure 23. Weighted average (by net assets) annual return of investment plans (%)

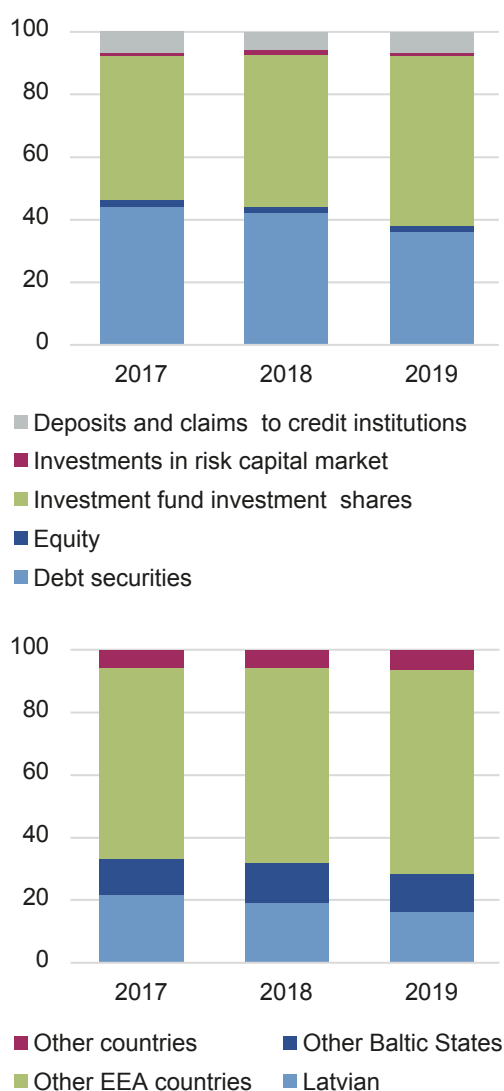


The investment plan management expenses continued to slightly reduce, and for all types of investment plans, i.e., conservative, balanced, and active, the management expenses to net assets ratio was at the level of 0.5% at the end of the year.

Overall, the investment policy of investment plans remained conservative; nevertheless, a steep rise in stock prices in the reporting year triggered the growth of the share of financial instruments with a higher potential return in investment portfolio. Over the year, the share of debt securities in the overall investment plan portfolio decreased (from 42% to 36%), while the share of investment fund investment shares grew (from 48.5% to 54%). At the same time, the improvement of the quality of debt securities was also observed - at the end of 2019, 82.2% of debt securities had a credit rating of the investment level (at the end of 2018 - 77.6%).

Though the amount of investments made in Latvia grew over the year, nevertheless, as investment in other EEA Member States grew steeper, the share of investments in Latvia continued to reduce. The amount of funds invested in Latvia at the end of the year reached EUR 729.6 million, or 16.2% of total investments (including EUR 271.3 million investments in the securities issued or guaranteed by the government, EUR 90 million – in debt securities of commercial companies, EUR 3.5 million – in stocks, EUR 52.9 million – in investment funds, EUR 18.5 million – in the Latvian venture capital market, and EUR 291.6 million placed with credit institutions). 92.4% of all foreign investments were placed in EEA Member States, including the majority in Ireland, Luxembourg, and Lithuania.

Figure 24. Structure of investment portfolio of State-funded pension plans by type of financial instruments and by group of countries (by the country of registration of the issuer), %



PRIVATE PENSION FUNDS AND PENSION PLANS

SUPERVISORY MEASURES APPLIED TO PRIVATE PENSION FUNDS AND PENSION PLANS

In 2019, 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, the income and costs structure, and compliance of their activities with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, and other laws and regulations.

In the off-site inspection field regular reports were received and analysed in 2019 on a quarterly and annual basis.

In the reporting year, two on-site inspections of private pension funds were also carried out to assess the activities of the pension fund when carrying out the functions specified in the Law on Private Pension Funds. During the inspections, close 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. Within the scope of inspection of each pension fund, the activity of the manager of the funds thereof and the holder of the funds thereof was 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 representatives of the private pension funds, and action plans for necessary adjustments were agreed upon to ensure the successful functioning of the pension funds. 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 in 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.

An extensive assessment of the risk profile of private pension funds was carried out.

Also, meetings were held with the management representatives 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 actively participated in the work of the EIOPA in the field of pension fund supervision, by providing answers to survey questions and self-assessments, as well as taking part in the work of the Occupational Pensions Committee that dealt with topical pension fund supervision issues at the European level. Active part was also taken in the EIOPA Review Panel.

A representative of the FCMC participated in the Peer Review on Prudent Person Rule for IORPs as a project leader. During the project, the practices of Member State supervisory authorities regarding prudent and diligent host principle supervision were reviewed, with pension funds investing in pension capital. As a result of the analysis 27 recommendations were set to 19 supervisory authorities from 16 Member States, as well as six best practice examples were identified. Also, during the reporting year, the representatives of the FCMC participated in the work of the committees set up by the OECD in the field of pensions.

In order to strengthen the supervision framework, during the reporting year internal normative documents in the field of on-site inspections were updated, in order to emphasise a risk-based approach for carrying out inspections and to provide a review to market participants in a more understandable way about their risk profile in compliance with the results of on-site inspections, as well as in the field of sanction and corrective measure application. At the same time, the work was in progress regarding external laws and regulations, which

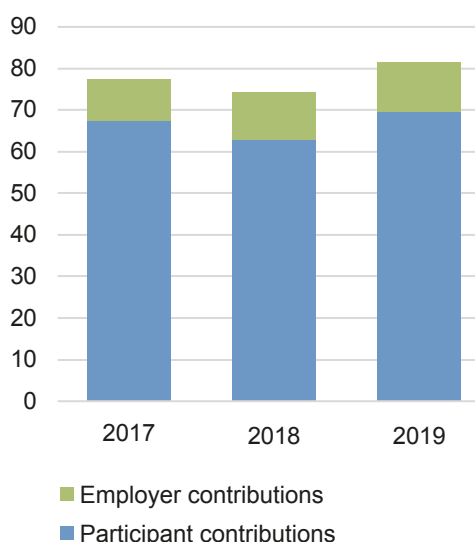
were prepared for IORP II Directive, or directive on the activities and supervision of occupational retirement provision in the transposition process and which sets new requirements for private pension funds in the field of prudential supervision, investment management, and freedom of information.

PERFORMANCE INDICATORS OF PRIVATE PENSION FUNDS

At the end of 2019, there were five open-end pension funds and one closed-end pension fund in Latvia, managing 16 pension plans in total.

In 2019, both the number of individual participants (by 20.6 thousand) and the number of such participants for whom the contributions are paid by the employer (by 347) increased. At the end of the year, the number of individual participants reached 273,883, while the employers paid contributions for 50,946 participants of the third-pillar pension plans. The number of foreign clients gradually grew, reaching 648, or 0.2% of all pension plan participants, at the end of the year. The total number of participants (residents) of private pension plans reached 33.4% of economically active Latvian residents at the end of the year.

Figure 25. Contributions to pension plans over the year (EUR million)

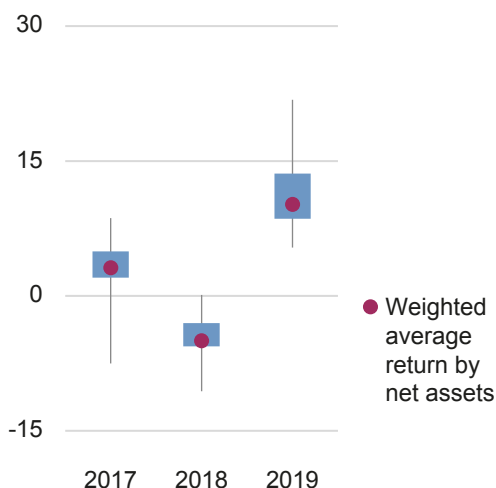


The amount of contributions paid into pension plans by both inhabitants and employers increased. In the reporting year, a total of EUR 85.7 million was paid into pension plans or by 11.3% more than in the previous year. Participant contributions grew by 10.9%, while employer contributions grew by 2%; besides, a comparatively significant increase in total contributions

was made up by transferring the part of solidarity tax for 2018 into the third-pillar pension system. Total capital accumulated by pension plans over the year grew by 21.2%, reaching EUR 559 million at the end of December.

Positive trends in financial markets were also reflected in the performance of pension plans, with the average return of pension plans reaching 10.1% (for individual plans it ranged from 5.4% to 21.8%). The level of management expenses, in turn, continued to reduce - administrative costs and investment management expenses to net assets ratio comprised 1.2% at the end of the year.

Figure 26. Average weighted annual return of pension plans (%)

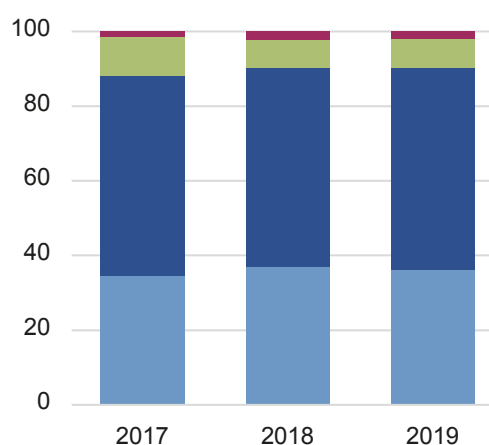


Investment structure of private pension plans did not change significantly during the year - the share of debt securities reached 36% at the end of the year, while investment fund investment certificates reached 54%, of which the majority or 53.5% had a focus on investments in equity securities, and 43.2% - on investments in fixed income instruments. Over the year, the share of debt securities issued by commercial companies increased from 41% to 43%, whereas the share of debt securities with an investment credit rating - from 79% to 81%.

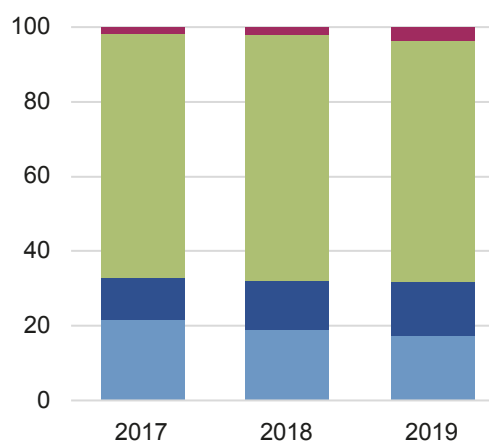
Even though the amount of funds invested in securities of Latvian issuers increased over the years, the share thereof continued to decrease. At the end of the reporting year, EUR 97 million were invested in Latvia and the share of these investments in the total portfolio comprised 17.3% (at the end of the previous year - 19%).

Investments in other EEA Member States accounted for 79% of all investments, remaining at the level of the end of the previous year. As the pension funds diversified investments, the share of investments in non-EEA countries slightly grew, reaching 3.6% of all investments at the end of December.

Figure 27. Structure of the investment portfolio of private pension plans by type of financial instruments and by group of countries (by the country of registration of the issuer), %



■ Other investments
■ Deposits and claims to credit institutions
■ Investment fund investment shares
■ Debt securities



■ Other countries
■ Other EEA countries
■ Other Baltic States
■ Latvian

INVESTMENT SERVICE PROVIDERS

At the end of 2019, investment services were provided by three investment firms licensed in Latvia, 13 credit institutions registered in Latvia, nine investment management companies registered in Latvia, and five branches of EU Member State-based credit institutions and investment firms. Likewise, more than 2,000 investment service providers from the EEA countries were also entitled to provide investment services according to the principle of freedom to provide services.

In 2019, regular off-site measures were carried out that were basically related to the evaluation of reports submitted by market participants, assessment of customer compliance with the offered products, and conflict of interest management. The supervisory practice launched in 2016 was continued - namely, meetings with the management representatives of the structural units of market participants providing investment services, during which market participants presented their activity in the investment services sector as well as the measures taken and plans related to internal control measures in providing investment services. During the reporting year, such meetings took place at 10 market participants. In 2019, two on-site inspections were carried out as well - one in the credit institution and one in the investment firm.

To ensure consistent application of legal acts in the sector of provision of investment services, over the period of 2019 several ESMA guidelines were introduced and responses to questions asked by market participants were published on the website of the FCMC. Seminars and meeting with market participants in the Finance Latvia Association took place as well, discussing practical issues of implementation of MiFID II, the most frequent flaws discovered during the supervisory process, examples of good and bad practice.

To promote investor protection and set equal conditions for operation to the various types of investment service providers, in 2019, the FCMC devoted considerable resources for consulting with investment platforms engaged in selling credit claims, for the purposes of arranging and transforming their activities for the application of the FIML requirements, in order to bring these service providers under the supervision of the FCMC in the nearest future.

SANCTIONS AND CORRECTIVE MEASURES

In 2019, no sanctions or corrective measures

have been applied in the field of provision of investment services. The significance of violations detected during one on-site inspection is still being evaluated. For the elimination of the drawbacks and deficiencies identified within the framework of other on-site and off-site inspections, the FCMC provided market participants with individual guidance and controlled the process of the elimination of deficiencies.

FINANCIAL INSTRUMENTS MARKET

SUPERVISION OF THE POINTS OF SALE OF FINANCIAL INSTRUMENTS AND THE CENTRAL SECURITIES DEPOSITORY

In 2019, one regulated market - *Nasdaq Riga* (hereinafter in this Section - Stock Exchange) and one multilateral trading system or alternative market - *First North Latvia* - continued operating in Latvia. Both points of sale are organised by AS *Nasdaq Riga*.

The task of the FCMC is to supervise the activities of the points of sale of financial instruments, regularly following whether the points of sale ensure the fulfilment of the corresponding requirements of the legal acts regulating their activities. The main supervisory aspects are:

- compliance with organisational requirements;
- maintaining effective internal control system;
- compliance of IT system operation;
- non-discriminating treatment of market participants.

The FCMC also assesses the regulations of the points of sale, so that they correspond to the requirements of legal acts.

In 2019, the FCMC for the first time performed the assessment of activities of the Central Securities Depository *Nasdaq CSD SE* in accordance with Article 22 of Regulation No 909/2014. The Regulation prescribes the minimum scope of inspection, which includes the assessment of operational risk, continuity of operations risk, legal risk and the operation of the securities settlement system, evaluation of the financial stability, recovery plan, internal control system, governance, and other operational aspects of the depository. Within the scope of the referred-to assessment, the FCMC carried out on-site inspection at *Nasdaq CSD SE*. The FCMC did not detect any violations of the requirements of the referred to Regulation. Also, regarding the supervision of *Nasdaq CSD SE*, the FCMC carried out regular off-site measures related to the evaluation of

the statements, reports, and other information submitted by the central securities depository, but within the framework of the supervision several discussions with *Nasdaq CSD SE* representatives took place as well. Taking into consideration the fact that *Nasdaq CSD SE* is providing services in Lithuania and Estonia as well, the FCMC, within the framework of the *Nasdaq CSD SE* supervisory college, cooperates closely with supervisory authorities and central banks in Lithuania and Estonia, as well as with the Bank of Latvia. At the end of 2019, the FCMC received the application from *Nasdaq CSD SE* for the permit to provide the services of central securities depository in Iceland, and, in line with Articles 19 and 23 of Regulation No 909/2014, the FCMC involved in the assessment thereof the supervisory authority and central bank of Iceland, as well as Eurosystem.

ACTIVITIES OF ISSUERS OF THE FINANCIAL INSTRUMENTS LISTED ON THE REGULATED MARKET AND SUPERVISORY MEASURES APPLIED THERETO

During 2019, the regulated market (Stock Exchange) stock list was reduced by one issuer, and at the end of the year in total the stocks of 18 joint stock companies were listed on the Stock Exchange, out of which the stocks issued by four issuers were listed on the Official Listing and the stocks of 14 issuers – on the Second Listing. At the end of 2019, the debt securities listing in total included 39 various debt securities issues in a total of 12 issuers, whereof seven issues were Latvian government debt securities and 32 issues were corporate debt securities.

The task of the FCMC is to supervise whether the issuers, whose transferable securities are listed on the regulated market, are disclosing the regulated information in due time and in accordance with the requirements of the FIML and Regulation No 596/2014. In carrying out the aforementioned supervision, the FCMC followed whether the issuers had published financial statements (both audited annual and interim) in a timely manner and in accordance with the requirements of the legal acts, and the FCMC acted so that the issuer eliminated the identified deficiencies; there were also sanctions imposed on the issuers for violations committed. In total, in 2019 the FCMC sent two letters of reprimand to the issuers with respect to the violation of the issuer regarding the audited statement, because the issuer had already acted so as to eliminate the deficiencies. Letters of reprimand were also sent to two issuers

who had failed to act in accordance with the requirements with respect to disclosing such regulated information as internal information.

Administrative proceedings were instigated against the issuers whose infringements with respect to publishing the regulated information, including financial statements or financial information (by three or nine months), had been material, protracted, or repeated; in total, in four administrative proceedings decisions were adopted, providing public statements regarding the infringements of two issuers and imposing a fine on two issuers for the infringements of the FIML (in the amount of EUR 3,000 and EUR 1,000). In one instance, a term was set for the issuer, within which it must act so that the regulated information is published.

In two of the administrative cases instigated during 2019 with respect to the violations of the issuers regarding disclosure of regulated information, the decisions were still not adopted in 2019.

Off-site enhanced inspections were carried out with respect to the compliance of financial information (statements) prepared by the issuers with the requirements for the preparation of the statements. Significant deficiencies or violations in statement preparation were not identified. Correspondence on individual financial statements was conducted with individual issuers and their auditors. In separate cases, it was asked to eliminate the identified discrepancies in the subsequent financial statements.

To promote both the protection of investor interests and the actions of the market participants who have the duty to disclose key investor information, in accordance with the norms of law, the FCMC, also in 2019, as in previous years, continued the practice launched to ensure informative measures (seminars and informative letters), by informing the issuers on the coming-into-effect of the new requirements, explaining the application of requirements of separate legal acts, and directing the attention of the issuers to the most frequent deficiencies. For example, a seminar was organised on absolutely new requirements related to the protection of shareholder rights and the conduct of the issuer, in line with the principle of sound corporate governance.

As regards separate issues, referring to the rights of investors to receive timely and comprehensive information sufficient for investors, with respect to several issuers the FCMC acted so that the issuer's corporate governance statement would be elaborated; before the corporate governance statement was published,

it invited separate issuers, when providing information about their corporate governance, to explain to investors the circumstances causing the deviation from the relevant corporate governance principle.

SECURITIES TRADED IN THE MULTILATERAL TRADING SYSTEM

At the end of 2019, the stocks of three joint stock companies were listed in the stock listing of the multilateral trading system *First North Latvia*, and the bonds of two issuers were listed in the debt securities listing of *First North Latvia*.

The alternative market does not have the status of the EU regulated securities market. The enterprises listed on *First North Latvia* market are bound by the regulations of *First North Latvia*, and they are not subject to the requirements prescribed by legal acts for the enterprises listed on the regulated market (*inter alia*, requirements of disclosure of regulated information), which are usually stricter.

TRADING IN FINANCIAL INSTRUMENTS (ON THE REGULATED AND ALTERNATIVE MARKET) AND THE SUPERVISION OF INVESTOR ACTIVITIES

In 2019, in the Latvian regulated market (Stock Exchange), an increase in the activity of trading in stock was observed. The total number of transactions in the stock market increased by 25.4% in 2019 compared to 2018, whereas the total turnover in the stock market was EUR 24.1 million in 2019, which was by 72.3% more than in 2018. In 2019, larger-scale transactions were made in the Stock Exchange, with the average transaction amount growing by 37.5% as compared to the year before. At the end of 2019, the stock market capitalisation in the Stock Exchange comprised EUR 810.6 million, demonstrating a growth of 9.9% compared to the end of 2018. The increase of capitalisation was influenced by the rise in prices of listed undertakings - the Stock Exchange index OMXR increased by 11.5% to 1,036.15 points over the year.

Trading activity on *First North Latvia* decreased in 2019, as the investors made fewer transactions with the stocks of *SIA Madara Cosmetics*. In 2019, the number of transactions made on *First North Latvia* reduced by 20.1%, while the total stock turnover comprised only EUR 734 thousand, demonstrating a drop of 87.4% as compared to the turnover of 2018.

The FCMC continuously carried out supervisi-

on by following the transactions closed by the shareholders and bondholders, and analysed the purchase and sales orders submitted to the Stock Exchange, as well as to *First North Latvia*. The task of the FCMC is to supervise trading in financial instruments with the aim to identify and prevent market manipulation and insider dealing, thus fostering the stability of the financial instruments market and transparency of its operations. In 2019, the FCMC also received and analysed 26 reports from market participants about suspicious transactions with financial instruments. In-depth verifications regarding suspicious transactions were carried out in seven instances. There were no administrative sanctions imposed for market manipulation or insider trading in 2019. In separate cases, the FCMC carried out the corrective measures by sending a letter of reprimand and indicating to the investor that signs of market manipulation had been observed in its transactions performed, and required it to immediately cease the actions that might mislead other investors regarding stock price, demand, and supply. In 2019, one inspection was commenced regarding possible insider trading in transactions with stocks, but the inspection was not yet completed by the end of the year.

Likewise, the FCMC regularly supervised whether the information on changes in a significant holding was disclosed, as well as whether the whether the persons who according to the requirements of Regulation No 596/2014 are considered to be the managers, or the persons closely related to them according to the requirements of Regulation No 596/2014, had reported their transactions performed with issuer's securities.

In turn, under the circumstances, when the threshold of the holding was reached, which creates a duty to express the mandatory stock redemption offer, the FCMC took measures necessitating that the person express the mandatory stock redemption offer to other stockholders.

In following up the fulfilment of the referred to requirements, in several cases the FCMC corresponded with persons, so that the notifications to be submitted under the legal acts would be submitted and, where the submitted and published notification had not been prepared correctly, they would be clarified, thereby ensuring the availability of full and precise information to other participants of the financial and capital market. A letter of reprimand was sent to one person on non-observance of the deadline regarding the notifications submitted according to Regulation No 596/2014. Letters

of reprimand (six in total) were sent to several persons who had failed to act according to the requirements so that information about significant holding would be disclosed, in one of the cases also specifying in the letter of reprimand the violation of the person with respect to non-observance of the requirements of Regulation No 596/2014.

With respect to expressing the mandatory stock redemption offer, the FCMC, in two administrative cases instigated by it, concluded administrative agreements - in one of the administrative cases instigated by the FCMC, by concluding an administrative agreement, a fine was imposed in the amount of EUR 10,800, while in the second case a fine in the amount of EUR 131,250 was imposed, which was paid by two persons, both in equal parts.

SUPERVISION OF COMPLIANCE

In the field of AML/CTPF in 2019, the work started in the previous years to improve the regulatory framework and the supervisory processes of compliance with AML/CTPF requirements for banks and non-bank financial institutions, as well as in the strengthening of the AML/CTPF supervisory function carried out by the FCMC, was actively continued.

To ensure the transposition of the requirements of Directive (EU) 2018/843 of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU, (AMLD 5), to prevent the deficiencies of the AML/CTPF Law detected in *Moneyval* Report on the Effectiveness of the AML/CTPF System of Latvia, and to implement the sub-objectives to be achieved set by Action Plan for the Prevention of Money Laundering and Terrorist Financing for the Time Period until 31 December 2019 approved by the Cabinet of Ministers, the FCMC took part in the development of amendments to the AML/CTPF Law.

The referred-to amendments supplement the circle of subjects of the Law; prescribe the duty of the subjects of the AML/CTPF Law to assess the effectiveness of the internal control system, correspondingly documenting this assessment; set requirements for the member of top management and the employee in charge of the fulfilment of the requirements of the AML/CTPF Law and procedure for suitability assessment of the candidate; prescribe a duty of the subject of the Law to carry out customer due diligence, if virtual currency is used in the transaction;

and set a prohibition for credit institutions and financial institutions to keep anonymous individual safe deposit boxes. It was prescribed that in cases where the means of determination have been exhausted and it is not possible to determine any natural person - beneficial owner - and at that moment the position in the senior management body of such legal person or legal arrangement is held by the insolvency administrator, the insolvency administrator may be considered to be the beneficial owner. Additionally, the amendments changed the procedure for the submission of reports to be submitted to the Financial Intelligence Unit of Latvia, refusing the term of 'unusual transaction' and stipulating only the reporting of suspicious transactions, at the same time imposing a duty on the subject of the law to submit other information - namely, information on threshold declarations. It was prescribed that the Enterprise Register of the Republic of Latvia henceforth, for the purposes of fulfilment of the duties prescribed by the AML/CTPF Law, will provide records and details on the shareholders and beneficial owners online and free of charge, and it was also prescribed that the State Revenue Service will develop and maintain an informative system providing access to information about politically exposed persons of the Republic of Latvia and their family members; the requirements were set for business relationship with the client from high-risk third countries, as well as number of other amendments.

Considering the delegation prescribed by the AML/CTPF Law, the FCMC issued **Regulations on the Establishment of Customer Due Diligence, Enhanced Customer Due Diligence, and Risk Scoring System**, which are binding on credit institutions, payment institutions and electronic money institutions, private pension funds, investment companies, investment management companies, alternative investment fund managers, insurance companies, insofar as they provide life insurance or other insurance services related to the accumulation of funds, insurance intermediaries, insofar as they provide life insurance or other insurance services related to the accumulation of funds, reinsurance companies and to the branches of all of these subjects of Member States and third countries in the Republic of Latvia, as well as to credit unions. The regulations have been issued taking into consideration the joint guidelines issued by the European Banking Authority on 4 January 2018, "Joint Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the

money laundering and terrorist financing risk associated with individual business relationships and occasional transactions". The regulations set risk factors to which the institution assigns a certain number of points. The referred-to risk factors are divided into two groups - risk factors, upon the occurrence whereof the institution carries out enhanced customer due diligence; and risk factors, upon the occurrence whereof the institution carries out one or more enhanced customer due diligence measures to such an extent that ensures the examination of the relevant risk factor. The regulations also prescribe risk-decreasing factors, which the institution may apply when performing customer risk scoring. The regulations provide for elaboration of methodology for the customer risk scoring system, ensuring that the customer's risk scoring system appropriately and effectively reflects the overall risk inherent to each customer in numbers. As compared to the previous regulation, the Regulation provides for the rights to extend the term for carrying out enhanced due diligence and prescribe the conduct of the institution in such cases. The regulations also stipulate the types and content of enhanced due diligence, as well as elaborate on the restrictions to be set within the scope of enhanced supervision.

In addition, in 2019, the FCMC issued **Regulations on Conducting an Independent Assessment of the Internal Control System for the Prevention of Money Laundering and Terrorism and Proliferation Financing**, binding on credit institutions; licensed payment and electronic money institutions; and credit institutions, licensed payment institutions, and electronic money institutions of branches of Member States and third countries in the Republic of Latvia, and prescribing the frequency, scope, and procedures for performance of the independent assessment of the AML/CTPF internal control system of the institution. The FCMC also issued Regulations on Information Accompanying Transfers of Funds, prescribing minimum measures to be taken to ensure the fulfilment of the requirements of Regulations (EU) 2015/847 of 20 May 2015, on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006 and to minimize the MLTPF risk associated with transfers of funds.

Considering the delegation prescribed by the Law on International Sanctions and National Sanctions of the Republic of Latvia, in 2019 the FCMC issued Regulations on Sanctions Risk Management, binding on credit institutions, payment institutions and electronic money institutions, private pension funds, investment

companies, investment management companies, alternative investment fund managers, insurance companies, insofar as they perform life insurance or other insurance activities related to the accumulation of funds, insurance intermediaries, insofar as they provide life insurance or other insurance services related to the accumulation of funds, reinsurance companies, and to the branches of such subjects registered in the Member States and third countries in the Republic of Latvia, as well as to credit unions. The referred-to regulations determine minimum requirements for carrying out the sanctions risk assessment and establishing an internal control system for sanctions risk management and control thereof; the circumstances to be taken into account by the institution in carrying out an assessment of sanctions risk, specifying those Member States of the EU or the North Atlantic Treaty Organization whose sanctions have a serious impact on the interests of the institution or the financial and capital markets; as well as the requirements in relation to the application of financial restrictions if they result from the sanctions imposed by the Member State of the EU or North Atlantic Treaty Organization where compliance with them have a serious impact on the interests of the institution or the financial and capital markets. In 2019, the referred-to regulations were supplemented, *inter alia*, providing for the exemptions in the regulation which are not subject to financial restrictions - namely, if a person subject to financial restrictions is related to an EU or EEA Member State, and the exemption is necessary to ensure the coverage of expenses of basic needs or basic economic activity of a person subject to financial restrictions. In order to apply exemptions, an institution must initially assess whether the financial transaction corresponds to the framework prescribed by the exemption and then address the FCMC to receive approval. The FCMC prescribes the limit for covering the expenses necessary for basic needs and basic economic activity.

At the same time, the FCMC continued its regular monitoring in the AML/CTPF area, and as a result in 2019 a fine was imposed on four credit institutions for failure to comply with the requirements laid down in the AML/CTPF Law in a total of EUR 5,398,039; restrictive measures were set, and a set of duties was imposed that should be carried out in order to fine-tune and improve the internal control systems of the banks. The FCMC carried out the follow-up supervision of the fulfilment of these obligations. Additionally, in one case, a warning was issued to the Board Member in charge of the AML/CTPF field. In 2019, the number of on-si-

te inspections in banks was increased by 20% as compared to 2018, and the number of employees of the FCMC in the field of compliance control was increased as well.

For one bank, the FCMC adopted the decision not to impose a fine for violations of the requirements laid down in the Law on International Sanctions and National Sanctions of the Republic of Latvia and the FCMC's Regulations on Sanctions Risk Management which were detected in its activities, but instead to publicly announce its violations, specifying the essence of the violation.

The FCMC continued regular supervision in the field of AML/CTPF in the non-bank sector as well, as a result of which in 2019 one payment institution and one investment management company had fines imposed due to non-observance of the requirements of the AML/CTPF Law and laws and regulations related thereto in the sum total of EUR 18,188, and the referred-to investment management company also had a number of legal duties imposed with respect to the improvement of the effectiveness of operation of its internal control system. The FCMC carried out the follow-up supervision of the fulfilment of these obligations. Additionally, the warning was expressed to the AML/CTPF responsible persons of the referred-to payment institution regarding the allowed-for violations, while the institution itself adopted the decision to refuse the status of the registered payment institution. Likewise, the FCMC continued to carry out the assessment of the internal control systems established by the potential market participants within the scope of the licensing and registration process, as well as strengthened the supervision of foreign payment service providers operating in Latvia within the scope of freedom of establishment in the field of AML/CTPF, incl. cooperating with foreign supervisory and control authorities, fulfilling equivalent functions in the relevant country for the purposes of minimising the MLTPF possibilities when providing financial services. As a result of the supervisory measures taken by the FCMC, *inter alia*, by changing the licensing regime for payment institutions and electronic money institutions by the amendments adopted to the legal acts in 2018, stipulating stricter criteria for the institutions entitled to work in the status of a registered institution, in 2019 the number of payment institutions and electronic money institutions reduced, respectively, by 33.3% and 38.5% as compared to 2018; *inter alia*, the institutions with high MLTPF risk inherent to their activities and circle of clients terminated their activities.

In 2019, concerning the issues of the prevention of money laundering, the FCMC represen-

tatives participated in the work of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures *Moneyval* of the Council of Europe, and also participated in the execution of the tasks set by the "Action Plan for the Prevention of Money Laundering and Terrorist Financing for the Time Period until 31 December 2019" approved by the Cabinet of Ministers. In addition, a member of the FCMC is included in the Committee for Control of Goods of Strategic Significance operating within the Ministry of Foreign Affairs and participated in the meetings of this committee in 2019. In 2019, the Sanctions Coordination Council was established, and, within the composition thereof, the Sanctions Operational Response Group. The purposes of the referred-to Council is to coordinate the activities of those competent authorities which are in charge of the fulfilment of international or national sanctions or the supervision or control thereof, and to foster a uniform approach to the application of laws and regulations in the field of international sanctions and national sanctions of the Republic of Latvia. The representative of the FCMC participates both in the Sanctions Coordination Council and in the Sanctions Operational Response Group.

In accordance with the FCMC's register of unusual and suspicious financial transactions, in 2019, 22 reports were sent to the Financial Intelligence Unit of Latvia.

SECURITY OF FINANCIAL SERVICES AND INFORMATION SYSTEMS

In 2019, the FCMC carried out on-site inspections of information systems in three banks, two insurance companies, one central securities depository, as well as in three credit unions, one payment institution, and one electronic money institution. Increased attention was paid to the ability of the institutions to ensure business continuity and cybersecurity or resistance against external attacks.

Considerable effort was made for the registration and licensing of the applications of new services of market participants and applications of new market participants by assessing the conformity thereof to the requirements of statutory regulations on information systems and providing consultations with respect to the application of requirements.

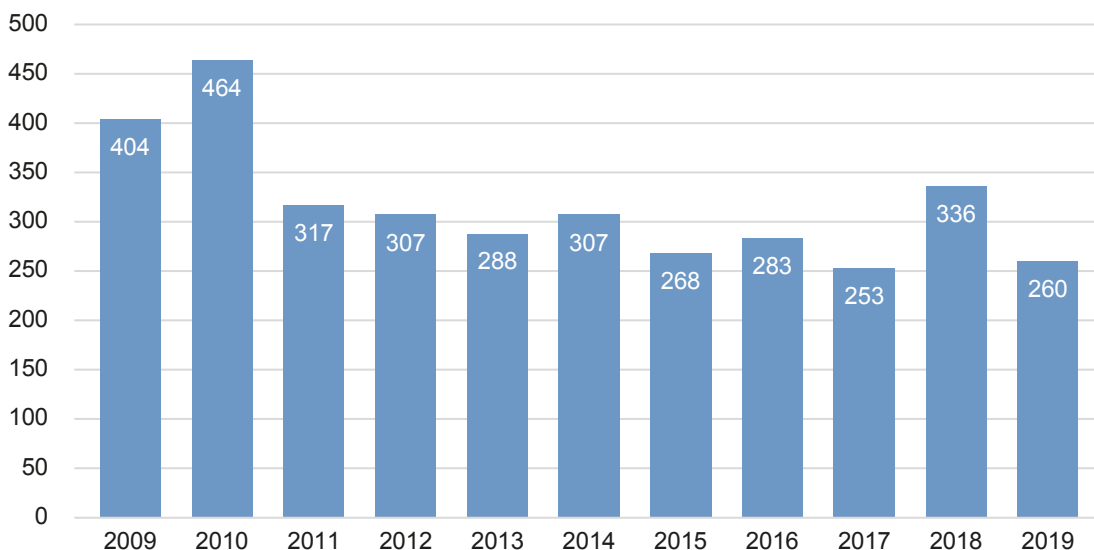
Likewise, the work with market participants continued in the form of consultations about the requirement of the LPSEM for payment services providers to ensure solutions so that the clients, by using third-party service providers, would be able to initiate payments from their accounts and analyse statements of account.

REVIEW OF CUSTOMER COMPLAINTS ABOUT THE ACTIVITIES OF MARKET PARTICIPANTS

The protection of the rights of the clients of market participants and the reviewing of complaints of the actions of market participants was also one part of the FCMC supervision in 2019.

In 2019, the FCMC received and reviewed 260 complaints regarding the actions of financial and capital market participants – 213 complaints on credit institutions, 27 – on insurance companies, 10 – on payment and electronic money institutions, seven – on market participants providing investment services, and three - on pension funds, incl. on State-funded pension schemes.

Figure 28. Number of received complaints



The FCMC received 213 complaints from the customers of credit institutions on 13 credit institutions, incl. 145 complaints from natural persons and 68 complaints from legal entities. As compared to 2018, the number of received customer complaints and applications was smaller. Having reviewed that, which was mentioned in the complaints, the FCMC, within the scope of its competence, did not identify any violations of the Credit Institution Law and the laws and regulations subordinated thereto in the actions of the credit institutions, but the information provided in complaints was used for supervisory purposes. Having reviewed that which was mentioned in five complaints, deficiencies were identified in the management of operational risk at the relevant credit institutions.

In 2019, the FCMC received 27 customer complaints regarding 11 insurers, incl. 17 complaints from natural persons and 10 complaints from legal entities. As compared to 2018, the number of received customer complaints and applications was smaller also in this segment. The FCMC did not detect any violations of the laws and regulations, which would be subject to the imposition of sanctions prescribed by the Insurance and Reinsurance Law in any of the cases mentioned in the complaints. In 22 cases the mutual issues of the client and the insurer were subject to resolution under the civil dispute procedure, one case was sent for the review to the Motor Insurers' Bureau of Latvia, but in four cases the requested information or explanation was provided.

During the reporting period, the FCMC received 10 complaints (all from natural persons) regarding payment and electronic money institutions, *inter alia*, two complaints regarding the institutions licensed in other Member States, the review whereof is not under the competence of the FCMC; thus, these were forwarded to the supervisory authorities of the relevant countries. Three complaints were forwarded for review to the CRPC, but one complaint was related to the possible provision of payment services without the corresponding permit (licence or registration). One more complaint was received regarding the electronic money institution, which took measures to eliminate the flaws contained in the complaint with respect to the actions of the institutions. One complaint against a payment institution is under review, while another two were recognized as ungrounded.

In 2019, the FCMC also received and reviewed four complaints on issuers, three complaints on the actions of investors, and two complaints on the activities of investment firms.

In 2019, the FCMC received three complaints on investment funds from the investment fund investors, as well as two complaints on the activities of the SFPS from the participants of the SFPS investment plans. One participant of the pension plan filed an application on the activities of a private pension fund, inquiring about the regulatory framework of the activities of the pension fund. In none of the cases did the FCMC detect any violations which would be subject to the imposition of sanctions prescribed by laws and regulations.

WHISTLE-BLOWERS' REPORTS RECEIVED BY THE FCMC

A whistle-blower may file a report to the FCMC on possible or actual violations in accordance with the requirements of the Whistleblowing Law (the law took effect on 10 May 2019) and the FCMC's Regulations on the Procedure under which a Person Submits and the Financial and Capital Market Commission Reviews the Report on Possible Actual Violations of the Laws and Regulations Governing the Financial and Capital Market (approved on 17 August 2016). The main difference between these two regulatory enactments of different hierarchy is that the Whistleblowing Law imposes a duty to establish a whistleblowing system in any institution of a public person, incl. in the FCMC, therewith encompassing a broad range of possible violations, *inter alia*, violations in the financial and capital market sector, that a person can report, and a person providing information in accordance with the Whistleblowing Law must execute his or her report so that it has a legal force. In turn, the FCMC's regulations are issued on the basis of various norms of law governing the financial and capital market and provide for reporting violations of particular type, therewith fulfilling the requirements of the EU regulatory framework, and permit reporting also in the form of an e-mail message or even anonymously (namely, there is not a requirement as to mandatory execution of an application in accordance with the conditions for the preparation of documents).

During the development of the Whistleblowing Law and along with the coming into force thereof on 1 May 2019, the State Chancellery carried out a broad campaign for informing the population regarding the essence and purpose of whistleblowing. The purpose set in this Law is very similar to the essence and purpose of the FCMC regulations. Thus, the interest appeared as to whether and how the reports on possible violations can be submitted, and the FCMC started to receive reports from persons on possible or actual violations.

In the financial and capital market sector, persons can file reports on violations of various nature, for example, on the activities of both market participants licensed by the FCMC and non-licensed subjects, and it is possible to report both the violations resulting in breach of external legal acts (for example, the law) and the violations pointing out to the deficiencies in the internal control system of a licensed market participant.

In accordance with the requirements of the Whistleblowing Law, in 2019, (since the law is in effect) the FCMC received four applications (two applications initially from the applicant, one application was forwarded from the State Chancellery as the contact point and one application from another competent authority), which, in the opinion of the applicants, were on possible or actual violations in the financial and capital market sector. In two cases, the FCMC initially recognised the applications executed in the form of a whistle-blower's report to be such whistle-blower's reports (thus, the report was on such infringement of rights that affects the interests of the entire public and not only a particular individual); nevertheless, during the review it was resolved that they are to be forwarded for review to another institution, in line with the competence. In turn, in the two other cases, applications were not recognised as whistle-blower's reports, because the contents thereof did not correspond to the essence of whistleblowing. However, in one case, even though the application was not recognised as a whistle-blower's report, it was concluded that the applicant points out a material problem existing in practice, and the FCMC sent a letter to another institution inviting it to assess whether it is necessary to introduce changes in the laws and regulations in order to improve the situation in the particular matter.

In accordance with the requirements of the FCMC regulations, in 2019 the FCMC received two whistleblowing reports. In one case the report was used for the needs of supervision carried out by the FCMC, but in the second case, obtaining additional information during the review, it was resolved to forward it to another institution, in line with the competence.

In turn, in four cases the FCMC received reports which did not correspond to the Whistleblowing Law and to the FCMC regulations, and they were registered under a special procedure set by the FCMC to protect the submitter of information and the information provided by him/her. Even though the reports did not correspond to the conditions to be recognised as whistle-blower's reports, an additional information check was carried out with respect thereto.

LICENSING

In 2019, minor changes in the number of participants were observed in several segments of the financial market. At the beginning of the year, after the completion of reorganisation, *Luminor Bank AS* Latvia Branch started its activity. *Scania Finans Aktiebolag* Latvia Branch, in its turn, terminated its activities. Also, in September of 2019, the court declared the insolvency of *AS PNB Banka*.

In the segment of payment institutions, registration of six institutions was cancelled. Registration was cancelled also for four electronic money institutions, and the licences of *SIA Qiwi Wallet Europa* and *SIA Ducascopy Payments* were withdrawn. The referred-to changes are partially attributable to the changes in the regulation of the field of payment services, which, starting from 2019, determined the number of services the provision of which no longer requires the permit for the activities of a payment institution, because the exemptions were pro-

vided for when such registration or licence is not necessary; the criteria for the cases when a merchant can operate only within the scope of registration or by correspondingly receiving a license were narrowed down as well, and applied to the operation at a national level. At the same time, a licence for the activities of a payment institution was issued to the State JSC *Latvijas Pasts*.

Licences of two investment firms – *AS Alpari Europe* IBS and *ABLV Capital Markets*, IBAS – were withdrawn as well.

The field of insurance intermediaries went through considerable changes. Along with the coming into effect of the Insurance and Reinsurance Distribution Law, the maintenance of the register of insurance agents is henceforth performed by the insurance merchant or the branch of the foreign insurer, and not by the FCMC.



Table 1. Changes in the number of licensed market participants in 2019

	At the beginning of 2019	At the end of 2019	New market entrants in 2019
Banks	14	14	0
Branches of EU Member State banks	5	5 (-1 branch and +1 branch)	0 ⁵
Cooperative credit unions	34	35 (+1 union)	+1 ⁶
EEA-based providers of banking services	358	375 (-12 banks)	+29
Insurance companies	6	6	0
Branches of EU Member State-based insurers	11	12	+1 ⁷
EEA-based providers of insurance services	546	551 (-31 companies)	+36
Investment management companies	12	11 (-1 company)	0
EEA-based providers of investment management services	29	30	+1
Investment firms	5	3 (-2 companies)	0 ⁸
EU Member State-based investment firms	1	1	0
EEA-based providers of investment firm services	2,115	2,213 (-12 companies)	+110
Agents engaged by the EEA-based providers of investment services	37	37 (3 companies less)	+3
Private pension funds	6	6	0
Insurance brokerage firms	72	72 (3 companies less)	+3 ⁹

⁵ The branches of EU Member State-based banks:

On 2 January 2019, after reorganisation, *Luminor Bank AS* Latvia Branch started activity in Latvia. *Scania Finans Aktiebolag* Latvia Branch terminated its activities in Latvia starting from 8 November 2019, due to withdrawal of its banking licence.

⁶ Cooperative credit unions

On 16 January 2019, a licence was issued to Cooperative Credit Union *Ziemeļvidzeme*.

⁷ Branches of EU Member State-based insurers

On 8 January 2019, *Telia Forsäkring AB* Latvia Branch started activity in Latvia.

⁸ Investment firms

On 8 January, 2019, the licence of *AS Alpari Europe* IBS was withdrawn.
On 28 May 2019, the licence of *ABLV Capital Markets*, IBAS was withdrawn.

⁹ Insurance brokers

Entry in the register withdrawn for *SIA PROVECTUS*, *SIA Prima broker*, *SIA CO Brokers*.
Registered: *SIA BSAFE*, *SIA BA ROOT*, *SIA Prima broker*.

	At the beginning of 2019	At the end of 2019	New market entrants in 2019
Insurance agents	*10		
EEA-based providers of payment services	384	451 (-11 companies)	+78
Payment institutions (registered)	12	6 (-6 companies)	0 ¹¹
Payment institutions (licensed)	3	4 (+1 company)	1 ¹²
Electronic money institutions (registered)	10	7 (3 companies less)	0 ¹³
Electronic money institutions (licensed)	3	1 (-2 companies)	0 ¹⁴
EEA-based electronic money institutions	241	240 (-1 company)	+47
Licensed alternative investment fund managers	7	7 (-1 company)	+1 ¹⁵
Registered alternative investment fund managers	14	13 (-2 companies)	+1 ¹⁶

¹⁰ Insurance agents

In accordance with Clause 5 of the Transitional Provisions of the Insurance and Reinsurance Distribution Law (came into force on 23 May 2019), an insurance agent, which until the day of coming into force of the referred-to law has been registered in the register of insurance and reinsurance intermediaries maintained by the FCMC as an insurance agent, registered as an insurance agent in the register of insurance agents maintained by the insurance merchant or the branch of the foreign insurer, or terminated its insurance distribution. In turn, an entry regarding an insurance agent which, by 1 October 2019, was not registered in the register of insurance agents maintained by the insurance merchant or the branch of the foreign insurer was cancelled in the register of insurance and reinsurance intermediaries maintained by the FCMC.

¹¹ Payment institutions (registered)

In 2019, entries in the register of payment institutions were withdrawn for SIA *BITE Latvija*, GPN DATA LATVIA, SIA, SIA WOT, SIA *Complete Payment Systems*, SIA *Money Express*, SIA *Digital Retail*.

¹² Payment institutions (licensed)

In 2019, a payment institution license was issued to State JSC *Latvijas Pasts*.

¹³ Electronic money institutions (registered)

In 2019, entries in the register of electronic money institutions were withdrawn for SIA *HappyCard*, SIA *LRG Service*, *Latvijas Mobilais Telefons* SIA.

¹⁴ Electronic money institutions (licensed)

In 2019, electronic money institution licences of SIA *Qivi Wallet Europa*, SIA *Ducascopy Payments* were withdrawn.

¹⁵ Licensed alternative investment fund managers

On 4 September 2019, the licence of *Hipo Fondi aktīvu pārvalde*, AS AIFP, was withdrawn.

On 7 May 2019, a licence was issued to SIA *SG Capital Partners* AIFP.

¹⁶ Registered alternative investment fund managers

On 7 May 2019, the entry in the register for SIA *SG Capital Partners* AIFP was withdrawn.

On 29 October 2019, the entry in the register for *SIGNET ASSET MANAGEMENT LATVIA* IPAS was withdrawn.

On 16 August 2019, an alternative investment fund manager was registered - SIA *Melliore Asset Management* AIFP.

RESOLUTION MECHANISM

THE PRINCIPLES OF THE RESOLUTION MECHANISM

According to BRRD one of three banking stability pillars – a resolution mechanism has been established.

The institution in charge of resolution in Latvia is the FCMC; it is responsible for the preparation of resolution plans, as well as for carrying out resolution activities or the rescuing of such institutions the resolution whereof is required in the interests of the general public, or for the adoption of decisions on non-application of the resolution.

The resolution mechanism is also applicable to the investment brokerage firms, subject to the minimum equity requirement in an amount of EUR 750,000.

The main objectives of the resolution mechanism are as follows:

- to set a uniform approach and effective instruments 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 critically important functions;
- to considerably minimise the possibility of taxpayers incurring losses, by requiring that the expenses for rescuing a bank that is important to the national economy are covered by the shareholders and creditors of the bank;
- to establish an effective cross-border banking group resolution mechanism.

The role of resolution authority is proactive, i.e., without waiting for the actual crisis to emerge, the resolution authority performs active work on resolution planning and creation of resolution mechanisms, to ensure well-reasoned and

immediate response to crisis and to ensure the continuity of operation of the financial system and minimisation of the impact of potential crisis on the real economy.

Taking into account that the FCMC as the resolution authority operates in a single system in close cooperation with the SRB and resolution authorities of other Member States, it is critical that the resolution tools and the application thereof are implemented within a regulatory framework harmonized at a maximum. To achieve this, in 2019 the FCMC, under the management of the EBA and the SRB and jointly with the resolution authorities of other Member States, continued to enhance resolution policies and procedures. In the reporting year, the FCMC experts developed internal guides for the application of resolution instruments (creation of a bridge institution and performance of bail-in) and the methodology for determination of the minimum requirements for institutions' own funds and eligible liabilities.

In May of 2019, Directive 2019/879 or BRRD II amending BRRD was adopted. Changes are directly related to the everyday resolution activities and are critical for strengthening the resolution framework. The term for implementation of BRRD II is the end of 2020, but, considering the scope and complexity of changes, the FCMC experts started working on the implementation of BRRD II already in 2019.

SINGLE RESOLUTION MECHANISM

The Regulation of the European Parliament and of the Council establishing the Single Resolution Mechanism came into force on 1 January 2016.

Considering the fact that Latvia is a Eurozone country, it automatically obtains the status of a member state of the SRM. An SRB has been established which, in cooperation with the involved national resolution authorities of the EU Member States (including the FCMC), implements efficient and coordinated functioning of the SRM and is responsible for the management and use of the funds of the SRF as well as for the performance of the functions of the resolution authority with respect to banks falling under the direct competence of the SRB.

The objective of the SRF is to ensure financial resources which, in the case of crisis, can be used to finance the resolution of the bank. The SRF is financed from the contributions of

the Member States' banks (including Latvian banks), aimed at gradually achieving (by 2024) an amount comprising 1% of the covered deposits in all credit institutions in all involved Member States.

The SRB carries out the functions of a resolution authority over Latvian banks which are subject to direct supervision by the ECB within the scope of the SRM; whereas the FCMC representatives take part in the resolution processes implemented by the SRB and preparation of the SRB decisions and implement the decisions adopted by the SRB. In 2019, four Latvian banks and one branch of the Member State-based bank with 81% share in the total banking assets were subjected to direct SRB resolution.

AS *PNB Banka* was transferred under direct resolution of the SRB in April of the reporting year, and on 15 August 2019, after the adoption of the ECB decision on declaring the bank as failing, the SRB adopted the decision that the implementation of the resolution of AS *PNB Banka* is not substantiated. When assessing the activities of the bank and the nature of the problem, it was identified that it is impossible to carry out measures in the private sector that could prevent the financial difficulties of the bank, that the bank does not perform critical functions, and that the bank does not have a significant impact on the financial system of Latvia. Therefore, it was detected that the resolution of the bank is not in line with the interests of the public and the bank should be liquidated according to the legal norms of Latvia.

Decision-making regarding the application of the resolution to another 10 Latvian banks falls within the competence of the FCMC.

To ensure the effective resolution of such banking groups, which are engaged in cross-border operations, resolution colleges have been set up within the EU, engaging experts of the FCMC in the activities thereof.

The SRM has been operating for four years already and, by accumulating additional experience each year, a secure and comprehensive resolution implementation system is being created. Based on the resolution plans developed in the previous years, in the reporting year the work on the more detailed development and improvement of the resolution plans continued. In 2019, the SRB resolution policy preserved the key principle "Joint Effort", in the implementation whereof the national resolution authorities (incl. the FCMC) preserved a signi-

ficant role in the preparation of the resolution plans of the banks within the direct competence of the SRB. In 2019, the FCMC resolution experts continued taking an active part in the development process of the resolution plans for the Latvian banks falling within the direct competence of the SRB. Having reviewed the resolution plans of the banks, an in-depth assessment was carried out on the more appropriate resolution instruments for each bank and on operational steps for their application. At the same time, also the banks themselves were invited to more actively engage in the development of a resolution plan. Involvement of the banks in the development of resolution plans is the next critical stage in the establishment of a comprehensive resolution system. The purpose and essence of a resolution plan is for the SRB, national resolution authority, and the bank under resolution - namely, all of them together - to be able in case of problems to immediately and effectively, with minimum impact on economy, recover the bank, preserving the functions critical to national economy. Therewith, it is important to ensure that the management of the bank fully comprehends the role of the bank itself in the resolution process and that all preliminary works for the implementation of the possible resolution are performed in the bank. To achieve this goal, in the reporting year the resolution experts cooperated closely with the banking specialists in order to ensure the receipt of information necessary for resolution planning, to identify obstacles for the resolution process and to take proactive measures for eliminating them.

Also, the FCMC continued the work on the development of resolution plans for other banks falling within the direct competence of the FCMC. In 2019, five (out of 10) resolution plans were developed anew. Therewith, at the end of 2019, resolution plans were developed for nine banks in total.

In 2019, developing resolution plans for banks according to the SRB methodology, the minimum requirements for institutions' own funds and eligible liabilities were determined at the consolidation level, which is one of the main resolution tools. In the reporting year, the minimum requirements for own funds and eligible liabilities were determined for the banks within the direct competence of the FCMC, based on the FCMC methodology for determination of the minimum requirements for own funds and eligible liabilities in line with the resolution plan strategy of the banks.

CRISIS MANAGEMENT

One of the key tasks of the FCMC is to be prepared to act immediately in response to a crisis of a particular bank or the financial system. Therefore, in 2019 the FCMC also continued to improve its internal processes, which ensure proactive and immediate action of the FCMC management and the involved employees in the crisis situation. The FCMC specialists, on an annual basis, carefully assess the previous experience of addressing crisis situations and make the necessary changes in internal regulatory documents regulating the measures of crisis situation prevention. In this field, the main task of the FCMC is to identify problems in the bank's activities in a timely manner, to implement the measures that may prevent the problems, and with the recovery measures foreseen by the bank itself or with the resolution tools to resolve the bank's operations, if it lies in the public interest, however, if it is not possible, to ensure the liquidation of the bank and starting of the depositors' protection system foreseen by the laws and regulations.

Considering the significant share of the banks of the Nordic countries in the Latvian financial system, it was very important for Latvia to take part in the joint Nordic - Baltic simulation exer-

cise for overcoming financial crisis, held from 22 January 2019 - 23 January 2019, involving 31 financial stability authorities from Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden, as well as representatives from the relevant EU institutions.

A hypothetical crisis scenario was applied in the training, the implementation whereof involved fictitious financial institutions in the Baltic States and the Nordic countries, verifying the abilities of the relevant institutions to overcome crisis and continue regional cooperation. After the exercise, the participants carefully analysed the results of simulations and, in light of the obtained experience, took measures to strengthen the readiness of the involved institutions to overcome the crisis.

In 2017, under the leadership of the Central Bank of Sweden (Riksbank), a working group was established within the framework of the Nordic-Baltic Stability Group. The Nordic-Baltic Stability Group comprises the ministries of finance, central banks, and supervisory and resolution authorities of eight Nordic and Baltic countries. Nordic and Baltic countries, within the group, have agreed to organise regular crisis simulation exercises.

CHANGES TO REGULATORY REQUIREMENTS

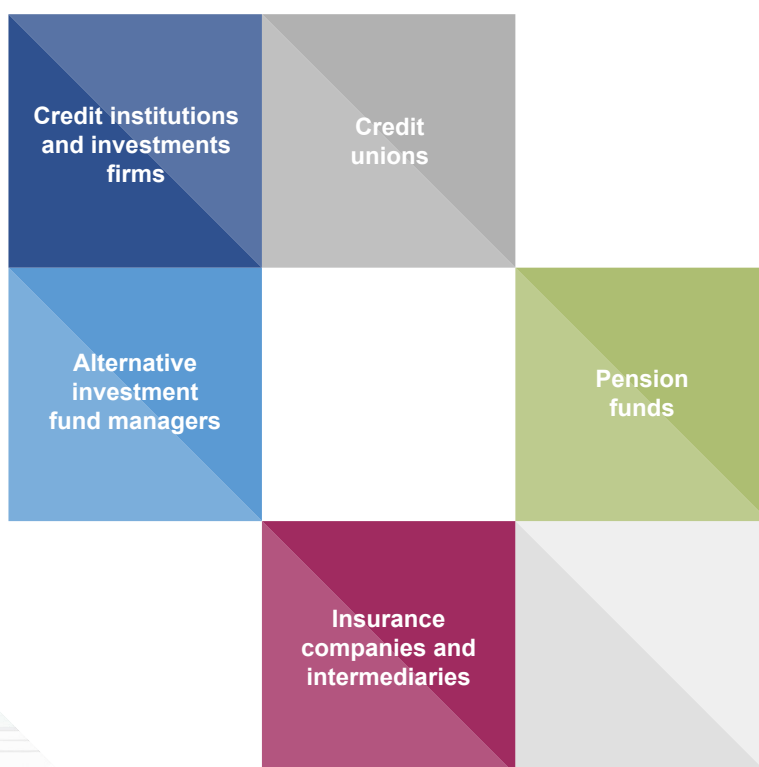
NATIONAL LAWS AND REGULATIONS

By developing the regulatory environment corresponding and appropriate to the Latvian financial sector, in 2019, the FCMC continued to improve the legal framework governing the activities of the participants of the financial and capital market. The changes in the framework of regulatory requirements were mainly based on the legal acts issued by EU institutions in order to ensure a harmonised framework in the EU single financial market, considering the risks and development trends of the Latvian financial sector and concurrently seeking solutions fostering the reduction of administrative burden. Within the process of improvement of

the regulatory environment of the financial sector, the FCMC actively expressed its standpoint in the EU institution, taking part in the preparation of the documents of the regulatory environment in accordance with the principle of proportionality, and protected the interests of the Latvian financial sector and financial service consumers.

Overall, in 2019 broad changes were introduced in the framework of regulatory requirements pertaining to such areas as credit risk management, establishment of corporate governance system, preparation of annual statements, and a number of others.

Figure 29. Achievements of the FCMC in 2019 in enhancing regulatory environment





Credit institutions and investments firms

To enhance credit risk management, in light of the changes in the EU regulations and supervisory practice, in 2019 the FCMC put considerable effort in enhancing the laws and regula-

tions in the field of credit risk.

New FCMC **Regulations for Calculating Credit Risk Capital Requirement** were approved, prescribing the threshold of materiality of delay in obligations for determination of default, providing for more extensive explanation of the features used in Article 178 of Regulation No 575/2013 to determine that the obligor is unlikely to pay its debt in full without realising security, as well as laying down the criteria to be considered when determining items related to especially high credit risk for the needs of calculating capital requirement.

Voluminous amendments were introduced to the **Regulations on Credit Risk Management**, *inter alia*, in order to reduce the amount of non-performing loans and to prevent repeated accumulation thereof in the future, the content of the credit risk strategy was adjusted, more detailed requirements were set for application of forbearance measures, additional requirements were set for the institution with high NPL share in the field of management of such loans. The regulations also incorporated the requirements from the FCMC Regulations on Asset Quality Assessment and Formation of Provisions, which became null and void along with the coming into fore of the **Regulations on Credit Risk Management**. Considerable changes were introduced in the requirements set for the loan-granting process, introducing binding borrower-based measures - quantitative limits ensuring effective credit risk management and well-reasoned assessment of creditworthiness of borrowers for consumer loans. The regulations also entailed specific restrictions for housing loans for the purposes of gaining income arising out of the borrower's real estate operations, and new requirements were set for using automated solutions in the loan-granting process.

Reducing the reporting burden for the banks in the field of credit risk management, in 2019, Regulations on Preparation and Submission of Information on the Bank Loan Portfolio Structure were abolished. Since 2018, information about the loans necessary for the supervisory

needs is available in the Credit Register maintained by the Bank of Latvia.

Fostering the implementation of better corporate governance standards, in 2019 the amendments to **Regulations on Establishment of the Internal Control System** were approved, introducing EBA guidelines on internal governance, as well as taking into consideration the core principles of Basel Committee on Banking Supervision in the field of corporate governance. The amendments change the requirements of the regulations in such material internal governance aspects as strengthening the role and independence of the internal control function holders, strengthening of risk culture and prevention of conflict of interest situations, introduction of corporate values and standards of professional conduct and ethics, and implementation of an effective organisational structure, and supplement the regulations with the requirements to assess the need to nominate an independent member of the supervisory board.

In addition, the **Regulations on the Assessment of the Suitability of the Executive and Supervisory Board Members and Key Function Holders** were developed, introducing "Joint EBA and ESMA Guidelines on the assessment of the suitability of members of the management body and key function holders". Regulations cover such aspects as the procedure and principles for the assessment of suitability of the officials, criteria for suitability assessment, implementation of diversity policy within the scope of the supervisory and executive board, principles for ensuring individual and collective suitability assessment of the supervisory and executive board members.



Credit unions

To ensure uniform understanding about the asset quality assessment and formation of provisions for prudential purposes, in 2019 the FCMC adopted the **Regulations for Assess-**

ing Assets and Off-Balance-Sheet Liabilities of Credit Unions. The regulations provide for more detailed requirements for documenting the assessment of creditworthiness of the borrower, prescribe the responsibility of the executive board of the credit union for the process of assessment of asset quality and other requirements.

In 2018, the amendments to the **Law on Credit Unions** (Law on Savings and Loan Associations) came into force. To set the requirements for controlling the observance of the transaction limits described by the Law on Credit Unions, as well as for calculating the indicators characterising the activities, the **FCMC Regulations for Calculation of the Indicators Characterising the Activities of Credit Unions** were developed.

By ensuring the implementation of the harmonised and uniform highest corporate governance standards in all financial and capital market segments, the **Regulations on Establishment of Internal Control System of Credit Unions** were adopted in 2019; it aimed at ensuring the establishment of effective internal control system also in such unions where up to now the relevant requirements had to be ensured only as the best practice. The regulations corroborate the requirements in such fields as establishment of development strategy, establishment of organisational structure, management of conflict of interest situations, accounting organisation, etc.



In 2019, the FCMC prepared amendments to the **Law on Alternative Investment Funds and Managers Thereof**, prescribing significant changes with respect to supervision of the activities of

the registered AIFM and the payments to the FCMC related thereto.

Amendments to the Law stipulate that the FCMC will perform the registration of a registered AIFM (registered manager), but will not henceforth perform the registration of the AIF under the management thereof. Registration of the manager will take place based on the reduced scope of information to be provided to the FCMC. If the investor of the fund of the registered manager would detect that the manager fails to observe the requirements laid down in the Law on Alternative Investment Funds and Managers Thereof or, due to the actions of the manager, the infringement of his or her rights have occurred, he or she will be entitled to address the court of the Republic of Latvia under the procedure prescribed by law and regulations. The FCMC continues performing the supervision of managers licenced in Latvia and the manager registering European

venture capital fund in Latvia, as well as the custodian banks in accordance with the Law on Alternative Investment Funds and Managers Thereof and directly applicable EU legal acts. At the same time, the FCMC is also in charge of supervision of the distribution in Latvia of the investment units (shares) of a member state fund under the management of a licenced manager.

After the coming into force of the amendments to the Law on Alternative Investment Funds and Managers Thereof, it was necessary introduce amendments to the **Regulations on Preparation of Reports of Alternative Investment Fund Managers** and the **Regulations on Preparation of Reports of Investment Management Companies**, to ensure that the frequency of provision of data on the activities of the registered manager to the FCMC is reduced to that prescribed by the Law on Alternative Investment Funds and Managers Thereof - once per year, at the same time preserving the volume and content of the received data for the FCMC to be able, within the scope of information exchange, to provide data to other institutions for aggregating statistical data in accordance with the requirements of the directly applicable EU legal acts.



At the end of 2019, the **Law on Private Pension Funds** was adopted, replacing the previous Law on Private Pension Funds, transposing and adjusting the norms contained therein, as well

as supplementing it with voluminous requirements to introduce into the national laws and regulations Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016, on the activities and supervision of institutions for occupational retirement provision. The Law prescribed the procedure for supplementary pension provision, types of pension funds and their operational principles, types of pension plans, the rights and obligations of the pension plan participants and recipients of supplementary pension, procedure for management of assets, competence of the asset-holder, and the procedure for performing supervision of the referred to activities.

Regulations on Provision of Information of Private Pension Funds were developed, in order to obtain information which the FCMC

must submit to the EIOPA. The Regulations prescribe the procedure for preparation and submission of information necessary for the EIOPA. In accordance with the criteria set by the EIOPA, it will be necessary for the pension funds to prepare annual and quarterly reports, an annual report or abbreviated annual report, for the FCMC to obtain data on the occupational retirement provision or on pension funds which have concluded collective participation with employers regarding the participation of the employees of such employers in a particular pension plan.

Under the delegation provided for in the Private Pension Funds Law, the FCMC regulations will be developed prescribing the requirements for pension funds with respect to corporate governance, preparation of reports, calculation of solvency standard and own funds, and other aspects.

The results achieved during the recent years in enhancing the regulatory environment are significant. Nevertheless, despite the achievements, the work should continue also in the future.



Insurance companies and intermediaries

On 23 May 2019, the **Insurance and Reinsurance Distribution Law** came into force. By this law the requirements of Directive (EU) 2016/97 of the European Parliament and of

the Council of 20 January 2016, on insurance distribution (recast; text with EEA relevance) were transposed into national laws and regulations of Latvia. The Law prescribes the commencement and performance of insurance and reinsurance distribution activities and applies to any person who is engaged or is willing to engage into insurance or reinsurance distributions (insurance merchant, insurance or reinsurance broker, insurance agent, and ancillary insurance intermediary).

In 2019, the amendments to the **Law on Payment Services and Electronic Money** were introduced twice. On 13 April 2019, the amendments came into force regarding restrictions of payments with a payment card, to prevent performance of payments (restrict performance of payments) to interactive gambling and interactive lottery organisers unlicensed in the Republic of Latvia.

In turn, on 12 November 2019, the amendments to this Law came into force providing for the rights of the FCMC and the CRPC to initiate an administrative case when it arises from the information provided in the submission and the materials appended thereto that such a violation has been committed which has caused or may cause significant harm to the interests (collective interests) of the groups of service users or electronic money holders or to an individual service user or to the electronic money holder. The rights were provided for to give a warning or impose a fine (on the payment service user which is not considered to be a consumer); the rights to impose a duty on the payment service provider or user, electronic money issuer, or holder were also provided, to eliminate the allowed-for violations and to set the term for the fulfilment of the activities necessary to this effect.

On 8 August 2019, the **FCMC Regulations on Preparation and Submission of Information of Cases of Fraud in the Field of Payments** were approved, prescribing the procedure for preparation and submission of statistical information on payments and cases of fraud in the field of payments.

Amendments to the **Financial Instrument Market Law** came into force on 6 June 2020. The amendments ensured compliance with the requirements of Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017, on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, deleting certain norms from the law in order to avoid redundancy in the regulation.

By the amendments to the **Financial Instrument Market Law** (came into force on 6 January 2020) and the amendments to the **Credit Institution Law** (came into force on 13 January 2020); the requirements of Article 71 of 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; and Article 28 of Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014, on key information documents for packaged retail and insurance-based investment products. By including in the Law the reporting mechanism on possible and actual violations of legal acts entailing the rights of any person to

report violations, the responsibility for the processing of reports was assigned to the FCMC. Considering that several other Sections of the FIML, after introducing the requirements of several other EU legal acts, already prescribed the requirements for reporting other violations of legal acts, one Chapter of the FIML aggregated the entire applicable reporting procedure with respect to various violations of legal acts.

By the amendments to **Regulations on the Procedure under which a Person Submits and the Financial and Capital Market Commission Reviews the Report on Possible or Actual Violations of the Laws and Regulations Governing the Financial and Capital Market** that came into force on 28 January 2020, certain significant changes were introduced, namely:

- the regulations were supplemented by the delegating norms from the AML/CTPF Law, the FIML, and the Credit Institution Law;
- in Clause 5.1 of the regulations the e-mail address specified for reporting violations, parkapumu.zinosana@fktk.lv was replaced by the new e-mail address, trauksme@fktk.lv. Such necessity arose because the FCMC, on an everyday basis, received at the e-mail address parkapumu.zinosana@fktk.lv diverse information not related to whistleblowing on possible or actual violations in the activities of the financial and capital market participant; *inter alia*, the complaints to be reviewed under general procedure were also received at this e-mail address;
- the regulations were supplemented by a report template developed by the FCMC that could facilitate the reporting - namely, the template offered for the submitters of the report contained more detailed information to be mandatorily indicated in the report by the person and which, in the opinion of the FCMC, would help to review the report as fast as possible.

From 16 July 2019, the amendments to the Financial Instruments Market Law are in force, introducing the Shareholder Rights Directive, prescribing the duty of the companies with the stocks being listed on a regulated market to develop the remuneration policy and the report. Likewise, additional disclosure requirements are set for the credit institutions and investments firms as regards investments in the stock of the companies listed on a regu-

lated market. Concurrently with the referred to changes, the shareholder identification requirements are also being introduced; however, they will come into force only on 1 September 2020.

From 16 July 2019, the amendments to **the Insurance and Reinsurance Law, the Law On Investment Firms, the Law on Alternative Investment Funds and Managers Thereof, and the Law on Private Pension Funds** (currently already replaced by the Private Pension Funds Law) are in force, introducing the Shareholder Rights Directive and setting additional disclosure requirements as regards investments in the stock of the companies listed on a regulated market.

MACRO-PRUDENTIAL SUPERVISION

OTHER SYSTEMICALLY IMPORTANT INSTITUTIONS

Under Sections 35.13 and 35.14 of the Credit Institution Law, the FCMC identifies credit institutions which qualify as O-SII once a year. To identify O-SIIs, the FCMC applied the methodology contained in the guidelines EBA/PN/2014/10 developed by the EBA. Systemic importance of each credit institution was assessed, taking into consideration the mandatory criteria and indicators laid down in the referred-to guidelines.

In 2019, the FCMC identified four O-SIIs of local financial sector to which the O-SII buffer reference point and more rigid requirements in corporate governance were set. The identified O-SIIs are the same credit institutions that were already identified in 2018 (AS *Citadele banka*, AS *Rietumu Banka*, AS *SEB banka* and *Swedbank AS*), with the exception of one – *Luminor Bank AS* – which, starting from 2 January 2019, continues its activities as Latvian Branch of the credit institution *Luminor Bank AS* registered in Estonia; thus, the requirements set to O-SII are no longer applicable to it.

For the purposes of ensuring the ability of the O-SIIs to absorb potential risks and therewith mitigate possible systemic risks of the financial system and costs to the national economy, in accordance with Sections 35.¹⁵ of the Credit Institution Law the O-SII capital buffer reference point of up to 2% of the total exposure amount is determined for the identified O-SIIs. The amount of O-SIICB reference points determi-

ned for the O-SII in 2019 has not changed:

	From 27 November 2019	From 30 June 2019	From 30 June 2018	From 31 December 2017
Credit institution	O-SIICB reference point to be maintained	O-SIICB reference point to be maintained	O-SIICB reference point to be maintained	O-SIICB reference point to be maintained
Swedbank AS	2%	2%	2%	1%
AS SEB banka	1.75%	1.75%	2%	1%
Joint stock company Citadele banka	1.50%	1.50%	1.50%	0.75%
Joint stock company Rietumu Banka	1.25%	1.25%	1.50%	0.75%
Luminor Bank AS	-	2%	2%	1%
ABLV Bank AS	-	-	2%	1%

To minimise the possibility of financial stress of the identified O-SIIs, it is important not only to increase the amount of capital buffers to be maintained by them, but also to ensure their compliance with the highest corporate governance standards. Due to this reason, the O-SIIs identified as operating in a field related to risk management and the activities of the supervisory and executive board, as well as their committees, are classified as systemically important for the purposes of applying separate requirements, which means a higher intensity of supervision of these requirements; they also do not have the possibility to apply separate allowances defined by laws and regulations which, with an FCMC permit, can be granted to systemically less-important institutions.

The FCMC will also henceforth review the list of identified O-SIIs and will publish it by 1 December each year. The O-SIIs may also become subject to other stricter requirements in the future.

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 during the economic downturn.

The requirement of the CCyB reference point regarding the transactions with Latvian residents in the amount of 0% came into force on 1 February 2016, for the first time and has remained at this amount also in the subsequent periods.

In 2020, the FCMC will continue to analyse the relevant indicators and trends when deciding on the determination of the CCyB reference point in the coming quarters. The FCMC will take a decision on the necessity to determine the CCyB reference point in the amount above 0%, if a significant increase of cyclical systemic risks is observed in the financial sector of Latvia.

COUNTERCYCLICAL CAPITAL BUFFER

The FCMC, as the institution responsible for determining the CCyB reference point, according to Section 35.⁵ of the Credit Institution Law, on a quarterly basis, in cooperation with the Bank of Latvia and the Ministry of Finance, analyses and evaluates the indicators to justify another decision on determination of a CCyB reference point.

The determination of the CCyB norm ensures that the credit institution, during its economic growth, accumulates sufficient capital base, in

BORROWER-BASED MEASURES

On 27 November 2019, the FCMC, in cooperation with the Bank of Latvia, the CRPC, Finance Latvia Association, and market participants, approved the borrower-based measures.

The borrower-based measures are quantitative limits that, in terms of their essence, ensure not only well-reasoned lending at the individual level of credit institutions, but also foster the overall stability of the financial and capital market, ensuring stronger overall resilience of the credit institutions and borrowers against potential future shocks, when the lending might resume.

TOPICALITIES IN THE ADOPTION OF THE LAWS AND REGULATIONS OF THE EUROPEAN UNION IN 2019

The year 2019 was the year of electoral and official replacement in the EU. New European Parliament was elected in May, followed by an inextricably related process of appointing the new composition of the EC. These events, to a large extent, determined the agenda and developments in the processes of drafting and adopting the EU legal acts.

In light of the structural changes in the EU institutions and the fact that in 2018 the EC had published a number of new draft legal laws which were still being discussed by the Member States in 2018, in 2019 the work continued on debates regarding the draft legal acts published in the previous years and the achievement of the final agreement. The FCMC staff was actively involved in these processes, taking part in the discussions of the working groups of the EU Council, thereby ensuring that the adopted legal acts, as far as possible, were corresponding to the interests of the Latvian financial market.

In 2019, the EC did not publish any proposal for the EU first-level legal acts in the field of financial services; nevertheless, the year was productive from the perspective of approval of the previously published proposals. Over the year, the parties involved in the EU legislative procedure managed to achieve the final agreement on many draft legal acts under discussion, and thus, during 2019, the following EU first-level legal acts were published:

- Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019, amending Regulation (EU) No 575/2013¹⁷ as regards **minimum loss coverage for non-performing exposures**, foreseeing the duty for banks to accrue adequate resources as soon as new loans become non-performing;
- Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019, amending Regulation (EU) No 648/2012 as regards the **clearing obligation**, the suspension

of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories, and the requirements for trade repositories¹⁸;

- four amendments to the legal acts within the framework for the **capital requirements and recovery activities and resolution of credit institutions**: Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019, amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012¹⁹; Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019, amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms²⁰; Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019, amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures, and powers and capital conservation measures²¹; Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019, amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC²²;

- Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019, **on facilitating cross-border distribution of collective investment undertakings** and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014, and Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019, amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings²³

¹⁷ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R0630>

¹⁸ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R0834>

¹⁹ <https://eur-lex.europa.eu/legal-content/LV/TXT/PDF/?uri=CELEX:32019R0876&from=EN>

²⁰ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R0877>

²¹ <https://eur-lex.europa.eu/legal-content/LV/TXT/PDF/?uri=CELEX:32019L0878&from=EN>

²² <https://eur-lex.europa.eu/legal-content/LV/TXT/PDF/?uri=CELEX:32019L0879&from=EN>

²³ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R1156> un <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019L1160>

aimed at reducing regulatory barriers hindering cross-border distribution of investment funds within the EU;

- Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019, on a **pan-European Personal Pension Product**²⁴, providing for establishment of a voluntary pension scheme of a cross-border nature in addition to the national pension plan, setting a legal framework thereof by the Regulation;

- Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019, **on the prudential requirements of investment firms** and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014, and (EU) No 806/2014, and Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019, on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU, and 2014/65/EU²⁵. They lay down single requirements in such fields as own funds requirements, requirements for limiting concentration risk, liquidity requirements, requirements for reporting, and public disclosures;

- legal acts in the **field of sustainable financing**, to ensure in the EU financial sector the movement towards a neutral, more resource-efficient, and resilient circular economy: Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019, on sustainability-related disclosures in the financial services sector and Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019, amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks, and sustainability-related disclosures for benchmarks²⁶. This regulatory framework prescribes single disclosure requirements regarding environmental, social, and governance factors with respect to financial services, requesting to perform sustainability-related disclosures both before conclusion of the agreement and, on a regular basis, on the websites in the form of descriptive in-

formation. The regulatory framework will also ensure application of harmonised criteria when measuring the carbon footprint of investment portfolios.

- Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019, amending Regulation (EU) No 648/2012 as regards the **procedures and authorities involved for the authorisation of CCPs** and requirements for the recognition of third-country CCPs²⁷;

- Regulation (EU) 2019/2160 of the European Parliament and of the Council of 27 November 2019, amending Regulation (EU) No 575/2013 as regards **exposures in the form of covered bonds** and Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019, on **the issue of covered bonds and covered bond public supervision** and amending Directives 2009/65/EC and 2014/65/EU Directive 2019/2160/EC and Directive 2019/59/EU²⁸. The new requirements have been introduced for the purposes of ensuring that covered bonds are evaluated as a qualitative instrument to which a preferential regime can be further applied in the determination of capital requirements. The legal acts adjust the basic elements and definitions of covered bonds, determine the structural features of the instrument, the quality and liquidity requirements of coverage assets, as well as the supervisory and disclosure duties of competent authorities in the field of covered bonds;

- regulatory package for **the revision of the European System of Financial Supervision**: Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019, amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instru-

²⁴ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R1238>

²⁵ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2033> un <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019L2034>

²⁶ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2088> un <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2089>

²⁷ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2099>

²⁸ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2160> un <https://eur-lex.europa.eu/legal-content/LV/TXT/PDF/?uri=CELEX:32019L2162&from=EN>

ments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds; Regulation (EU) 2019/2176 of the European Parliament and of the Council of 18 December 2019, amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, and Directive (EU) 2019/2177 of the European Parliament and of the Council of 18 December 2019, amending Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency I), Directive 2014/65/EU on markets in financial instruments, and Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing²⁹.

In 2019, the EU Council continued negotiations that are still not yet completed with respect to the following draft EU legal acts published in the previous years - the draft regulation on **European collective financing (crowdfunding) service provider companies**, the draft directive on credit servicers, **credit purchasers and the recovery of collateral**, the draft regulation on securities covered by government bonds, the draft regulation on **the establishment of a framework to facilitate sustainable investment**, called the Taxonomy Regulation, and the draft regulation on the **establishment of the European Deposit Insurance Scheme**.

A number of delegated and implementation regulations of the EC have also been adopted during 2019, laying down the technical standards for the application of certain previously adopted EU norms of law, including for the implementation of CRR/CRD IV, BRRD, Solvency II, PSD II, MiFID II, MiFIR, etc. first-level legal acts.

The relevant legislation has been published on the FCMC website <https://www.fktk.lv/tiesibu-akti/>, structured by market segment.

²⁹ <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2175>, <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019R2176> un <https://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:32019L2177>

GUARANTEE SYSTEM

The structure of financial stability in Latvia is composed of:

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

DEPOSIT GUARANTEE FUND

The guaranteed compensation for depositors of Latvian banks and credit unions (deposit-takers) (with certain exceptions provided for in Section 23 of the Deposit Guarantee Law) has been set at EUR 100,000 per deposit-taker. In the cases specified in Section 4 of the Deposit Guarantee Law, the guaranteed compensation has been set at EUR 200,000.

The State guarantees compensation specified in the Deposit Guarantee Law to each deposit-taker irrespective of whether there are sufficient funds in the DGF at a given time. Under the Deposit Guarantee Law, in cases when the funds are not sufficient, they would be provided by 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. For the purposes of managing risks, if the DGF has to commence the disbursement of guaranteed compensation within the term set by the Deposit Guarantee Law and if the funds of DGF are not sufficient, the FCMC has developed the procedure under which it concludes the loan agreements on borrowing of the missing amount.

Under Section 6 of the Deposit Guarantee Law, the FCMC shall perform the stress test of the DGF once in every three years. The FCMC has developed the procedure for, and set the terms within which, in accordance with the procedure which is stated in the EBA guidelines EBA/GL/2016/04 on stress tests of deposit guarantee schemes under Directive 2014/49/EU, the DGF stress test is carried out. The regulations provided for the DGF stress test programme for 2017 - 2019.

The developed stress test provided for performance of the stress tests of four scenarios over the period of three years. Stress test programme entailed the set of activities through which the ability of the DGF to fulfil its functions was verified, possible risks in the activities of the DGF were identified and the measures were set for the prevention or mitigation of risks.

The following DGF functions were tested during the stress test:

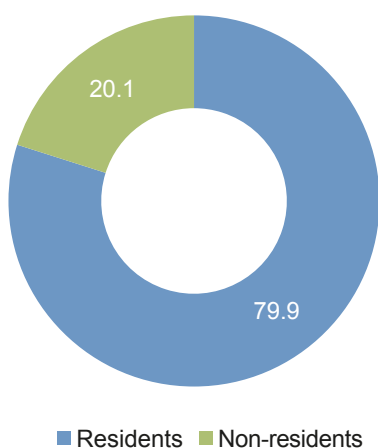
- ability of the credit institutions to prepare and submit to the FCMC information on the guaranteed compensations' file in compliance with the requirements of the FCMC;
- the ability of the FCMC to receive and process the guaranteed compensations' file;
- verification of the function of disbursement of the guarantee compensations under various scenarios, namely, for a credit institution having a branch or several branches in other Member States.

The fourth stage of the stress test implementation was completed in 2019. Thereby, the DGF stress test programme for 2017 - 2019 was fulfilled. The FCMC obtained a comprehensive view about the activities of the Latvian DGF under various scenarios, risks, and the necessary measures for improvement of implementation of the DGF functions.

Table 2. Deposits of Latvian deposit takers as at 31 December 2019

	Amount	Share, %
Total number of depositors	2,005,519.0	100.0
including residents	1,883,138.0	93.9
including non-residents	122,381.0	6.1
Balance of covered deposits, in thousand EUR	8,347,174.1	100.0
including residents	6,670,528.9	79.9
including non-residents	1,676,645.2	20.1
Amount paid by the deposit takers into the DGF by 31 December 2019, in EUR thousand	346,704.2	-

The share of the total covered deposit balance amount of Latvian deposit takers (of Latvian credit institutions, excluding credit institution branches in Latvia, and credit unions) as of 31 December 2019 is reflected in Figure 30.

Figure 30. The share of the covered deposit amount of Latvian deposit takers as of 31 December 2019, %

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 covered deposits with the deposit taker in the previous quarter. Additionally, according to the procedures determined in the Deposit Guarantee Law deposit-takers determine the adjustment ratio applicable to their covered deposits. When establishing the adjustment ratio applicable to the payment, each deposit taker's capital, liquidity and large exposure indicators are considered, and the loan portfolio quality indicators in the previous calendar year, as well as the business

model indicator of the deposit taker. In 2019, the average applicable adjustment ratio applicable to the banks was 127.68%, but to credit unions – 98.87%, meaning that the banks paid in 27.68% more than they would have had to pay of the amount of the covered deposits, while the credit unions – on average, 1.13% less. Deposit-takers paid EUR 17 million into the DGF for 2019.

On 27 February 2018, the FCMC adopted the decision on unavailability of the *ABLV Bank AS* deposits, providing for the transfer of its monetary funds in the amount of EUR 480 million into the DGF's current account, to ensure the funds for the disbursement of guaranteed compensation to the depositors of *ABLV Bank AS* in the amount of the covered deposits. On 2 March 2018, the FCMC entered into an agreement with *AS Citadele banka*, in order to secure the disbursement of guaranteed compensation to the depositors of *ABLV Bank AS*.

During the reporting year, the FCMC ensured the disbursements of State guaranteed compensation via *AS Citadele banka* (the disbursing bank) to the depositors of *AS Latvijas Krājbanka* in liquidation (hereinafter in this section – *Latvijas Krājbanka AS* in liquidation) and the depositors of *ABLV Bank AS* in liquidation (hereinafter in this section – *ABLV Bank AS* in liquidation) in the amount prescribed by the Deposit Guarantee Law.

On 15 August 2019, the ECB, as the direct supervisor of *AS PNB Banka*, resolved to recognise it as the financial institution failing or likely to fail. The SRB, in its turn, adopted the decision not to carry out the resolution of *AS PNB Banka* - namely, not to take measures to

stabilise the operation of the bank. Considering the adopted decisions and taking care of the protection of deposits of the bank clients, the FCMC Board took a decision to suspend the provision of financial services for AS *PNB Banka* and the decision on the occurrence of an unavailability of deposits.

The FCMC took a decision on the procedure for disbursement of guaranteed compensation to the clients of AS *PNB Banka*, starting from 22 August 2019, entrusting to perform the disbursement of guaranteed compensations to AS *Citadele banka*. Thus, the disbursement of guaranteed compensations to the clients of AS *PNB Banka* in liquidation (hereinafter in this section – *PNB Banka* AS in liquidation) was commenced on the fifth business day since the occurrence of the unavailability of deposits.

During the reporting year, the guaranteed compensation has been disbursed:

- in the amount of EUR 146.2 thousand to the depositors of *Latvijas Krājbanka* AS in liquidation;
- in the amount of EUR 54,889 thousand to the depositors of *ABLV Bank* AS in liquidation;
- in the amount of EUR 247,979.6 thousand to the depositors of *PNB Banka* AS in liquidation.

Table 3. Ensuring the disbursement of guaranteed compensations payable to the depositors by 31 December 2019

	<i>Latvijas Krājbanka</i> AS in liquidation			<i>ABLV Bank</i> AS in liquidation			<i>PNB Banka</i> AS in liquidation		
	number of depositor	amount, EUR thousand	amount share, %	number of depositor	amount, EUR thousand	amount share, %	number of depositor	amount, EUR thousand	amount share, %
Rights to GC	281	713.7	100	22,351	481,790.8	100	60,850	270,647.7	100
Disbursed GCs	10	2.7	0.4	13,876	444,819.9	92.3	43,680	247,979.6	91.6
Unpaid GCs	271	711.0	99.6	8,475	36,970.9	7.7	17,170	22,668	8.4

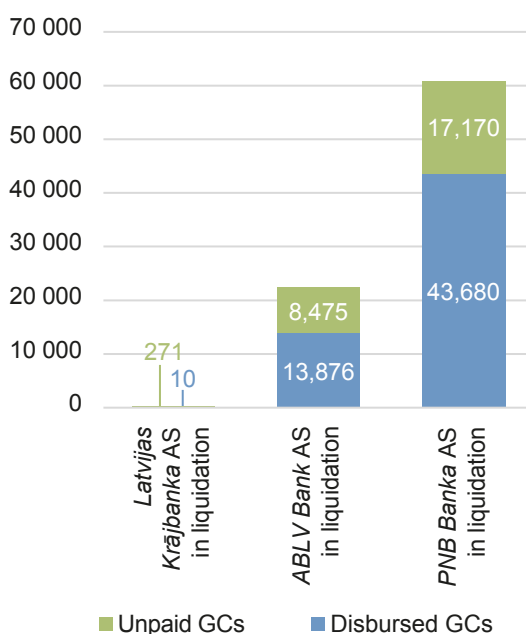
Section 3, Paragraph four of the Deposit Guarantee Law (the wording in force from 1 July 2015) states that the depositor shall lose his right to claim receivables from the DGF regarding the disbursement of the guaranteed compensation on the date after five years from the date of the occurrence of unavailability of deposits or the date on which all the circumstances forming the basis for the refusal to disburse the guaranteed deposit as referred to in Section 27, Paragraph one of this Law cease to exist.

Based on that which is stated in Section 3, Paragraph four of the Deposit Guarantee Law, starting from 14 June 2019, the disbursement of guaranteed compensations was fully ceased to the depositors of the liquidated AS *Ogres komercbanka*, liquidated AS *VEF banka*, *Latvijas Krājbanka* AS in liquidation, and *Rauna* Cooperative Credit Union, which had the guaranteed compensation available by 13 June 2019, but had not received it.

In turn, Section 19, Paragraph five of the Deposit Guarantee Law states that, if a sworn bailiff or tax (duty) administration has not started the enforcement procedure against the depositor on cash recovery within a period of five years from the date of the occurrence of unavailability of deposits, restrictions imposed on the disbursement of guaranteed compensation shall cease to exist. Therewith, based on registration data, starting from 14 June 2019, only 281 depositors of *Latvijas Krājbanka* AS in liquidation preserved the right to claim receivables regarding the disbursement of the guaranteed compensation.

The number of depositors of *Latvijas Krājbanka* AS in liquidation, *ABLV Bank* AS in liquidation and *PNB Banka* AS in liquidation entitled to the guaranteed compensation is reflected in Figure 31.

Figure 31. The number of depositors of *Latvijas Krājbanka AS* in liquidation, *ABLV Bank AS* in liquidation and *PNB Banka AS* in liquidation entitled to the guaranteed compensation broken down by - disbursed and unpaid guaranteed compensations as at 31 December 2019



The DGF has the priority right to claim amounts from the banks which are 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 remaining creditors to claim receivables in the amount of the disbursed guaranteed compensation. Notwithstanding the first priority claim rights of the DGF against the bank to be liquidated, the FCMC still has to assess the ability of the bank to be liquidated to sell the assets of the bank and to determine the recoverable value thereof, in order to evaluate its claims in the balance of the DGF. To this effect, there are provisions formed in the DGF in the amount of EUR 164,689.8 thousand, in 2019 forming provision reversal in the amount of EUR 35,213.6 thousand.

In 2019, the FCMC ensured the accumulation and management of the funds of the DGF, and at the end of the year, the amount held in the NGF account with the Bank of Latvia was EUR 25.3 million.

The FCMC ensured the accounts of the DGF in accordance with the financial accounting policy of the FCMC. The financial statements of the DGF for 2019 and the independent auditor's report thereon are available on the FCMC website at: <http://www.fktk.lv/lv/komisija/gada-par-skati.html>.

DISBURSEMENTS OF GUARANTEED COMPENSATIONS TO THE DEPOSITORS OF AS TRASTA KOMERCBANKA

The FCMC made the decision to charge AS Trasta Komercbanka to pay guaranteed compensation from the bank's own assets, considering that:

- the provision of Section 25 of the Deposit Guarantee Law that the guaranteed compensation from the deposit-taker and from the assets of the DGF may be disbursed through the deposit-taker to whom the inaccessibility of deposits has occurred;
- upon the occurrence of the unavailability of deposits, AS Trasta Komercbanka had sufficient funds to disburse the full guaranteed compensation to all its depositors which were entitled to the guaranteed compensation.

Therefore no assets of the DGF had been used to disburse guaranteed compensation to the depositors of AS Trasta Komercbanka.

Table 4. Ensuring the disbursement of guaranteed compensations to the depositors of AS Trasta Komercbanka, as at 31 December 2019

AS Trasta Komercbanka			
	number of depositor	amount, EUR thousand	amount share, %
Rights to GC	5,274	60,665.9	100
Disbursed GCs	2,910	56,636.8	93.4
Unpaid GCs	2,364	4,029.1	6.6

FUND FOR THE PROTECTION OF THE INSURED

The assets of the FPI are made up of deductions of 0.1% by insurance companies from their total gross insurance premiums received from natural persons for the types of insurance specified in the law. Since the beginning of the operation of the FPI, the assets thereof have been allocated in an amount of EUR 12.3 thousand for the disbursement of guaranteed compensation.

As since the end of 2015, the amount of the assets of the FPI had exceeded the amount specified in Section 288 of the Insurance and Reinsurance Law, the FCMC suspended contributions to the FPI in 2016. At the end of 2019, EUR 19.3 million was accumulated in the FPI.

The payment of insurance indemnity in the case of defaulting on the liabilities by the insurer may only be received by a policyholder who is a natural person:

- 1) for life insurance – 100% of the insurance indemnity, capped at EUR 14,230 per policyholder, excluding insurance in respect of the market-linked life insurance contract;
- 2) for other types of insurance set out in the law – 50% of the insurance indemnity, capped at EUR 2,850 per policyholder.

Where the FPI does not have sufficient assets for the disbursement of insurance indemnity under the Insurance and Reinsurance Law, the FCMC may enter into a loan agreement on lending the missing amount from one or several banks or insurers.

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 non-recoverable financial instruments or losses resulting from investment services that have not been executed. The compensation per investor is 90% of the value of the irrecoverable financial instruments or of the loss caused by a non-executed investment service, capped at EUR 20,000. 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 procedures, 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 instrument 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 instrument 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.

ADMINISTRATION OF THE FINANCIAL STABILITY FEE

The purpose of 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 benefitted 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, as well as by branches in Latvia of banks registered in the Member States and other foreign countries. Under Section 6, Paragraph one of the Financial Stability Fee Law, the FSF is administered by the FCMC.

In 2019, the FCMC controlled the payment of the FSF into the state 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 Latvia or another Member State, issued mortgage bonds and subordinated liabilities, subject to the FSF rate in the amount of 0.072%. In 2019, the FSF was collected in the amount of EUR 7.41 million, which, as compared to 2018 (EUR 10.05 million), is 26.3% less.

Table 5. FSF payers' indicators

	2019	2018	2017
FSF payers	20	21	23
FSF object, in EUR million	9,953.6	10,540.4	15,563.1
FSF, in EUR	7,166,560	7,589,117	11,201,499
Fee payment received in the State budget, in EUR	7,406,666	10,046,568	11,249,954

INTERNATIONAL COOPERATION

On an international scale, the activities of the FCMC are mainly focussed on cooperation and information exchange with supervisory authorities of other countries and participation in the SSM and the work of the European financial supervision authorities. The FCMC also provides support to the ministries in international forums regarding projects and issues relevant to the Latvian financial market, for example, by participating in the work of the EU Council or the OECD committees, and other forums.

INTERNATIONAL AND EUROPEAN ORGANISATIONS

In the reporting year, the FCMC experts participated both on-site in the **EU Council** for consultation of the proposals related to the regulation of the financial sector and prepared written opinions and positions for Latvian representatives in meetings. In the reporting year, the negotiations were continued regarding the draft regulation on **European collective financing (crowdfunding) service provider companies**, the draft directive on **credit servicers**, **credit purchasers and the recovery of collateral**, the draft regulation on **securities covered by government bonds**, and the draft regulation on the **establishment of the European Deposit Insurance Scheme**. Information about the approved legislation is available in the Section of the Annual Report “Topicalities in the adoption of the laws and regulations of the European Union in 2019”.

Outside the EU format, the FCMC was involved in the representation of Latvia in the OECD. The OECD Working Group on Bribery, in evaluating how Latvia complies with Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, paid attention also to the anti-money laundering issues. The OECD representatives made an on-site visit in Latvia, evaluated the current situation,

and prepared the Stage 3 report with further recommendations for Latvia. To this effect, the FCMC reported on the accomplishments in the field of its competence and provided information for the preparation of the report. In their report, the OECD experts have specified that the reforms of the recent years in the fields of finance and justice in Latvia demonstrate significant positive changes that have mitigate the risks for cross-border bribery and money laundering possibilities in Latvia, as well as that the sufficiently effective reforms were launched and already partially implemented to consolidate these changes both in legislation and in practice. Nevertheless, a considerable work is to be continued on country risk mitigation and combating the detected violations and crimes.

The work and information exchange in other OECD committees has entered an everyday mode. The FCMC has regularly verified the statistics in fields such as pensions and insurance which the OECD employs when preparing the relevant sectoral summaries in all OECD countries.

The year 2019 was highly important for Latvia in preventing the deficiencies referred to in *Moneyval* Fifth Round Evaluation Report, because, in light of the enhanced follow-up status that *Moneyval* had granted to Latvia, it was possible that also FATF would set the enhanced follow-up or add Latvia to the so-called “grey list”. The FCMC, within the scope of its competence, put forth considerable effort in consolidating the financial sector supervision, enhancing the regulation, and explaining these changes to the representatives of *Moneyval* Member States. As a result, in *Moneyval* Report published on 22 January 2020, the statutory regulation of Latvia was assessed as compliant or largely compliant with all FATF 40 Recommendations. In turn, in the FATF plenary session, held in Paris from 16 February 2020, till 21 February 2020, it was concluded that Latvia has established a strong and resilient financial system for protection against money laundering, terrorist financing, and proliferation of weapons of mass destruction, and will not be made subject to enhanced follow-up.

In 2019, the dialogue with the IMF continued, on the basis of the consultations of Article IV of the IMF Articles of Agreement. During the visits of the IMF experts, information was provided regarding the market indices and topicalities in the sector, as well as on the adopted and planned changes to laws.

On the basis of requests expressed by the State of Latvia in 2017, the IMF Financial Sector Assessment Program was launched in autumn of 2019. At the end of 2019, voluminous information requests were received from the IMF in the field of macro-prudential supervision, *FinTech*, crisis management, and anti-money laundering; data was also provided for the stress testing of the banking sector. The FCMC also prepared the self-assessment on the compliance of the Latvian banking sector supervision with the Basel Principles for Effective Banking Supervision. It is planned that in 2020 on-site visits will be held and the closure reports will be prepared.

One of the key aspects of international cooperation is the participation of the FCMC in the work of the European supervisory authorities (the EBA, EIOPA, ESMA and ESRB), enabling to have an impact on the formation of the European regulatory and supervisory policy and practice, and in the SSM established by the ECB. At the FCMC expert level, the work was carried out in the committees and working groups of the European supervisory authorities, whereas the FCMC management took part in the meetings of the Supervisory Board of these authorities.

The EBA priorities in 2019 were to continue working on the issue of non-performing loans, draft Pillar II standards for the implementation of the risk reduction package (CRD V, CRR, BRRD), new prudential framework of investment companies, and issues of the implementation of Basel III in the EU. The FCMC also continued to aggregate risks and possibilities arising out of financial innovations in the banking sector, and the framework for cooperation of supervisory authorities in the AML/CTPF field was strengthened. Public consultations took place, analysis was performed, and reports prepared.

In 2019, the EBA, supplementing the Single Rulebook of the European banking sector, approved several technical standards and guidelines for the implementation of CRD and Payment Services Directive (PSD2) and guidelines on outsourcing, cooperation, and information exchange between the competent authorities supervising credit institutions and financial institutions in the field of AML/CTPF, *inter alia*, setting up a framework for the establishment and operation of the AML/CTPF colleges and on IT and security risk management; it also updated the Guidelines on harmonised definitions and templates for funding plans of credit institutions and continued drafting laws and regulations in other fields. In 2019, there was still no clarity

as to the conditions for the withdrawal of the United Kingdom from the EU, and a lot of time was devoted to defining a uniform approach to further work in relation to the activities of the market participants of the United Kingdom after its withdrawal from the EU.

Additional information on the activities of the EBA in 2019 may be found on the website <https://eba.europa.eu/all-news-and-press-releases>.

In 2019, the work of EIOPA on the development of technical standards was mainly conducted in the consultation stage. The documents were submitted for public discussion with respect to the potential second-level regulation in the field of pan-European private pension products; changes in the key information documented under the packaged retail and insurance-based investment products, or PRIIPs, Regulation; on issues of revision of the Solvency II Directive; principles of remuneration in the field of insurance; and on the establishment on a single insured guarantee scheme and other issues. The EIOPA continuously monitored and assessed the risks to the insurance and pension sector and the vulnerability of the industry with a view to facilitating or coordinating supervisory activities, if necessary. The *InsurTech* issues were updated. Similarly as in other institutions, the issues related to the withdrawal of the United Kingdom from the EU were on the agenda.

Additional information on the activities of the EIOPA in 2019 may be found on the website https://www.eiopa.europa.eu/newsroom/news-press_en.

The ESMA had set as priority areas for 2019 the implementation of the MiFID II and MiFIR, prospectus and securitisation regulation, MiFIR data reporting and quality matters, the implementation of the Capital Markets Union and *FinTech* operational plans.

The year 2019 was comparatively inactive for the ESMA with respect to the approval of technical standards; the work mainly proceeded at the consultative stage. Nevertheless, several guidelines were approved - on the risk factors laid down in the Prospectus Regulation, on non-significant benchmarks under the Benchmarks Regulation, on application of Annex 6 and 7 of MiFID II Directive, on reporting internalised settlement under the Central Securities Depositories Regulation (CSDR), on positions calculation by trade repositories under the European Market Infrastructure Regulation (EMIR), on liquidity stress testing in investments funds, etc.

Much attention was paid to the fields and solutions that are important in relation to the United Kingdom's, as a significant player of the financial market, withdrawal from the EU, the conditions whereof were still not clear by the end of the year.

Additional information on the activities of the ESMA in 2019 may be found on the website <https://www.esma.europa.eu/press-news/esma-news>.

The ESRB assessed the stability risks of the EU financial system. In 2019, they still remained high, taking into consideration significant political uncertainty in the world and the EU. The ESRB assessed both cyclical and structural risks in the EU financial system, focussing on the adequacy of macro-prudential policy measures in Member States. Separately, guidance notes were developed for assessing the systemic risks of residential and commercial real estate and application of appropriate macro-prudential tools, and the report was published on potential complications for ensuring financial stability caused by a significant role of branches of foreign credit institutions in the local financial sector.

Additional information on the activities of the ESRB in 2019 may be found on the website

<https://www.esrb.europa.eu/pub/reports/html/index.en.html>.

The FCMC activities within the SSM of the ECB are reflected in the section on banking supervision.

BILATERAL COOPERATION

In ensuring the supervision and stability of the financial sector, cooperating with the supervisory authorities of the financial sector of other countries plays an important role. The agreement on cooperation and information exchange was mainly concluded with the financial supervision authorities of the United Kingdom, preparing for the possibility that the United Kingdom would withdraw from the EU without agreement.

The FCMC exchanged information also within the existing concluded agreements. The FCMC received the most information requests within the framework of the agreement concluded with the International Organisation of Securities Commissions. On-the-spot cooperation also has a positive result. Supervisor and resolution colleges have played a significant role in experience and information exchange, more details whereof are described in the section on supervision of the report.

COMMUNICATION AND PROMOTING FINANCIAL LITERACY

According to the strategic guidelines of the institution, in 2019 the FCMC ensured wide availability of information to the public on the website and operational flow of information on topical issues through the media; it also implemented several activities to the end of promoting financial literacy. Much attention in communication was paid to the implementation of *Moneyval* and FATF recommendations and the process of transformation of the banking sector, as well as the impact of the US OFAC sanctions on the Latvian financial sector.

EXTERNAL COMMUNICATION

In 2019, the FCMC was mentioned 9,849 times in the media, reaching the largest publicity intensity in the second half of the year, attributable to the termination of activities of AS *PNB Banka* and to the change of governance model and management of the FCMC. In July 2019, up to the time when the new FCMC Chairperson would be elected under tender procedure, the Saeima of the Republic of Latvia approved Kristīne Černaja-Mežmale to the office of the FCMC Chairwoman, but in October, Santa Purgaile was approved for the office of the FCMC Chairwoman. At the end of the year, large media attention was paid to the inclusion of Aivars Lembergs and institutions related to him in the US OFAC sanctions list.

The Communications Division, in parallel to the daily information flow, in this phase organised three press conferences - on 16 August 2019, on the decisions of the ECB, the SRB, and the FCMC with respect to termination of the activities of AS *PNB Banka*, a press conference on 17 August 2019, on the procedure of guaranteed compensation disbursement to the clients of AS *PNB Banka*, whereas the press conference on 12 December, 2019, was organised to inform about the impact on the Latvian financial

sector of the sanctions set by the US OFAC.

In the reporting year the Communications Division spread 89 communications to the mass media in Latvian and 35 in English on the decisions taken by the Board of the FCMC, the activities of financial market participants, topicalities of regulatory requirements, changes implemented in the banking sector, the sanctions imposed by the FCMC on market participants, and other FCMC topicalities.

In 2019, eight FCMC infographics were developed and made public in Latvian and five - in English on the results of transformation of the banking sector, on the change of business models of the banks previously servicing foreign clients, on the Latvian deposit guarantee scheme, as well as on financial literacy results of the population of Latvia in 2018.

The FCMC continued its ongoing communication on social networks as well, by maintaining the dialogue with the public on the microblogging site Twitter, as well as by posting materials on the video sharing online social media website YouTube.

In the reporting year, comments and explanations were provided to the Latvian and foreign mass media representatives; regular interviews of FCMC management were organised both in the Latvian and international media, thus ensuring a wide-ranging explanatory framework that gradually contributed to the change of understanding in the media environment regarding both the work of the FCMC in managing the changes in the financial sector and the process of transformation of the Latvian financial sector as a whole.

DEVELOPMENT OF DIGITAL TOOLS

In 2019, the Communications Division, in cooperation with the Information Technology Division, completed the scheduled reconstruction works of the FCMC website, www.fktk.lv, establishing a new platform for informing the public as well as a modern and easy-to-use database of the Latvian financial and capital market participants.

Ensuring support for Latvian *FinTech* start-ups in the financial sector, the FCMC continues providing support in two financial innovation support programs:

- **FCMC Innovations Centre**, where it is possible to obtain all of the necessary information

in one place for the receipt of the licence, as well as to receive the consultations from the FCMC experts by telephone, to ask the questions in an electronic form, or to organise the on-site meeting in the office of the FCMC;

- **Innovation Sandbox**, ensuring the process whereby the enterprises can test or verify innovative financial products, financial services, or business models under a special testing plan which they have agreed upon with the FCMC (<https://www.fktk.lv/licencesana/inovacijas-un-fintech/fintech-konsultacijas/>).

In the reporting year, in total about 80 interested individuals applied to the Innovations Centre and received the necessary consultations on the new financial services (account information services and payment initiation services) included in the revised payment services Directive (PSD II), as well as on crowdfunding services and the possibilities of using virtual assets and the regulation applicable thereto in Latvia. Concurrently, negotiations with several candidates were commenced regarding participation in the Innovation Sandbox and the testing of possible innovative financial services.

In order to raise awareness among clients of market participants and also of the general public about the current quarterly performance indicators of banks and insurers operating in Latvia, the operation of and data updates in the interactive tools “Banking Compass” and “Insurance Compass” were ensured.

CORPORATE COMMUNICATION

In 2019, a significant role in the external communication implemented by the Communications Divisions was played by the corporate communication, to strengthen the reputation of the FCMC as a professional supervisory authority and a significant interinstitutional partner. The Communications Division was also involved in the activities of the Financial Sector Development Council and strategic communication activities of the government, as well as developed the content for the news page of the Cabinet of Ministers’ Financial Sector Update on a regular basis.

In the reporting year, active communication was carried out with respect to the input of the FCMC into implementation of *Moneyval* and FATF recommendations in the Latvian financial sector, explaining the areas of competence of the FCMC, the accomplishments therein, and the changes pertaining thereto.

At the end of 2019, a strategic dialogue was

commenced with the entrepreneurs of various sectors and foreign investor organisations, to identify the issues to be resolved in cooperation with the Latvian financial sector institutions. Concurrently with this course of action, the interinstitutional communication of the FCMC with Latvian and international institutions and organisations was strengthened.

IMPROVEMENT OF CRISIS MANAGEMENT

Effective cooperation with the sector is important, especially in extraordinary and sectoral crisis situations. Based on the assessment of the experience of the crisis situations (February – May 2018), the crisis management mechanism among the FCMC structural units and cooperation institutions was improved, in order to create a unified understanding and approach to the exchange of information with the FCMC during crisis communication situations.

Concurrently with the crisis communication improvement, the communication with respect to termination of the activities of AS *PNB Banka* was ensured, organising the interinstitutional coordination of communication, cooperation with media representatives, and preparation and distribution of versatile informative materials through various information channels.

PROMOTING FINANCIAL LITERACY

One of the priority directions of the FCMC is the promotion of the financial literacy of the population, by ensuring the coordination of activities at the national level, representation in the OECD working group International Network on Financial Education and research activity.

STRATEGY

In assessing the fulfilment of the planning document “Strategy for Financial Literacy of the Population of Latvia for 2014–2020”, it can be seen that overall the indicators of the achievement of the strategic goals of the financial literacy demonstrate the desired progress. The most significant positive trends are the growing digitisation of financial services and the involvement of residents in the use of such tools, the steady growth of domestic deposits for the duration of several years. Residents have become more satisfied with their financial situation, they use insurance services more, continue forming provisions (+2 percentage points), and seek information on financial products more purposefully. The number of inhabitants having a “safety buffer” for at least three mon-

this has increased by 7 percentage points.

In the second half of 2019, the Communications Division, in cooperation with SIA *Aptauju Centrs*, ensured a survey of financial literacy of the population of Latvia, which was previously carried out in 2014 and 2015. The survey was carried out in order to record the level of involvement of residents of Latvia in the use of financial services, as well as to clarify the knowledge and the customary practical conduct with respect to various financial literacy topics.

The level of knowledge of the population of Latvia regarding financial matters has slightly increased over the period of five years. In 2019, the score thereof has reached 21.7 points out of 99 possible points. Results of the study provide for the insight that in 2019, as compared to 2014, inhabitants have become more satisfied with their financial situation, they use insurance services more, continue forming provisions (+2 percentage points) and seek and assess information on financial products more targeted, as well as follow the changes in the tax policy (+5 percentage points). The financial literacy index of the population of Latvia in 2014, when the first study was performed, was 20.6 points out of 99 possible points. Over a period of five years, this index has grown by 1.1 percentage point; this is a good sign, but at the same time also a trigger showing that we still have much room for development.

The survey results are available for the review in the Section "Study" of the financial literacy website www.finansupratiba.lv.

FINANCIAL LITERACY WEEK 2019

According to the partner agreement on organisation of the annual financial literacy week, so that financial literacy materials would reach increasingly new population groups also in 2019, simultaneously with the eighth Global Money Week organised by the Child and Youth Finance International, the FCMC organised the seventh Financial Literacy Week in Latvia. The concept of this week in 2019 was "Understand. Save up. Earn" inviting the population of Latvia to more actively engage in deepening their knowledge about various themes related to personal finance. Within the scope of the week, various lectures, informative events, and initiatives were organised, providing for the involvement of pupils.

Information about the Financial Literacy Week 2019 and the activities taking place in order to educate the population of Latvia in financial literacy issues, as well as all financial literacy materials – "Strategy for Financial Literacy of the Population of Latvia for 2014–2020", Standard of competences, The latest Latvian and international research, an archive of the financial literacy weeks, studies, a news feed, a timeline and links to current study materials – are available on the website www.finansupratiba.lv.

In addition to these activities, over the period of the entire year partner lectures and practical workshops were held in high schools and universities. Also, the improvement of the content of the educational portal "Client school" was continued.

KEY TASKS IN 2020



SUPERVISING CREDIT INSTITUTIONS:

- in the assessment of the strategies and business models of banks – the supervisors still focussed on the profitability and sustainability of the new business models and the banks' capacity to adapt to new conditions, continuing smooth and steady achievement of the goals set and implementation of new activity directions and enhancement thereof;

- the continuous work on the assessment of operational recovery plans of banks remained in the focus, taking into consideration the important role of recovery plans in ensuring stable operations of the bank within the scope of a full development cycle of the economy;

- in strengthening the operational compliance and risk control functions – in-depth attention to ensuring stable and effective functioning of the internal control system of banks, and continuing to assess and follow up the risk appetite defined by banks and the ability of the banks to ensure fully-fledged and quality management of the risks they have undertaken, playing an important role also in the context of the assessment the business model change of the banks;

- in strengthening the quality of the reports submitted by the banks – taking into account the complicated structure of the reports, their quality assurance plays a significant role; thus, the work of supervisors proceeds by their embedding the inspection mechanism and implementing horizontal inspections focussed on types and elements of individual reports;

- the assessment of credit risk and the quality of its management is still among the tasks of the supervisors, paying particular attention to the NPLs, their development strategies and their problematic assets, the level of adequacy of provisions, and exposure concentration aspects.

SUPERVISING THE FINANCIAL INSTRUMENTS MARKET:

- enhancement and unification of the supervisory practice of the financial instruments market participants;

- strengthening the depositors' interest protection by supervising the compliance of the services of the investment service providers with the requirements of legal acts, trading in financial instruments and issuers' information disclosure;

- ensuring the supervisory process of the central securities depository in accordance with

the EU Regulation on central securities depositories (CSDR);

- inspections of data quality of transactions reported by market participants.

SUPERVISING THE INSURANCE MARKET PARTICIPANTS:

- carrying out of on-site and off-site inspections of insurance market participants according to the approved plan of supervision measures;

- improvement of on-site supervisory process of insurance market participants by preparing methodology for making entries about the on-site inspections in the *UIS* database;

- enhancing the supervisory framework of the insurance and reinsurance distributors, in order to ensure the supervision of the compliance of the activities of the insurance and reinsurance distributors with the requirements laid down in the Insurance and Reinsurance Distribution Law.

SUPERVISING PENSIONS AND INVESTMENTS:

The supervision priority of the market segments under the authority of the Pensions and Investment Funds Division is the supervision of investment funds, taking into consideration the expected liquidity test to be carried out at the EU level, and the supervision of the SFPS and private pension funds, in light of the new requirements of laws and regulations on the issues of involvement policy and on the performance of sustainable investments.

SUPERVISING COMPLIANCE:

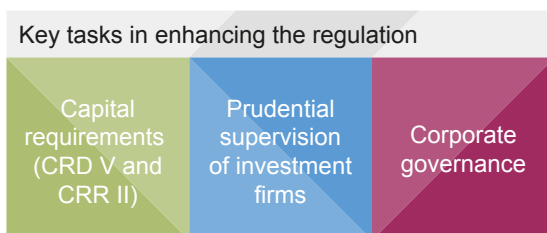
The key tasks in the AML/CTPF field in 2020 are to continue strengthening the dialogue with the financial sector, in order to foster effective and risk-based implementation of the requirements of legal acts, as well as to ensure the fulfilment of the tasks set by the Action Plan for the Prevention of Money Laundering and Terrorist and Proliferation Financing for the Time Period from 2020 till 2022, in order to decrease the MLTPF risks, ensuring compliance with the international obligations and standards in the AML/CTPF field.

In the plenary session of *Moneyval*, held in December 2019, the technical compliance progress report of Latvia was accepted, and seven

out of FATF 40 Recommendations were assessed as compliant and 33 - as largely compliant. Therefore, in 2020, the FCMC will get down to effective implementation of these legal requirements and, to this effect; the work was commenced on the development of the AML/CTPF handbook. The purpose of the handbook is to provide more extensive explanation of the legal requirements, by means of practical examples. At the same time, in 2020, the FCMC continues working on enhancement of the methodology of supervision of the financial sector supervisory methodology, to ensure the implementation of the risk-based approach, also when taking supervisory measures.

IN THE FIELD OF REGULATORY REQUIREMENTS:

To ensure a harmonised approach, the majority of the EU laws and regulations are being adopted as directly applicable EU legal norms - regulations. Therewith, the work during the development of drafts of these directly applicable EU legal norms will remain to be important, participating in the respective working groups and committees, preparing the positions and proposals, protecting the interests of the Latvian financial sector and consumers of financial services. After the adoption of regulations, the preparatory works must be performed for the application and control thereof.



▲ In 2020, the FCMC performed voluminous work on the implementation of Directive 2019/878 (CRD V) and Regulation 2019/876 (CRR II), especially in exercising the discretionary powers. The new regulatory framework provides for significant changes in the regulation of the activities of credit institutions, *inter alia*, amendments will be introduced to the Credit Institution Law and several FCMC regulations with respect to the calculation of the credit risk own funds requirements, the calculation of market risk own funds requirements, public disclosure of information, corporate governance, and sustainability. CRD V and CRR II provide for considerable changes in the EU macro-pru-

dential framework. The most significant changes are as follows:

- The responsible authorities of the EU Member States will be henceforth able to more flexibly apply the systemic risk buffer - it will be possible to determine it also with respect to particular exposure segments, for example, residential or commercial property mortgages. This will allow for more accurate application of higher capital requirements specifically only for exposures of credit institutions with those sectors of national economy, the operation whereof would materially affect the total system risk volume in the financial sector. In cases of several sources of systemic risks, CRD V would allow applying several requirements of the systemic risk buffer at a time;

- maximum amount of the O-SII capital buffer reference point to be set is increased from 2% to 3% of the total value of exposures of the credit institution;

- to prevent overlapping of applied supervisory tools, CRD V prescribes that henceforth it will be allowed to set Pillar 2 capital requirements only for the purposes of reducing or preventing micro-prudential risks, while, in cases of macro-prudential risks, the tools specifically intended for that will have to be used.

▲ During the process of implementation of the requirements of Directive 2019/2034 on the prudential supervision of investment firms approved at the end of 2019, significant changes are planned in several laws and regulations of operational regulatory framework, *inter alia*, the development of the new Law on Investment Firms and the Supervision Thereof, amendments to several laws and the FCMC regulations, setting requirements with respect to the initial capital of investment firms, supervisory powers and tools for prudential supervision of investment firms, type of prudential supervision of investment firms, and other aspects.

▲ In 2020, the requirements in the field of corporate governance will be harmonised also in the segment of payment institutions and electronic money institutions, ensuring the requirements for establishing effective control system and implementation of a uniform best practice.

By way of ensuring the implementation of CRD V and implementing the EBA guidelines on remuneration, changes are planned in the FCMC **Regulations on Core Principles of Remuneration Policy.**

In 2020, the FCMC will continue providing methodological support to market participants in preparation of supervisory reports and implementing enhanced control over the results of calculations and quality of preparation of the reports, until the confidence as to their compliance with the requirements would be obtained.

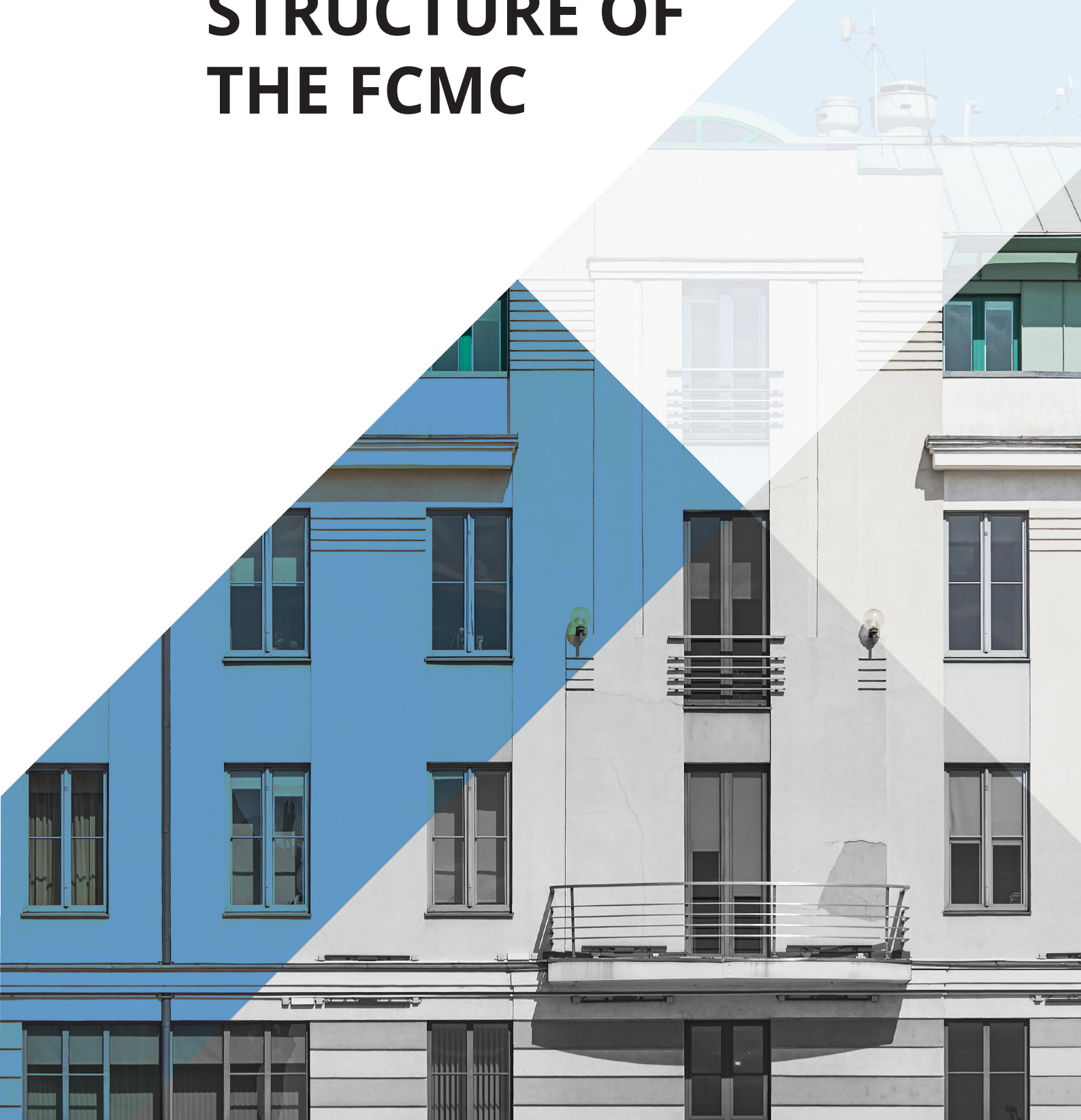
IN CRISIS MANAGEMENT IN THE FIELD OF RESOLUTION MECHANISM:

- implementation of the new requirements of Directive 2019/879 (BRRD II) and Regulation 2019/877 (SRMR II) at a national level;
- continuation of measures for ensuring effective integration into the Single Resolution Mechanism by adhering to, in in-depth detail, the internal regulatory framework of the resolution with respect to the resolution planning process and application of resolution tools;
- considering the lessons learned in the previous year, enhancement of the crisis management process by means of an effective and coordinated crises management mechanism.

IN FCMC GOVERNANCE:

- Enhancing corporate governance of the FCMC by implementing sound governance principles as an integral part of everyday culture and creating a flexible and innovation culture-based work environment, where effective information exchange, mutual cooperation, inclusion, respect, and team approach prevail;
- increase of effectiveness of financial sector supervision and control measures;
- strengthening the prudential, the AML/CTPF, and international sanctions supervision capacity and intellectual potential;
- focus on attracting and preserving the best employees, motivation, acquisition of the necessary knowledge and skills, and building the ability to adapt to the challenges of changing environment;
- fostering improvements in operational processes, information systems and results, as well as optimisation of the activities, by continuing constant identification, implementation, and monitoring of improvements, as well as the development of modern and secure IT-based work environment, implementing effective, secure, and cost-efficient IT solutions and infrastructural changes.

GOVERNANCE AND STRUCTURE OF THE FCMC



STAFF POLICY

Highly educated and professional staff plays a major role in the achievement of the strategic goals of the FCMC and the further development of the institution.

STAFF BREAKDOWN BY NUMBER AND THE CHANGES THEREOF

In the reporting year, considering the resources required for the fulfilment of *Moneyval* and FATF evaluation process requirements and the OECD recommendations, the number of job positions increased by nine in comparison with the previous year, reaching 186 job positions.

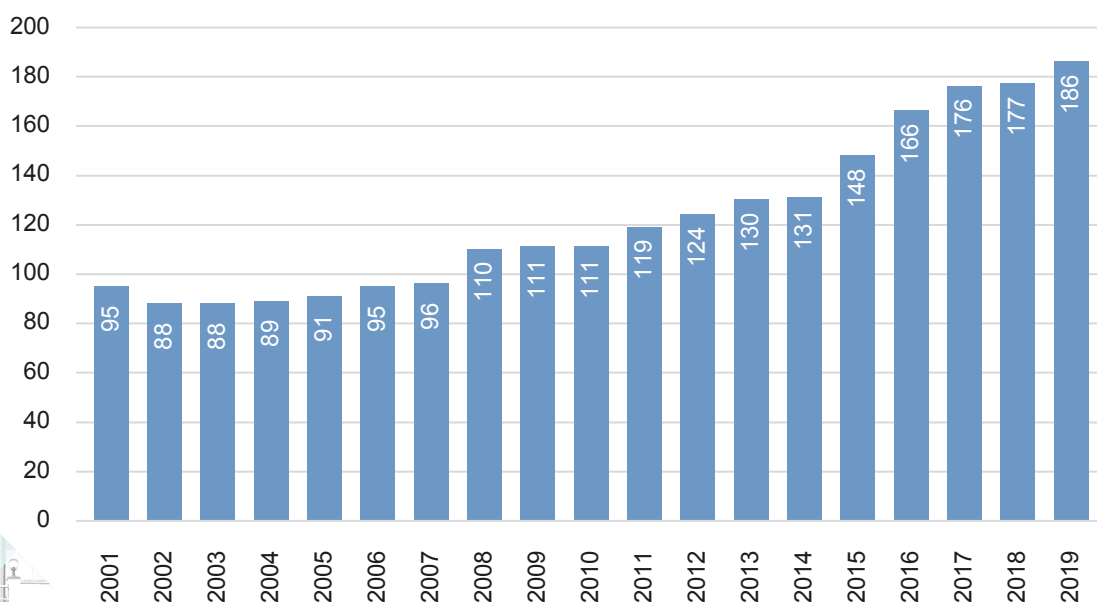
For the purposes of ensuring the fulfilment of the referred-to tasks, three job positions for unspecified period of time and five job positions for a specified period of time were created in the Compliance Control Department; thus, the total number of job positions grew from 20 job positions at the beginning of the reporting year to 28 job positions in November of the reporting year.

At the same time organisational measures were taken for enhancing the effectiveness of

the work of the Financial Division. Breakdown of functions was assessed, separating the business trip organisation function (delegating it to another structural unit) and closing the job position of Chief Accountant.

In the reporting period, significant changes were introduced in the FCMC governance model. On 13 June 2019, the Saeima of the Republic of Latvia adopted amendments (came into force on 29 June 2019) to the Law on the Financial and Capital Market Commission, stating that the FCMC Board shall consist of three Board members: the FCMC Chairperson and two Board members, approved in the office by the Saeima of the Republic of Latvia. Previously the FCMC Board consisted of the Chairperson, his/her Deputy, and three Board members, concurrently also being the Directors of the Departments of the FCMC. The Chairperson and the Deputy Chairperson of the FCMC resigned from the office. In turn, in accordance with the referred-to amendments to the Law, the FCMC Chairperson and one of the Board members were approved in the office in the reporting period.

Figure 32. Staff number dynamics, 2001-2019



In 2019, the average number of employees, including those on long-term leave, was 173.1. At 31 December 2019, the FCMC employed 172 employees, whereof:

- 141 (82%) were engaged in performing principal activities and 31 (18%) were engaged in performing support functions;

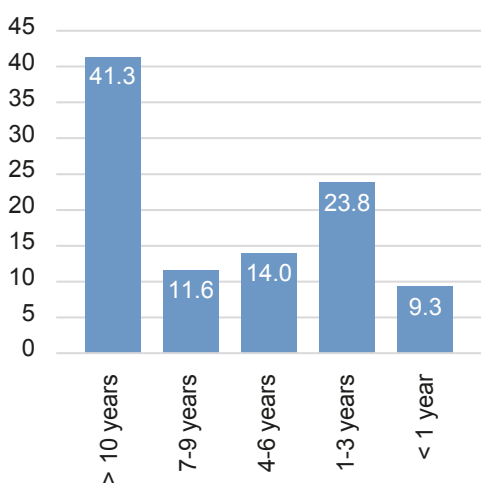
- 125 (73%) were civil servants and 47 (27%) were employees;

- all employees were engaged in performing intellectual work.

In 2019, the staff turnover rate was 7.0%. During the reporting year, 19 employees were hired by the FCMC, including 13 employees who were hired for performing principal activities and one employee for performing support functions, as well as five employees for the term required to replace employees on extended leaves of absence. The employment relationship was terminated with one employee who failed to pass the probation period, while the rest of the employees, in accordance with the established adaptation period plan, received a positive assessment and continued working. During the reporting year, the FCMC terminated the employment relationship with 11 employees, and the FCMC Chairperson and the Deputy Chairperson resigned from the offices. According to the amendments to the Law on the Financial and Capital Market Commission, the FCMC Chairwoman and one of the Board members commenced the fulfilment of their official duties. Of 11 permanent employees who terminated their employment relationship with the FCMC, one employee retired, while the others chose to pursue a career in both the public and the private sector (of which one works in Belgium).

In 2019, 90.7% (156) of employees of the FCMC had been employed by the FCMC for more than one year, while 9.3% (16) of employees had been employed by the FCMC for less than a year. 25% (43) of employees had been employed by the FCMC for 18 years, i.e. as of the establishment of the FCMC (in 2001).

Figure 33. Breakdown of staff by length of service at the FCMC



JOB-RELATED BUSINESS TRIPS

During the reporting year, 96 (55.8%) employees were assigned on 468 business trips, of which:

- 55 (32%) employees were involved, on a regular basis, in the work of the working groups of the European Union and the European financial supervisory authorities (EBA, EIOPA, and ESMA);

- three (1.7%) employees were regularly involved in the activities of the working groups of the European Council;

- seven employees (4%) met with US financial supervision authority representatives as experts in Washington and New York;

- two employees (1.2%) participated in *Monneyval* meetings;

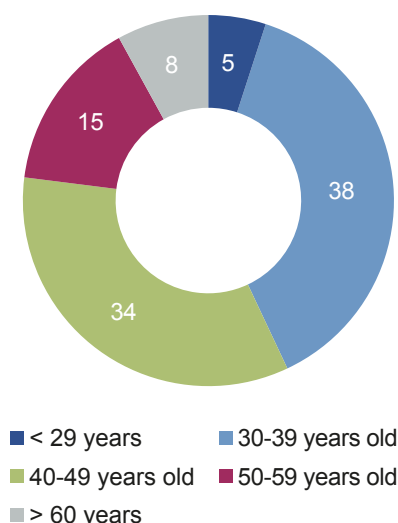
- two employees (1.2%) participated in FATF meeting.

BREAKDOWN OF FCMC STAFF BY GENDER AND AGE

In 2019, 72.1% of all FCMC employees were women (124), whereas 27.9% were men (48). The age profile of the staff in the reporting year is characterised by the following indicators: 5% of employees (9) were aged up to 29 years old, 38% (65) were aged from 30 to 39 years old, 34% (59) were aged from 40 to 49 years old, and 23% (39) were aged over 50 years old.

In 2019, the average age of the FCMC staff employees 43 years.

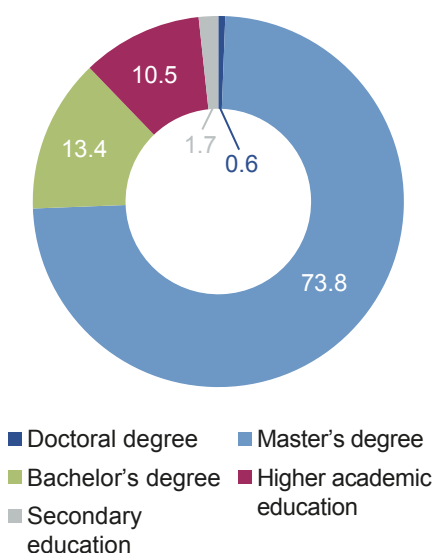
Figure 34. Breakdown of the FCMC staff by age groups



STAFF QUALIFICATIONS

In the reporting year, 98.3% of FCMC employees (169) had a university degree (of which 75.1% had a Master's Degree), while 1.7% of employees (3) had general secondary or professional secondary education.

Figure 35. Breakdown of FCMC staff by educational attainment level



IMPROVING STAFF QUALIFICATIONS

With a view to continue improving FCMC operational processes, raising the effectiveness and efficiency of performance, as well as for carrying out the supervision of the financial sector, 59.9% of FCMC staff (103) improved their qualifications by attending job-related training held in Latvia - for example, raised knowledge in rapid assessment of the financial situation of businesses and legal updates pertaining to the FCMC activities, as well as continued developing their digital skills (*SAP Business Objects Web Intelligence*, data processing automation and effective report generation principles, for *MS Excel* experts, basics of data analysis, *Power Bi*, *SQL* data model development, data processing automation, *IBM i2* updates, etc.).

In 2019, the FCMC in cooperation with other financial sector professionals organised internal seminars for its employees, providing for the possibility to master such topical themes as, for instance, sanctions risk management aspects for banks for the employees of the Compliance Control Department, non-performing loans, changes in IFRS 16 "Lease", and application of the Whistleblowing Law and referring the requirements thereof to the operation of the FCMC. Training on change management and

the *Agile* approach to project management was organised for the heads of structural units of the FCMC.

In 2019, special attention was paid to the issues of development of technology-based financial innovations, or *FinTech*; therefore, the employees improved their qualifications by attending various seminars and conferences both in Latvia and abroad on the development of e-commerce, because the aim of the FCMC is to create *FinTech*-friendly environment that would promote innovative financial services in Latvia.

40% of FCMC employees (69) attended seminars and workshops on a variety of issues on financial supervision and regulation, including improved knowledge on bank liquidity and financing risks and risk management, acquired knowledge on the new securities framework (STS Securitisation & The New Securitisation Framework), and continued to take active part in the experience exchange events of the ECB Joint Supervisory Teams.

The employees of the Compliance Control Department continued supplementing their knowledge in increasing the effectiveness of anti-money laundering, in issues concerning international and national sanctions and the features of violation and evasion thereof, as well as in sanctions risk management, obtaining additional knowledge on the types of international transport documents and the execution thereof, taking part in the FATF International Cooperation Review Group exercise in the composition of Latvian delegation, as well as attending other seminars and conferences related to the AML/CTPF field.

The FCMC also facilitates the sharing of staff knowledge with other colleagues: for example, an internal seminar was organised on suspicious transactions by means of financial instruments, as one of the components of the internal control system (53 employees) and on their topicality in sanctions risk management (40 employees).

STAFF PERFORMANCE APPRAISAL

In 2019, under the procedure set forth by the FCMC, 161 employees underwent performance appraisals, including 30 individuals heading structural units (including three members of the Board); 131 were experts.

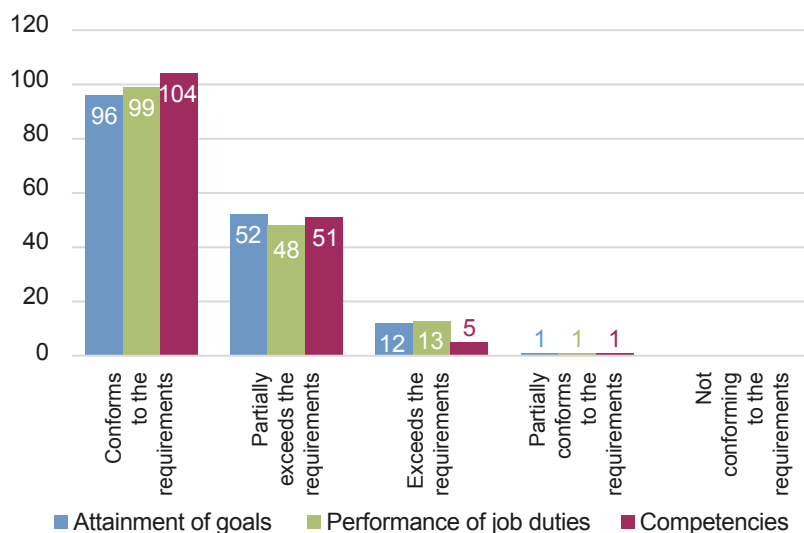
Three criteria were set for assessing performance: attainment of established goals, performing of job duties, and the required job-related

competencies. In 2019, none of the employees received the overall assessment of all criteria as Not conforming to the requirements.

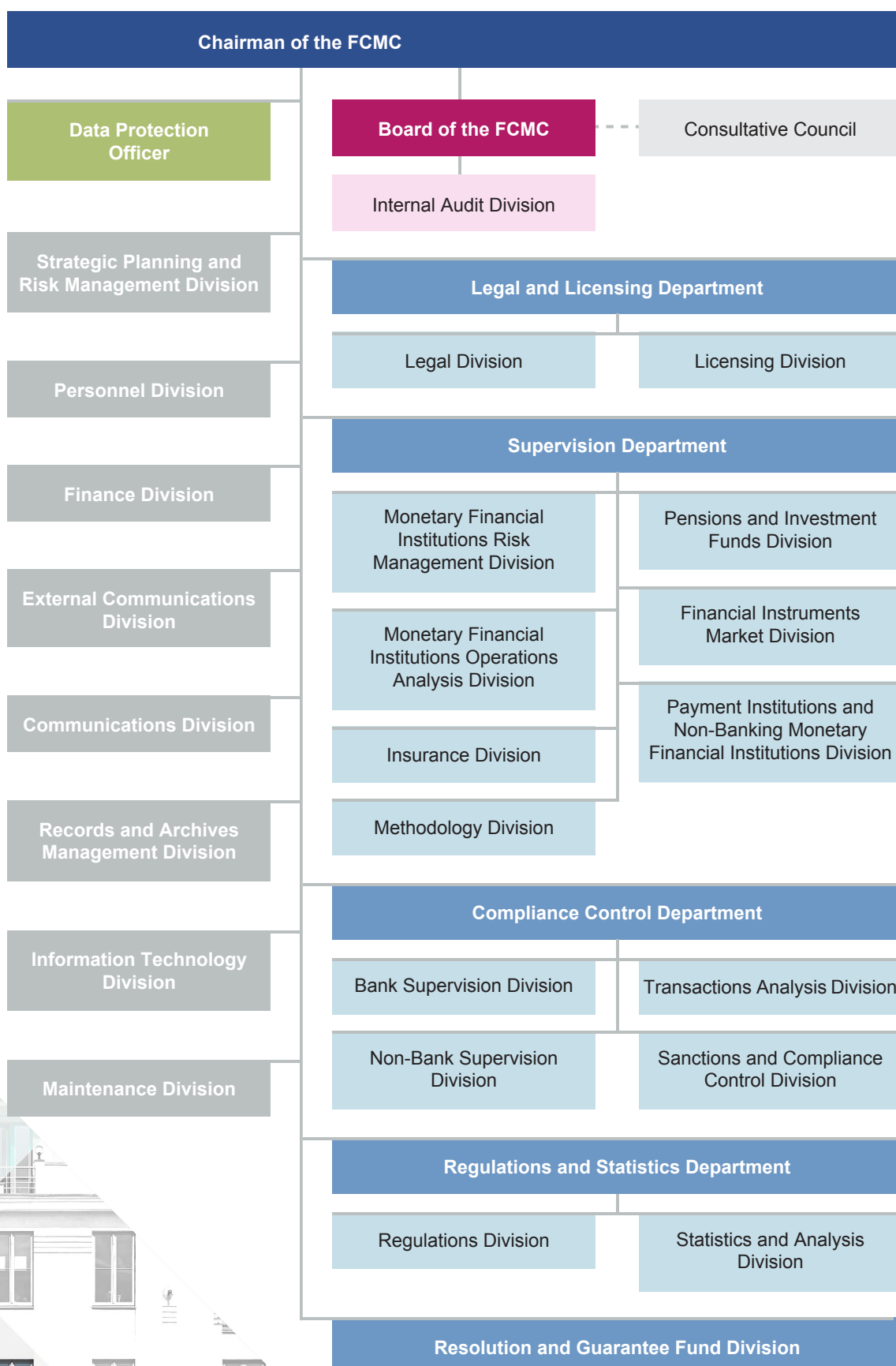
The majority of employees also received the assessment Conforms to the requirements in-

cluding regarding each individual criterion – for attaining established goals – 60% of employees (96), for the performance of job duties – 61% of employees (99), and for the required job-related competencies – 65% of employees (104).

Figure 36. Breakdown of the staff performance appraisal by criteria, number of employees



FCMC STRUCTURE



QUALITY AND RISK MANAGEMENT

Quality and risk management in the FCMC is ensured by the Strategic Planning and Risk Management Division, the aim of operation whereof is in line with its competence, to promote constant enhancement and improvement of the activities of the FCMC. In 2019, the FCMC continued to enhance the quality management system, by reviewing and making operational processes more effective, as well as enhancing the regulatory framework of the process management.

In the reporting year, the FCMC Board approved new internal regulations Quality Policy of the Financial and Capital Market Commission aimed at implementing the FCMC mission, sustainable development, and achieving the goals defined in the strategy, promoting improvements in work organisation, maintaining high effectiveness, and quality of performance.

The Quality Policy, in line with the strategy of the FCMC, states that the quality management system of the FCMC is based upon EFQM excellence model. The FCMC also ensures resources required for establishment, introduction, maintaining, and constant improvement of the quality management system.

In 2019, the FCMC continued the enhancement of the risk management process established during the previous years in accordance with the international best practice, as well as in line with the requirements set by the ECB in the field of risk management. In the reporting year, the FCMC Board approved the Risk Management Policy laying down the objectives and key principles of risk management, as well as the duties and responsibilities of the employees involved in the risk management process. In accordance with the Risk Management Policy, the risk management forms a component of the FCMC corporate governance system and leadership and represents a systematic process

encompassing risk identification, analysis, assessment, risk response, supervision, and regular revaluation of the risks, in order to timely aggregate, appropriately measure, and effectively manage the risks that can adversely affect the ability of the FCMC to achieve the set goals and to fulfil the tasks prescribed by laws and regulations in due quality and effectively, *inter alia*, to take part in ensuring the fulfilment of the SSM functions. In line with that which is stated in the Risk Management Policy, a detailed risk management process description was developed and laid down in the internal regulations Procedure for Risk Management, under which the risks are managed in all FCMC functions and the processes corresponding thereto, as well as in the projects at all levels of organisation, considering the risk management principles and risk tolerance.

In the reporting year, having performed the identification and measurement of the risk, the plan of risk-mitigating measures was developed and approved.

To ensure the maximum speed and effectiveness of incident identification and prevention, to renew the activities of the FCMC, in line with the requirements provided for in the legal acts, concurrently minimising the adverse effects of the incidents on the implementation of the functions and processes of the FCMC as well as the achievement of its goals; the incident management process was also enhanced in the reporting year by developing new internal regulations Procedure for Incident Management. Incident management is integrated into the risk-management process and is directed towards promoting the achievement of the goals of the FCMC and the SSM, as well as the protection of reputation and finance thereof.

When enhancing the risk management process, the crisis management process also was reviewed, considering the lessons learned in the previous periods.

The process of the initiation and performance of internal reviews was also enhanced in the reporting year by issuing new internal regulations Performance of Internal Reviews, the purpose whereof was to lay down the procedure for performance of the reviews regarding possible violations of the norms of law, established work procedures, or employment contract on the part of the FCMC employees, in order to clarify the facts or to assess the conduct of the relevant FCMC employees.



FINANCING OF FCMC ACTIVITIES

In 2019, the activity of the FCMC was fully financed from the payments of participants of the financial and capital market. During the reporting year, within the scope of the budget for ensuring FCMC activity, the FCMC also managed the DGF and the FPI and administered the FSF contribution to the state budget

and contributions to the SRF at European level. The FCMC carried out the administration of the DGF and FPI, as well as the FSF and SRF, within the scope of the approved budget, and the financial means from these funds are not deducted for the purposes of administration thereof for the benefit of the FCMC.

Table 6. Financing of the activities of the FCMC in 2018-2019, in EUR

	Actual ³⁰ performance in 2018	Actual ³⁰ performance in 2019	Budget for 2019 ³⁰	Budget performance for 2019, %	Share of the actual performance in total in 2019, %
REVENUE (+)	11,034,856	12,760,668	12,078,420	106	100
PAYMENTS BY THE PARTICIPANTS OF THE FINANCIAL AND CAPITAL MARKET	10,995,604	12,745,565	12,058,420	106	100
REVENUE RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	8,143,648	9,851,465	9,228,820	107	77
Payments by credit institutions	7,853,562	9,593,886	8,904,000		
Payments by credit unions	39,929	42,674	42,970		
Payments by payment institutions	75,285	129,944	100,610		
Payments by electronic money institutions	174,872	84,961	181,240		
REVENUE RELATED TO THE SUPERVISION OF THE FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	963,222	962,365	916,360	105	8
Payments by participants of the financial instruments market	663,153	628,348	649,290		
Payments by private pension funds	300,069	334,017	267,070		

³⁰ In accordance with the accrual principle, except accruals for leave, which are not included in the planning of the budget and the control of the budget performance.

	Actual ³⁰ performance in 2018	Actual ³⁰ performance in 2019	Budget for 2019 ³⁰	Budget performance for 2019, %	Share of the actual performance in total in 2019, %
REVENUE RELATED TO THE SUPERVISION OF INSURANCE	1,888,733	1,931,735	1,913,240	101	15
Payments by life insurance companies	343,051	356,941	338,460		
Payments by other insurance companies	1,489,768	1,519,573	1,504,780		
Payments by insurance brokers	55,914	55,221	70,000		
Lost income					
OTHER REVENUE	39,252	15,103	20,000	76	0.1
EXPENSES (-)	10,664,559	10,780,526	11,966,378	90	100
Salary for work, other payments to employees, and national social insurance mandatory contributions	7,843,178	8,042,699	8,707,251	92	74.6
Employee insurance	44,390	37,168	53,485	69	0.3
Improving professional qualifications of the staff	140,253	141,838	194,000	73	1.3
Telecommunications, communications, and information	152,880	161,898	186,556	87	1.5
Information to the general public, internal and external communication	53,127	81,031	107,500	75	0.8
Maintenance and operational expenses	849,593	887,015	851,061	104	8.2
Services for the provision of supervision	268,161	138,158	354,787	39	1.3
International cooperation	1,104,230	1,083,434	1,293,932	84	10.0
Amortisation/depreciation of capital investments	208,747	207,285	217,806	95	1.9
RESULT	370,297	1,980,142	112,042		

The actual financing of the FCMC for 2019 grew by 15.6%, as compared to 2018. During 2019, the provision of the core operational functions was strengthened in accordance with *Moneyval* and OECD recommendations. In the middle of 2019, the number of employees in the Compliance Control Department was increased by additional eight job positions.

In 2019, 60% of the FCMC working resources were allocated to the function of financial market supervision, whereas for client interest protection and AML/CTPF control – 16% and for the management and support function – 24%. During 2019, the functions in the field of compliance control and resolution and guarantee system enhancement were implemented, which was already assigned an increase in

³⁰ In accordance with the accrual principle, except accruals for leave, which are not included in the planning of the budget and the control of the budget performance.

2017 and it was maintained equivalent both in 2018 and 2019 in the amount of 14% –15%.

In 2019, FCMC financing was fully planned from the contributions of market participants. It was planned that 76.4% of all payments by market participants are sourced from monetary financial institutions, 7.6% from financial instruments market participants together with private pension funds, and 15.8% of payments are sourced from insurance market participants. However, in accordance with the actual fulfilment of the plan the monetary financial institutions ensured financing in the amount of 107% of the planned one, thus ensuring contributions into the FCMC budget in the amount of 77% of the total financing by market participants in 2019.

In 2019, the actual total expenses of budget implementation (without provisions for annual leave and without the reinstatement costs of the previous periods) comprised EUR 10,780.5 thousand, which is 10% less than planned (EUR 11,966.4 thousand). The fulfilment of budget expenses was affected by several factors. In 2019, changes took place in the distribution of the job positions in the FCMC, and the work also continued on the revision of the use of internal resources and ensuring effective course of processes, incl. by investments into IT solutions. Having assessed the feasibility and cost-effectiveness of business trips, it was possible to reduce the total business trip costs.

In 2019, the largest costs of operational provision of the FCMC were comprised of the expenses on remuneration of employees of the FCMC (74.6%).

Table 7. Breakdown of FCMC staff remuneration in 2019, in EUR

Salaries and similar payments	6,489,620
including bonuses	245,963
including supplements	61,852
including remuneration to the FCMC Board	572,075
National social insurance mandatory contributions	1,553,079
including the national social insurance mandatory contributions on the remuneration of the FCMC Board	138,536

In 2019, the leasehold expenses of the FCMC were EUR 466.3 thousand, which constituted 4.3% of the total FCMC expenses. The office

premises of the FCMC are at 1 Kungu iela, in Riga, and at 2 Krāmu iela, in Riga, with a total area of 2,241 m².

In 2019, the FCMC represented Latvia in eight European and global level organisations supervising financial markets and supervision coordination organisations, the membership of which cost 8.2% more than in 2018.

Table 8. Membership fees paid by the FCMC to EU and global organisations in 2018-2019, in EUR

	2018	2019	Changes in 2019/2018
Payments to EU organisations	595,688	641,786	7.74%
Payments in international organisations	52,885	57,280	8.31%
Total	648,573	699,066	7.8%

In 2019, the intensity of business trips of FCMC staff remained unchanged for participation in the activities of the ECB, the EC, and other bodies and organisations, as well as in the working groups for the improvement and coordination of supervision processes. At the end of 2016, a Single Resolution Mechanism became operational, as represented by the Board thereof, co-ordinating the functioning of the Eurozone Deposit Guarantee Schemes and in the organisational structures of which the representatives of the FCMC have been actively involved for the entire year 2019; therefore, the number of official business trips during the reporting year slightly exceeded 450, the same as in 2018, whereas the costs thereof amounted to EUR 384 thousand. Also, the training related business trips abroad for the FCMC employees were ensured according to the needs and offers by training organisers.

The FCMC has been continuously improving the technical resources of the activity support thereof, particularly in the IT field; therefore, EUR 306 thousand was spent on capital expenditure during the reporting year (in accordance with the cash flow principle).

The approved financial statements of the FCMC for 2019, the financial statements of the DGF and FPI for 2019, as well as independent certified auditor's reports on them are available on the FCMC website: <https://www.fktk.lv/par-mums/gada-parskati/>.

INTERNAL AUDIT

Internal audit, by using a systemic and planned approach, provides the FCMC Board with an objective and independent assessment of the effectiveness of FCMC governance, risk management and control system, including processes, effectiveness, as well as consultations for enhancing the operation of the FCMC.

The internal audit function at the FCMC is implemented by the Internal Audit Division, which in 2019 consisted of two employees (Head of the Division and senior internal auditor).

Internal audit is organised and carried out according to the Internal Audit Policy approved by FCMC Board, as well as the Internal Audit Procedure approved by the Internal Audit Division. Internal audit is conducted in compliance with the Core Principles for the Professional Practice of Internal Auditing, International Standards for the Professional Practice of Internal Auditing, and the Code of Ethics by the Institute of Internal Auditors.

Internal audit takes due care of the quality of the internal audit function, therefore its compliance with the International Standards for the Professional Practice of Internal Auditing and the Code of Ethics by the Institute of Internal Auditors is evaluated by an independent external evaluator every five years. In 2018, an agreement was concluded with SIA *KPMG Baltics* on performance of the external assessment of the operation of the internal audit for the period from 2013 till 2018. The performed assessment confirmed that the internal audit activity complies overall with the International Standards for the Professional Practice of Internal Audi-

ting, and the Code of Ethics by the Institute of Internal Auditors. The Internal Audit Division has developed and also maintains a current independent programme for quality assurance and improvement of the internal audit.

Internal audits are planned, using a risk-based approach, and considering the strategic goals and priorities of the FCMC. The findings of the results of each audit are reported to the Board of the FCMC with a view to excluding the exertion of any influence on the results of the audit.

The Internal Audit Division conducts internal audits in accordance with the annual internal audit and consultation plan approved by the FCMC, which includes the audits scheduled in the audit plan of the Internal Audit Committee of the system of the European central banks/SSM.

In 2019, the Internal Audit Division carried out both the internal audits of the FCMC in accordance with the risk assessment of the FCMC functions and processes and the audits included in the audit plan approved by the Internal Audit Committee of the ECB in accordance with the ECB SSM functions evaluation. In 2019, the Internal Audit Division carried out the audits regarding the IT security, risk management, supervision of less important credit institutions, participation of the FCMC staff in the SSM committees and working groups, as well as regarding the process of review of complaints on conduct of market participants received by the FCMC and provision of answers thereto.

The internal audit carries out a regular follow-up of the course of introduction of the recommendations provided, ensuring that the key recommendations are fulfilled and the control environment is correspondingly improved. In 2019, 35, or 46% of, the recommendations to be implemented were implemented.

According to the requirements of Section 27 of the Law on the Financial and Capital Market Commission, the FCMC once a year – not later than on 1 July – shall submit a written report to the *Saeima* and the Ministry of Finance of the Republic of Latvia on its work in the previous year and a full annual financial report checked by a sworn auditor.

The audit of the financial report of the FCMC for 2019 was conducted by independent external auditors – SIA *Baltic Audit*.

