FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

2020 annual and activity report

Contents

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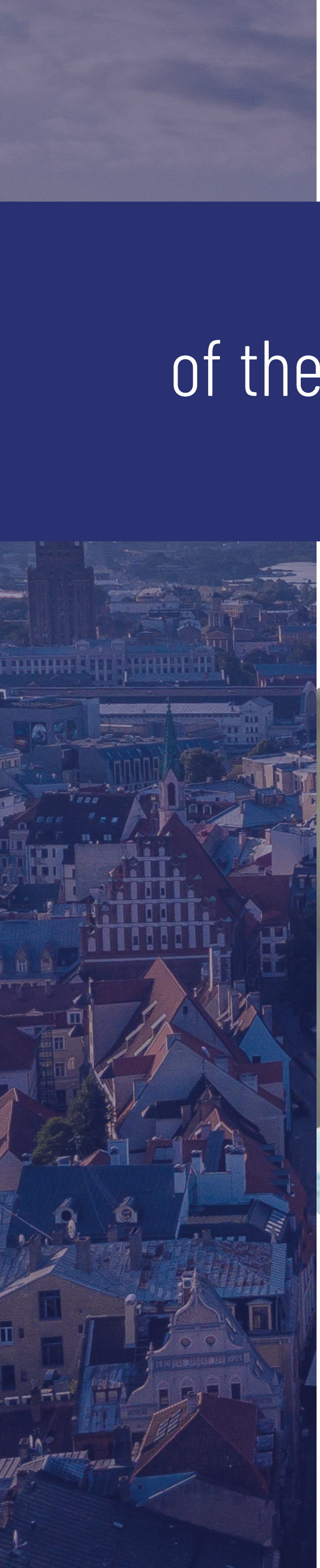


Foreword of the Chairperson of the FCMC

Photo: Evija Trifanova, LETA

Santa Purgaile,
Chairperson of the FCMC

The year 2020 will leave a lasting impression on our memory and on the history of the whole world, as we experienced the Covid-19 pandemic and the massive limitations in almost every field related to the spread of the pandemic. The shock caused by Covid-19 did not have a significant impact on the Latvian financial sector, as Latvian banks were well prepared for the Covid-19 crisis with sufficient capital reserves. But undeniably many things changed. In the spring of 2020, the Financial and Capital Market Commission (FCMC) restructured its processes in a short time, moving to fully remote work and providing a flexible approach to the supervision of the financial sector. Similar developments occurred in the European supervisory authorities, which have led to effective ways of implementing financial sector supervision and international cooperation in a new format that open up various possibilities, so we unlikely return to the supervisory work that existed before March 2020.

In the field of financial crime prevention, the reporting year began with the much-anticipated news that Latvia will not be included on the so-called “grey list”. To avoid being included on this list, a huge amount of work was put in, which had to be done quickly and decisively, thus without having in-depth discussions with the financial sector. Aware of this, the focus of the FCMC in 2020 was on ensuring a balance between the requirements of regulatory enactments and their application in life in accordance with a risk-based approach. The FCMC developed recommendations and explanations on the application of regulatory enactments, and our focus was on ensuring an open dialogue with market participants, investors, entrepreneurs, and various industries, as well as international partners.

It is obvious that changes cannot happen in one day, but the team of the FCMC has tried to do everything possible to promote the proportionate implementation of requirements that promote a risk-assessment based approach according to the principle - the lower the risk of the customer, the fewer questions a financial institution must ask the customer.

In 2020, the FCMC conducted 12 on-site inspections of banks in the field of prevention of money laundering and terrorist and proliferation financing and concluded that, in general, banks have taken significant measures to improve their internal control systems. In previous years, most of the inspections ended with the initiation of administrative cases and the imposition of fines, while in 2020 the FCMC only had to decide on the initiation of administrative proceedings or the application of sanctions in certain cases.

The reporting year also brought changes within the FCMC. During 2020, the organisational structure of the FCMC was transformed, it had not changed substantially since its establishment in 2001. The FCMC governance model was significantly revised by the decision of the Saeima on the FCMC Board consisting of three members instead of the current five Board members. When the new FCMC Board started its work on 30 March 2020, great attention was paid to the evaluation and efficiency of the FCMC's operation, recognising opportunities to improve the work process by implementing structural changes.

The purpose of restructuring of the FCMC was to promote the efficiency of the FCMC's work, while ensuring equal attention to all fields of the financial sector and the supervision of the capital market. As a result of the changes, the decision-making process and productivity improved in the FCMC, employee involvement and personal responsibility of each employee were promoted, as well as significant attention was paid to financial and capital market development issues and proactive action. The new structure came into force in November 2020, when several department heads selected through an open competition also took up their duties. In the change management, a significant emphasis was placed on the FCMC becoming an open institution capable of building constructive relations with supervised market participants and cooperation partners.

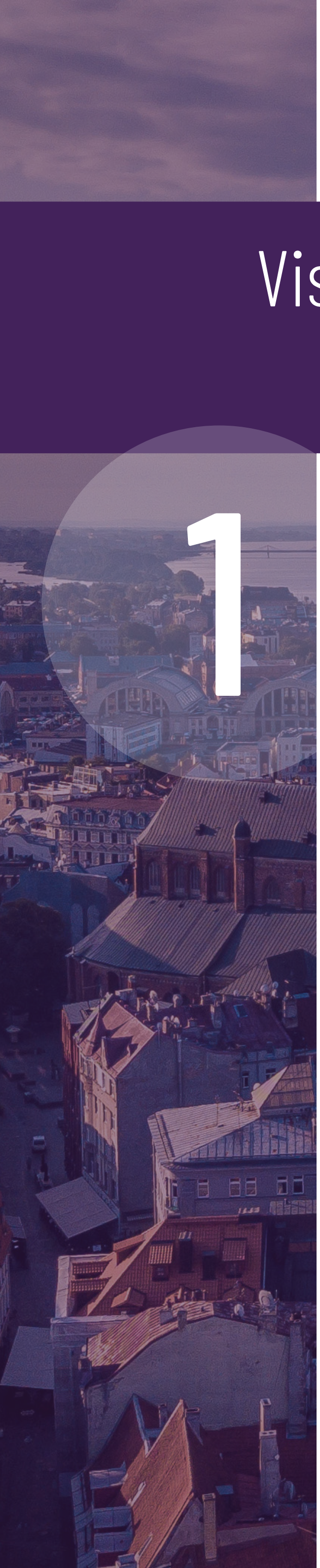
One of the goals of the change was to pay full attention to all segments and their development. Until now, the FCMC was often referred to as the banking supervisor, but banks are only one of the segments that the FCMC supervises. In 2020, we began working on issues related to Latvian capital market development, ensuring a strategic dialogue with all parties involved in the Latvian capital market, conducting a survey of past, present and potential issuers and preparing a Latvian capital market assessment, which was used as a basis for designing a 10-step programme for the development of Latvia's capital market. It was presented at the Latvian Capital Market Forum on 19 January 2021 and then integrated into the Latvian Financial Sector Development Plan for 2021–2023.

Sustainability issues should already become one of the central topics of the Latvian financial sector, therefore in 2020 the FCMC started active work on the implementation of sustainability aspects in the supervision and development of the financial sector, as well as in the operation of the FCMC.

The FCMC also calls on the financial sector to focus more actively on sustainability and green finance.

At the same time, the year 2020 marked the path to the integration of the FCMC into the Bank of Latvia (*Latvijas Banka*), and at the end of the year, work on the law on merging the Bank of Latvia and the FCMC began. The joint body is scheduled to become operational in 2023.

In 2021, the FCMC has set several priorities- focus on the development of all segments, monitoring the impact of Covid-19, sustainable finance, promoting a risk-based approach to the prevention of money laundering and terrorist and proliferation financing, development of the Latvian capital market, creation of an inclusive and sustainable innovation environment, as well as the promotion of efficiency, proactivity and development in the FCMC. Active work in the field of financial and capital market development is our central direction of activity, restoring the reputation and international competitiveness of the Latvian financial sector.



1 Vision, mission, values

The mission of the FCMC is to take care of the public interest:

- by regulating and supervising the activities of financial and capital market participants;
- by promoting the protection of interests of investors, depositors and insured persons, including financial literacy, as well as the development and stability of the financial and capital market.

FCMC vision is to be such a financial sector supervisor and regulator, which exercises its powers in a consistent, commensurate, clear, and explicit manner.

FCMC values

Accountability

We are accountable for our conduct and decisions. Decisions we take are well-reasoned and correspond to public interest. We can be trusted.

Professionalism

We are experts in our sector, constantly enhancing our professional knowledge and skills, demonstrating initiative, decisiveness, and results-orientated 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 develop ourselves as an organisation, becoming more effective, introducing innovative governance and processes rooted in modern technologies.

2 Consistent and professional supervision of the financial sector

2.1. Topicalities of licensing in 2020

There were slight changes in the composition of participants of the financial and capital market.

In some sectors, the number of market participants decreased, mostly in line with their own desire to close their operation.

In 2020, there were slight changes in the composition of participants of the financial and capital market. In some sectors, the number of market participants decreased, mostly in line with the own desire of market participants to close their operation.

In 2020, **13 banks** were licensed in Latvia, or one less than a year earlier. On 15 August 2019, the FCMC made a decision to suspend the provision of financial services of AS "*PNB Banka*", taking into account the fact that the European Central Bank (ECB), as the direct supervisor of AS "*PNB Banka*", recognised on 15 August 2019 the bank as a financial institution that is or will be in financial difficulties, and the European Single Resolution Board (SRB) decided not to resolve the bank, which means not to take measures to stabilise the bank. On 17 February 2020, the ECB decided to cancel the licence of AS "*PNB Banka*".

In 2020, **three branches of European Union (EU) member state banks operated in Latvia**, two less than in the previous year. On 14 January 2020, the FCMC issued a permit to Danske Bank AS Latvian Branch to transfer the shares of the branch to the ownership of AS "*Citadele banka*", implementing the strategy of Danske Bank AS Latvian Branch to terminate its operations in the Latvian market. On 23 March 2020, Danske Bank AS Latvian Branch was excluded from the Commercial Register. As of 31 March 2020, Svenska Handelsbanken AB Latvian Branch no longer provides financial services in Latvia. The branch will legally exist until it is excluded from the Commercial Register. In Latvia, Svenska Handelsbanken AB continues the provision of cross-border services within the framework of the freedom to provide services without the mediation of a branch.

In 2020, there were also changes in the cooperative savings and loan associations (CSLA) sector, the number of which decreased by one CSLA. On 14 July 2020, the licence of LABA Cooperative Savings and Loan Union was cancelled due to long-term non-compliance with the requirements of regulatory enactments. Currently, there are 34 CSLA in Latvia.

In 2020, **there were changes in the insurance sector**, as in 2020 the reorganisation of Seesam Insurance AS was completed through a merger, adding Seesam Insurance AS to Compensa Vienna Insurance Group ADB, as a result of which Seesam Insurance AS Latvian branch was liquidated. Currently, branches of insurers from 11 EU member states operate in Latvia.

At the end of 2020, there were no investment firms of the EU member states in Latvia. On 14 November 2020, **the only branch of an EU member state investment firm** - Admiral Markets UK Ltd Latvian branch - ceased its operation.

During the reporting period, **two new insurance brokerage companies** were registered: SIA "Altero Insurance" and SIA "Sanfreim". At the end of 2020, there were 74 insurance brokers licensed in Latvia.

In 2020, **the number of registered payment institutions (PI) decreased** due to the cancellation of the entries in the PI register of SIA "Express-Europe", SIA "Hermes Financial Services" and SIA "Eastern European Payment system". At the end of 2020, three PIs were registered in Latvia. These changes were due to the desire of market participants themselves to transform their operations. **The number of licensed PIs remained unchanged** (4), as in 2020 one licence was cancelled (SIA "Monetizator") and one was issued (SIA "Nordigen Solutions").

In 2020, SIA "Mobilly" **was issued an electronic money institution (EMI) licence** to continue developing electronic money payment services not only in the domestic market, but also in all EU and European Economic Area (EEA) countries, and thus its entry in the EMI register was cancelled. Also, **one new EMI was registered** - SIA "Andele Mandele PAY" - but the registration entry of SIA "Tirdzniecības centrs PLESKODĀLE" in the EMI register was cancelled at their own will.

In the financial and capital market, **interest remained regarding to the possibility to begin operation as a registered alternative investment fund manager**. In 2020, three new alternative investment fund managers were registered: Joint Stock Company "Development Financial Institution Altum", SIA New Nordic Ventures AIFP and SIA EMPO Ventures AIFP. At the end of 2020, there were seven licensed alternative investment fund managers and 16 registered alternative investment fund managers in Latvia.

2.2. Prudential supervision and compliance monitoring

2.2.1. Prudential supervision of the credit institutions sector

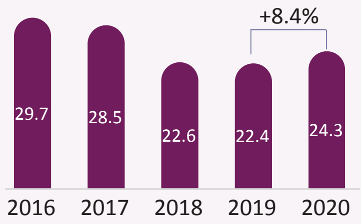
NUMBER OF BANKS AND TOTAL ASSETS

13 banks

3 branches of EU banks

EUR 24.3 billion or

~83% of GDP of Latvia



Assets, billion, EUR

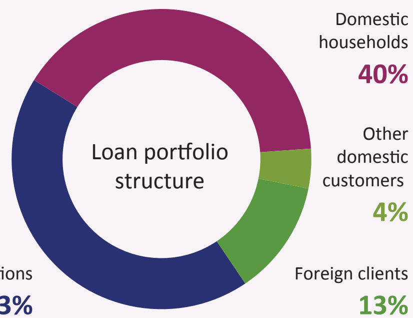
LOAN PORTFOLIO

The total loan portfolio amounts to EUR 13.1 billion

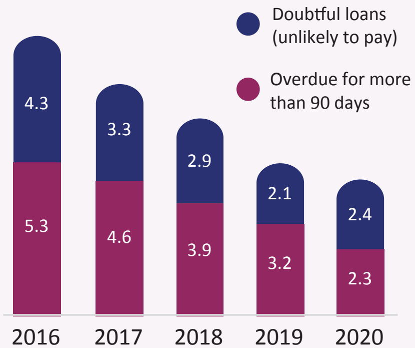
Compared to the end of 2019

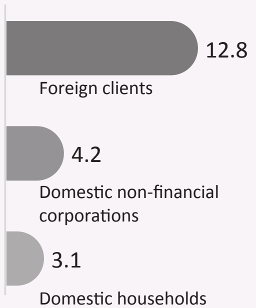
-3.9%

-1.0% Only active banks



Share of non-performing loans (NPLs) in the portfolio of non-bank customers, %





COMPLIANCE WITH REGULATORY REQUIREMENTS

Tier 1 Capital ratio

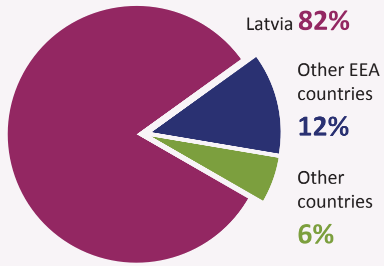
24.5% 15.4%

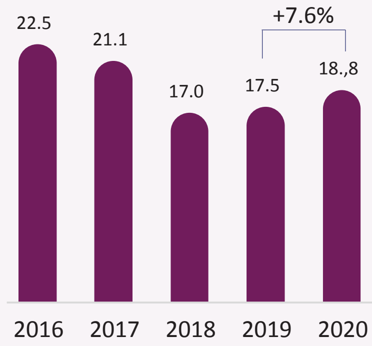
Liquidity coverage ratio

370.6% 171.3%

DEPOSITS

The total amount of deposits is EUR 18.8 billion





Deposits, billion EUR

PROFIT AND PROFITABILITY

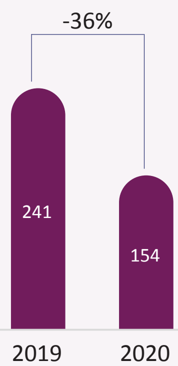
Profit of the banking sector EUR 154 million

Return on equity ratio (ROE)

5.4% 2.5%

Cost-to-Income Ratio (CIR)

67.8% 64.7%



Profit, million EUR

The FCMC regulates and supervises the Latvian commercial banks sector in close cooperation with the ECB within the scope of the Single Supervisory Mechanism (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.

In 2020, the FCMC continued to work on strengthening the framework for the supervision of credit institutions, ensuring a comprehensive supervisory process, as well as promoting the operation and development of a stable and crisis-resistant sector of credit institutions.

Credit institution supervisory priorities set in 2020

Based on the assessment of the risks inherent to the operation of credit institutions and trends in the financial system, as well as taking into account the priorities set by the ECB and the European Banking Authority (EBA), in the beginning of 2020 the FCMC identified the following credit institution supervision priorities:

Monitoring the implementation of strategy and business model change and valuation of profitability	Strengthening compliance and risk management functions	Credit risk and capital adequacy
with a focus on balancing sustainability and profitability	with a focus on the effective operation of the bank's internal control system and reputation risks	with an emphasis on problematic loans and bank measures to reduce them

Figure 1. **Credit institution supervisory priorities**

Based on the priorities set and considering the existing resources, the supervisory measure plan was developed for 2020, which included both on-site and off-site supervisory measures, including:

Priorities	Activities
Strategy, business model and profitability	• Evaluation of banking business models • Monitoring of revised business strategies of banks
Strengthening compliance and risk management functions	• Focus on the effective operation of the bank's internal control system • Thematic review "Stress testing"
Credit risk	• Focus on bank work with problem loans and implementation of non-performing loan management strategy, on-site inspections • Standards/criteria for signing credit commitments

Figure 2. **Credit institution supervision action plan of the FCMC in 2020**

During the spread of Covid-19, the FCMC successfully adapted the processes to work remotely, ensuring that all supervisory activities were performed as planned. The FCMC was able to take additional measures required by the circumstances caused by the Covid-19 pandemic.

To monitor the implementation of the change in strategy and business model and to assess profitability, the FCMC monitored the ongoing process of banking business model transformation, including the impact of the Covid-19 pandemic. The FCMC closely monitored the situation by maintaining regular structured dialogues with banks, focusing on business continuity in the circumstances of Covid-19, customer activity, asset quality and operational performance, as well as on the key areas such as bank profitability, business model transformation results and the fulfilment of financial forecasts.

The assessment of **strengthening the compliance and risk management functions** was provided within the framework of the relevant element of the supervisory review and evaluation process (SREP) through an in-depth assessment of the internal control system and increased focus on banks' ability to manage Covid-19 risks.

As part of **the credit risk** assessment, the assessment of credit underwriting standards and criteria continued at the beginning of the year. With the beginning of the Covid-19 pandemic, credit risk became one of the most significant risks to be monitored. The FCMC closely monitored both the changes in the quality of bank loan portfolios and the introduction and implementation of the moratorium announced by the Finance Latvia Association, as well as assessed the possible impact on loan portfolios after the end of this moratorium.

Impact from Covid-19

Latvia's approach to the application of regulatory requirements so far has provided banks with adequate capital and liquidity reserves, which serve as a safety net in times of stress and crisis. This means that the banks faced the Covid-19 situation well prepared. At the same time, the banks themselves have taken care of the ability to absorb potential negative effects, if necessary, without paying dividends and leaving the profits at their disposal.

During this period, supervisory authorities across Europe worked closely together to assess the situation and plan the necessary preventive measures. The actions of the supervisors were fast and synchronous. The FCMC, together with the ECB and other supervisors in Europe, adapted its supervisory processes and activities to the Covid-19 circumstances in order to provide sufficient operational assistance to the banks and to appropriately focus their supervisory efforts on their ability to cope with the crisis.

The FCMC has ensured an individual and flexible approach to the supervision of financial and capital market participants in order to facilitate the ability of banks to continue to play their role in financing the real economy and to minimise the negative effects of the consequences of Covid-19.

The government also provided assistance programmes to support the economic sectors affected by Covid-19 and to mitigate the negative effects. Additional support for borrowers was also provided by the moratorium announced by the Finance Latvia Association, which was accepted by the majority of banks and which allowed banks to grant credit holidays using a common approach.

Supervisory Review and Evaluation Process

Risk assessment-based supervision is still one of the key principles of supervision. Under this principle, the FCMC, using information disclosed in the reports received from the banks, as well as other information available thereto, is constantly assessing the performance of banks within the SREP, 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.

Risk assessment, within the scope of the SREP, is carried out on a rating scale from "1" to "4"; and in 2019, the following risk ratings were assigned to banks in Latvia (including to banks, that are under the direct supervision of the ECB):

Figure 3. **Risk assessment within SREP**

In 2020, the FCMC continued to implement the SREP according to the SREP guidelines developed by the EBA, as well as the ECB guidelines regarding the SREP for banks, with the process taking place within the scope of supervisory dialogues on the SREP results.

At the same time, the FCMC considered the guidelines of the EBA for the pragmatic SREP[1] in 2020, which focused on assessing the ability of credit institutions to address the problems of the Covid-19 crisis and the impact of the crisis on banks' current and projected risk profiles. Following the EBA guidelines, the FCMC maintained stable and unchanged capital requirements and special liquidity requirements for 2021, which were set within the framework of the full SREP assessment for 2019. The risk assessment of significant banks within the SREP in 2020 under the direct supervision of the ECB was also conducted in accordance with the pragmatic approach set by the ECB.

In 2020, the FCMC focused on the impact of Covid-19 on each of the SREP elements, as well as on assessing the magnitude of risks and identifying governance weaknesses. Based on the pragmatic SREP approach and the assessment of the basic elements of SREP, the FCMC has developed a number of qualitative requirements and recommendations, which will continue to support the improvement of the banks' internal control system and the strengthening of resilience to shocks, mainly focusing on **internal management, credit risk management, capital adequacy planning and operational risk, incl. money laundering and terrorist and proliferation financing (MLTPF) risk, management.**

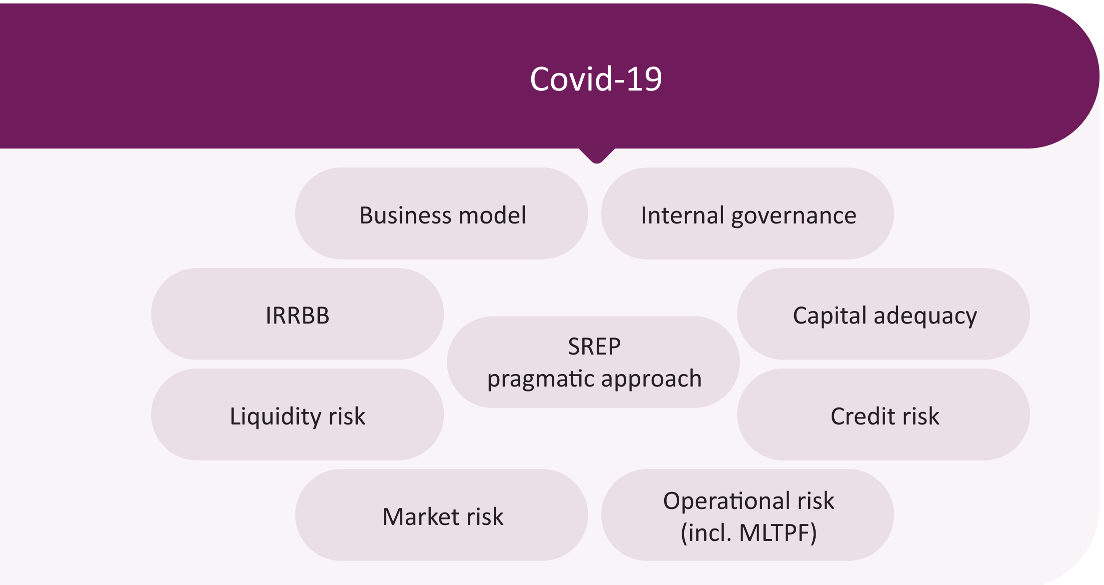


Figure 4. **Effect of Covid-19 on SREP elements**

In 2021, the focus of SREP will remain on the viability and sustainability of bank business models, as well as resilience to shocks caused by Covid-19 and the ability to absorb the impact of negative economic trends on banks' profitability and capital adequacy.

The main directions of assessment are the effectiveness of change management of the banks, the role of shareholders, governance model, risk appetite, verifications of financial forecasts, structure of income and expenses. The FCMC also focused on the changes in the assessment of services, interest and tariff policy, client attraction dynamics, stability of counterparties (cooperation partners), availability of distribution channels, integration of innovative solutions.

Overall, less significant banks have made progress in transforming their business models, shifting their focus from commission-based activities to the development of traditional banking services such as lending. Work on changing bank business models also continues in the Covid-19 situation, including assessing bank strategies from today's point of view and adapting to current conditions. Some banks have found the opportunity to increase their market share, others have acted more conservatively. The capital and liquidity buffers created so far have provided greater comfort and flexibility for the banks themselves in the Covid-19 situation.

The circumstances caused by Covid-19 highlighted the growing need to move towards the digitalisation of financial services and the ability to provide financial services remotely, which was already provided for in banking strategies, so that this implementation was possible with sufficient urgency.

On-site inspections in credit institutions

In 2020, due to the circumstances of the pandemic caused by Covid-19, the on-site inspection process called for a change from on-site to remote work. To a large extent, Covid-19 also brought new conditions to banks, creating the need to adapt and use digital communication channels in cooperation with third parties, including with the FCMC within the framework of its inspections.

The FCMC was able to successfully adapt to the new circumstances, and the inspection process was continued by promptly making changes to the on-site inspection plan. As a result, during the reporting year, the FCMC carried out six on-site inspections in banks,

[1] https://eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-process-srep-and-pillar-2/guidelines-pragmatic-2020-supervisory-review-and-evaluation-process-light-covid-19-crisis.

paying particular attention to the lending process, including work with problematic assets and industries affected by Covid-19, 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.

Single Supervisory Mechanism

4 November 2020 marked the sixth anniversary of the establishment of the SSM of ECB, the European system of banking supervision. Within the scope of the SSM competent authorities from the EU Member States operate together with the ECB (European System central banks and national supervisory authorities). The FCMC is also part of the SSM, which has three main objectives.

To ensure the security and sustainability of the European banking system	**To improve financial integration and stability**	**To ensure coordinated supervision**

Figure 5. **Goals of ECB's SSM**

At the end of 2020, there were **115 significant banks** under the direct supervision of the ECB, whereas under the supervision of national competent institutions there were 2,320 less-significant banks.

At the beginning of 2020, three significant banks from Latvia were the under the direct supervision of the ECB- AS "*Swedbank*", AS "*SEB banka*" and AS "*PNB Banka*" (until the withdrawal of authorisation on 18 February 2020). In July 2020, the ECB decided to classify AS "*Citadele banka*" as a significant credit institution and started its direct supervision as of 1 January 2021.

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

In 2020, the FCMC continued to supervise less-significant banks and at the same time, in cooperation with the ECB and other national competent authorities, to develop and clarify common guidelines for the supervision of such banks, promoting the consistent application of high-quality supervisory standards to less-significant banks.

In the context of the Covid-19 pandemic, the ECB SSM, together with other supervisors in Europe, reviewed its supervisory processes and activities to adapt to the Covid-19 pandemic situation and to provide adequate operational assistance to banks and ensure that supervisory work could focus on adapting and overcoming potential stress situations caused by the Covid-19 pandemic.

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, in 2020 the FCMC experts remotely took part in the committees and working groups set up by the ECB, contributing to the development and enhancement of the ECB's single supervisory methodology, as well as further coordination of the statutory regulation within the framework of the European Banking Union.

Participation in the decision making of the ECB SSM

As a member of the Board nominated by the FCMC, the FCMC participates in the Supervisory Board of the ECB; the FCMC was also involved in the decisioon-making process, adopting the SSM decisions both regaridng all of the significant banks under the direct supervision of the SSM, and regarding the methodological issues determining the procedure for the implementation of the banking supervision process in the Euro Area as a whole.

In 2020, the ECB SSM adopted **2,643** supervisory decisions. About **half of these decisions** were approved at meetings of the ECB's Supervisory Board, the **other half** through written procedures. Most of these decisions were related to the assessment of the suitability and adequacy of bank officials (44.1%), internal models (9.3%), equity (6.2%) and significant participation procedures (3.2%).

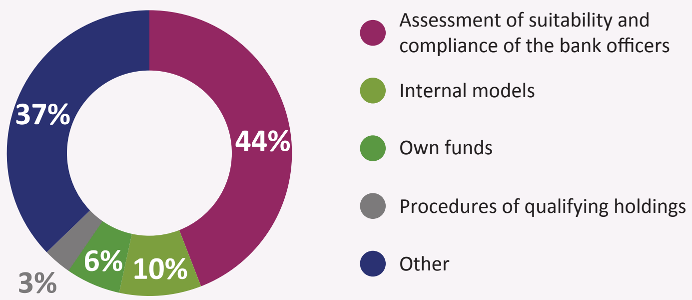


Figure 6. **Structure of the ECB's SSM decisions taken in 2020**

A total of 24 meetings of the ECB's Supervisory Board were held in 2020. FCMC experts assessed and provided their view on the issues to be reviewed at the Supervisory Board meetings as well as on the documents examined under written proceedings.

Supervisory measures applied to cooperative savings and loan associations

In 2020, the supervision of CSLAs 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 CSLAs and for the covering of losses. As a result of the Covid-19 pandemic, no on-site inspections were performed in the CSLAs during the reporting year. The FCMC experts continued one on-site inspection, which was started at the end of 2019 aimed at assessing the financial standing of the CSLA, management performance, quality of assets, income and cost structure, MLTPF risk management, as well as the compliance of their activities with the requirements of laws and regulations.

2.2.2. Supervision of the insurance sector

NUMBER OF INSURERS

6 insurance companies
Life: ●●
Non-life: ●●●●

11 branches of insurance companies
Life: ●●●●
Non-life: ●●●●●●●

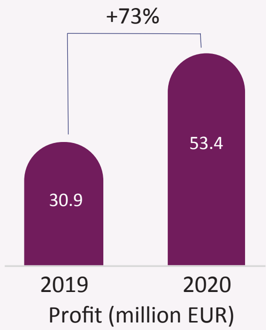
75 insurance brokers

PROFIT/LOSS AND SOLVENCY (OF THE COMPANY)

Profit
EUR 53 billion

Solvency ratio
173%

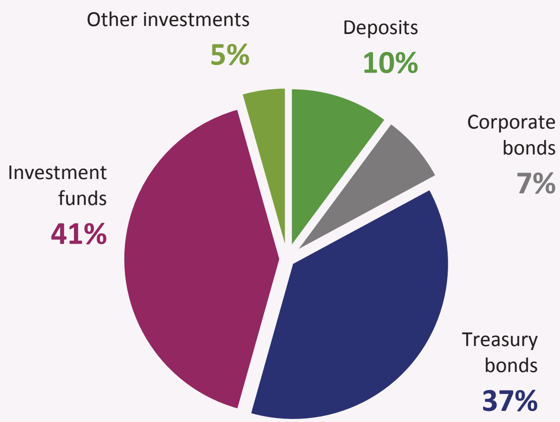
Return on assets (ROA)
3.6%



INVESTMENT PORTFOLIO (OF THE COMPANY)

The amount of investments
EUR 1.4 billion

Compared to 2019:
+8%
increase in investments



At the end of 2020, there were six insurance companies operating in Latvia - two life insurance companies and four non-life insurance companies as well as 11 branches of insurance companies. There were 74 insurance brokers included in the Latvian Register of insurance intermediaries, or two insurance brokerage companies more than a year before.

When assessing the results for 2020, the insurance sector has not suffered significantly because of the Covid-19 pandemic, although an impact had been observed. A decline in insurance premiums was observed in almost all major types of non-life insurance. In 2020, the amount of insurance premiums written in Latvia was 549 million euros, which is 1.8% less than in the previous year. The global nature of the pandemic is seen in the dynamics of premiums written by insurers registered in Latvia, including their operations abroad. The total amount of premiums in 2020 reached 809 million euros, which is 6% less than in 2019.

At the same time, as the population activity decreased due to the restrictions of Covid-19 announced by various countries, the paid claims decreased on average faster than the premiums. In 2020, 341.8 million euros were paid in insurance claims in Latvia, which is 6.6% less than in 2019, while insurers paid out 508 million euros throughout their territory, or 8% less than in the previous year.

The financial result of insurance companies in 2020 was positive, with all six insurance companies closing the year with a profit. Consequently, the compliance ratio of solvency capital requirement for insurance companies registered in Latvia also remained stable above the minimum requirements and reached 173.5% at the end of 2020 (the lower limit of the indicator is 100%), which is 12 percentage points more than at the end of 2019.

The increase in capital adequacy was influenced by a sharper decline in insurance claims compared to lower insurance premiums, as well as a relatively conservative and prudent investment strategy, due to which Covid-19 fluctuations in financial markets did not significantly affect the value of the insurance portfolio.

The insurance sector did not experience significant shocks in 2020 due to good capital adequacy. Market participants were able to adjust their activities in accordance with the principle of the remote provision of services. In recent years, the purchase of insurance policies in Latvia, the submission of claims, as well as the settlement of losses have been increasingly carried out using digital communication tools, as well as customer service by telephone. This approach is an advantage in the situation of a pandemic, where direct contact is difficult or even impossible.

In 2020, the FCMC consistently performed supervisory measures, verifying the compliance of reports and other documents submitted by insurers and insurance brokers with the requirements specified in the regulatory enactments. In 2020, two on-site inspections were carried out: one general inspection of the insurance company, which assessed organisational processes, internal information exchange, management system, creation of technical provisions, compliance with capital requirements, investment activity, equity adequacy, stress tests and ability to continue operations, as well as the annual inspection of the observance of the procedure for the establishment, accumulation and administration of the mandatory vehicle owner liability insurance guarantee fund administered by the association “Latvian Motor Insurers’ Bureau”. Several thematic off-site supervision activities were also carried out, including off-site inspection of branches of Member States’ insurers for compliance of the public register of intermediaries with the Insurance and Reinsurance Distribution Law and the inspection of the annual reports of insurance brokers on compliance with Article 32 (3) of the Insurance and Reinsurance Distribution Law regarding the reflection of insurance premiums.

Since the beginning of the Covid-19 crisis, the FCMC has implemented enhanced communication with insurers to monitor changes in their financial condition and the ability to meet their insurance obligations to customers. Even as the situation stabilises, the FCMC continues to pay attention to the development trends and financial indicators of the market participants in order to react to the negative impact on the operations of insurance companies caused by the increase of macroeconomic risks in a timely manner.

2.2.3. Supervision of investment funds and alternative investment funds, their managers, state funded pension schemes and private pension funds

Private pension funds

QUANTITY AND PARTICIPANTS

6 private pension funds:
5 open, 1 closed

35% of the economically active population

16 pension plans

Active

Balanced

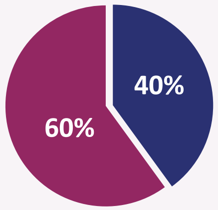
0.3 million members

ASSETS OF PLANS

Assets
EUR 0.6 billion

EUR 1.8 thousand per 1 member

Assets (billion EUR)

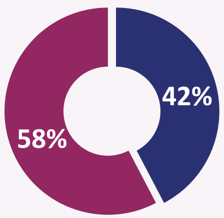


Assets

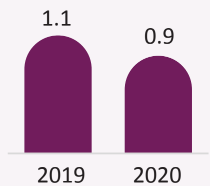
CONTRIBUTIONS TO PLANS AND MANAGEMENT EXPENSES

Contributions
EUR 0.1 billion

Compared to 2019:
+3% contributions



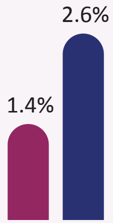
Contributions



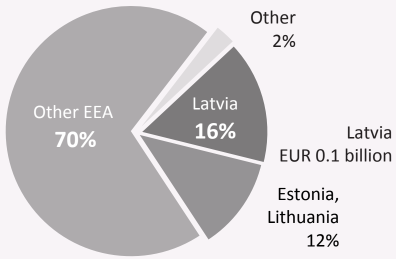
Management expenses (% of net assets)

GEOGRAPHICAL DISTRIBUTION AND RETURN ON INVESTMENTS

2.0% profitability



Profitability



Investments

State-funded pension scheme

QUANTITY AND PARTICIPANTS

7 State funded pension scheme managers

1.3 million members

31 investment funds

Active

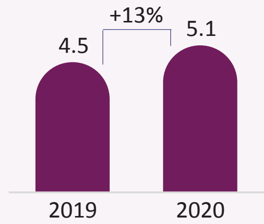
Balanced

Conservative

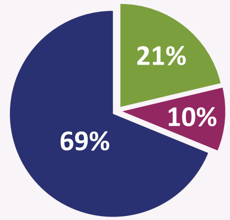
ASSETS OF PLANS

Assets
EUR 5.1 billion

EUR 3.9 thousand per 1 member



Assets (billion EUR)

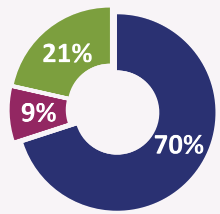


Assets

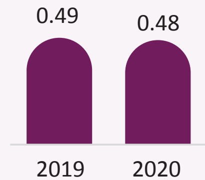
CONTRIBUTIONS TO PLANS AND MANAGEMENT EXPENSES

Contributions
EUR 1.0 billion

Compared to 2019:
+4% contributions



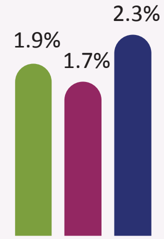
Contributions



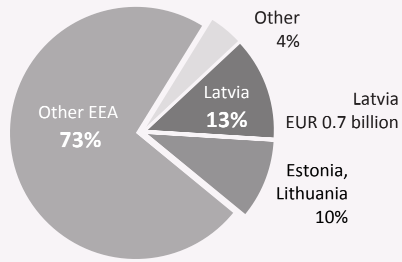
Management expenses (% of net assets)

GEOGRAPHICAL DISTRIBUTION AND RETURN ON INVESTMENTS

2.1% profitability



Profitability



Investments

Investment funds

NUMBER OF FUNDS AND FUND MANAGERS

11 investment management companies

23 investment funds

Bonds

Mixed

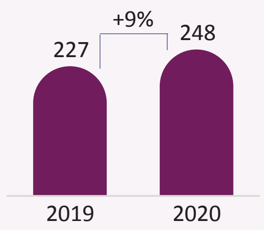
Stock

Compared to 2019: -1

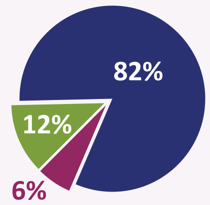
ASSETS OF FUNDS

Assets

EUR 248 million



Assets (million EUR)



Assets

INVESTMENTS, THEIR STRUCTURE AND RETURN

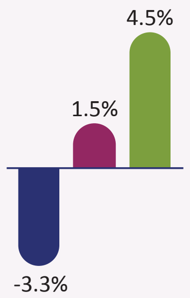
Investments

EUR 244 million

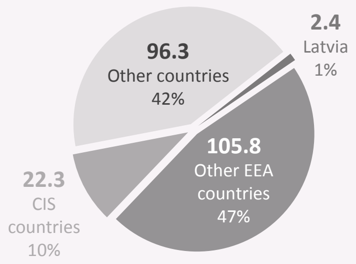
Compared to 2019:

+11% investments

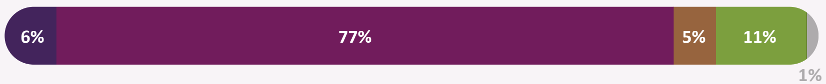
Profitability



Geographical distribution of investments (million EUR, %)



Investment structure by instruments



Claims against credit institutions · Debt securities · Stocks · Investment funds · Derivatives

Alternative investment funds

NUMBER OF FUNDS AND FUND MANAGERS

23 slternative investment fund managers

26 alternative investment funds

Compared to 2019: +3

Licensed

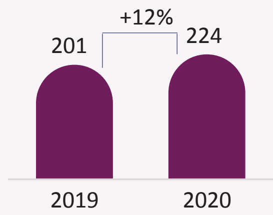
Registered

Compared to 2019: -2

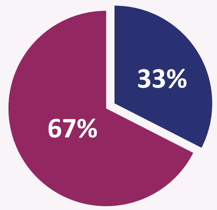
ASSETS OF FUNDS

Assets

EUR 224 million



Assets (million EUR)



Assets

INVESTMENTS, THEIR STRUCTURE AND RETURN

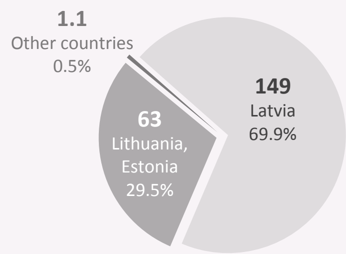
Investments

EUR 213 million

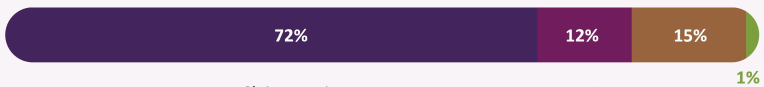
Compared to 2019:

+8% investments

Geographical distribution of investments (million EUR, %)



Investment structure by instruments



Securities · Claims against credit institutions · Loans · Investment property

The main emphasis in the implementation of the common FCMC strategy for the investment and pension sector was placed on the promotion of cooperation and open dialogue between the FCMC and industry representatives, as well as the support and further improvement of the regulatory environment appropriate to the current situation of market participants.

Supervision of investment plans, investment funds and alternative investment funds of the investment management companies and the state-funded pension scheme investment plans managed by them

At the end of 2020, there were 11 investment management companies in Latvia, of which eight companies managed 31 investment plans of the state funded pension scheme with total assets of 5.1 billion euros and four companies managed 22 investment funds with total assets of **246.1 million** euros. In 2020, compared to 2019, the number of investment funds managed by the investment management companies increased by one. While the number of alternative investment funds increased by three, with 23 funds operating at the end of 2020. The increase in the number of alternative investment funds took place in the segment of registered alternative investment funds, which can be explained by the amendments to the Law on alternative investment funds and their managers approved on 16 July 2019, which provided significant easements for the supervisory framework of registered alternative investment fund managers with the aim of reducing the administrative burden, as well as promoting the development of the sector as a whole.

In accordance with the assessment of the risk profile of each market participant, certain on-site and off-site supervision measures were provided. In 2020, during the on-site inspections of three investment management companies, the adequacy of the internal control system established by the asset managers, as well as the identification and management of significant risks were assessed. Particular attention was paid to the engagement and use of outsourced services, assessing the control systems established by the asset managers to assess them. The performance of the asset holder was examined as part of each inspection. The deficiencies and inconsistencies identified during the inspections were discussed with the management representatives of the asset managers, and action plans for necessary adjustments were agreed upon to ensure the successful functioning of the asset managers. 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.

Based on the received reports, within the off-site supervision the quality of assets, income and costs structure of investment management companies and licensed alternative investment fund managers were assessed, as well as the compliance of their activities with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, and other laws and regulations. To assess the impact of high-risk factors on the investment portfolio in critical scenarios, as well as to ascertain the existence of a plan of measures in the event of their occurrence, the analysis of critical situations performed by investment management companies was assessed.

In 2020, following the initiative of the European Securities and Markets Authority (ESMA), a thematic review was performed on the liquidity risk management of open investment funds managed by the investment management companies in accordance with ESMA's common liquidity risk management methodology. The purpose of it is to ensure uniform principles for the liquidity risk management of investment funds, to reduce the risk of the suspension of repurchase of fund units, to increase investor protection and to strengthen the stability of the financial instruments market. The findings of the audit on several aspects related to liquidity risk management, such as risk measurement, assessment, risk reflection and reporting procedure to the management of the company, as well as the assessment of the level of liquidity risk prior to making investments and follow-up assessments, and the need for liquidity risk stress tests, are at the basis for further liquidity supervision.

Supervision of private pension funds and pension plans managed by them

At the end of 2020, there were five private open pension funds and one private closed pension fund in Latvia, which managed a total of 16 pension plans with total assets of 610.5 million euros. With the entry into force of the new Private Pension Fund Law on 13 January 2020, all necessary steps were taken to implement the EU harmonisation minimum to protect the members and beneficiaries of occupational pension plans, ensure good governance, provide information to the plan members and ensure the transparency and security of occupational pension capital accumulation.

In 2020, the off-site supervision of private pension funds was carried out by analysing the submitted reports and assessing the quality of assets of pension plans, the income and expense structure, as well as the compliance of their activities with the requirements of the laws of the Republic of Latvia, FCMC regulations and guidelines, and other laws and regulations. Based on the critical situation analysis submitted by the pension funds, the specified risk factors, assessed scenarios and anticipated actions in the case of the occurrence of unfavourable scenarios were assessed for the investment portfolio of each pension plan.

In 2020, the FCMC evaluated the results of the own risk assessment performed by pension funds. These results are taken into account by the pension funds in the strategic decision-making process, and by the FCMC- when determining the risk level of pension funds. The pension fund's own risk assessment allows one to assess the effectiveness of the pension fund's risk management system, the possibility of conflicts of interest, financing needs, new or potential risks that may arise in addition to the environmental, social and governance factors taken into account in the investment policy, including those risks that may arise as a result of climate change or as a result of the use of the environment and resources, as well as those social risks and risks related to the depreciation of assets that may arise due to amendments to the regulatory enactments.

To build an active dialogue within the framework of supervisory activities, consultations were organised with the representatives of the management of pension funds in order to follow the most significant events in the activities of pension funds and the implementation of the determined business strategy.

Impact of Covid-19 on the investment and pension sector

Investment fund managers were among the first financial market participants to face the financial market turmoil caused by the Covid-19 pandemic at the end of February 2020. The challenges created by the volatile situation provided the basis for market participants to gain confidence in the most appropriate asset management strategy in all key market segments: in the management of investment funds, in the management of investment plans of state-funded pension schemes, in the management of pension plans of private pension funds, as well as in the individual management of investors' financial instrument portfolios. The market participants took all the necessary steps to continue investing in accordance with the planned long-term objective for the distribution of assets, as well as to comply with the set investment limits for investments and pension plan funds.

The FCMC, by performing extraordinary financial market supervision measures related to the circumstances caused by Covid-19, gained confidence in the ability of investment management companies and pension funds to ensure business continuity in remote working conditions, as well in the activities of external service providers in a high-risk situation.

The development of the financial instruments market during 2020 proved the importance of the long-term investment aspect in the formation of pension savings. Although the volatility of the pension system's investment portfolios was higher than usual because of Covid-19, it gradually stabilised, demonstrating the importance of evaluating the long-term returns for long-term savings, as short-term volatility affecting the portfolio balanced over the long term. Although the average return on investment and pension plans fell sharply in the first quarter of 2020 because of the financial market fluctuations caused by the Covid-19 pandemic, the situation improved rapidly in the remaining months of the year, ending 2020 with a positive average return of approximately 2%.

Legislative initiatives to deal with the consequences of Covid-19

Considering the fact that the financial market was in turmoil in the first and second quarters of 2020, fostered by Covid-19, and funded pension capital declined in the short term, amendments to the Law on State Funded Pensions were adopted, which stipulate the right of persons claiming an old-age pension to postpone the choice to add funded pension capital to unfunded pension capital or to purchase a life insurance (life pension) policy until 30 November 2021.

The Law on the Suppression of Consequences of the Spread of Covid-19 Infection included provisions for the establishment of an alternative investment fund managed by the joint-stock company "Development Finance Institution Altum". For this alternative investment fund, the managers of the state-funded pension scheme do not have to apply the limits set out in the Law on State Funded Pensions for investments in alternative investment funds and venture capital.

In relation to overcoming the consequences of the spread of Covid-19, if a small or medium-sized enterprise registered in Latvia issues debt securities with an issue amount of up to 2 million euros by 31 December 2021 and the maturity of these debt securities does not exceed three years, the manager of the state-funded pension scheme funds regarding investments in such securities is entitled to disregard the established restrictions and the requirement that investments in debt securities of one issuer may not exceed 10% of the debt securities issued by one issuer. The total amount of investments of the investment plan in such debt securities may not exceed 1% of the assets of this investment plan until 31 December 2024.

2.2.4. Supervision of payment institutions and electronic money institutions

NUMBER OF EMI & PI

8 Number of EMI | 0 within 1 year | EMI – electronic money institutions

7 Number of PI | -3 within 1 year | PI – payment institutions

EMI & PI LICENCES

2 Number of licensed EMI | 6 Number of registered EMI

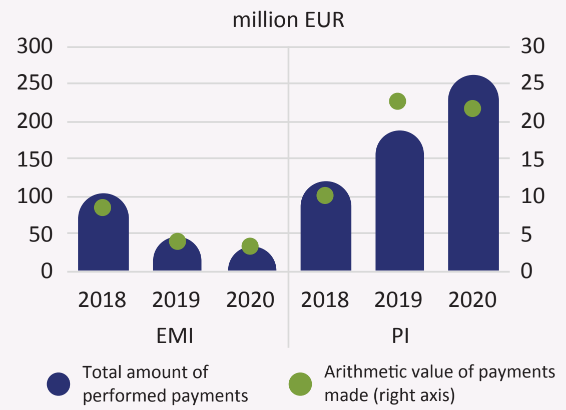
4 Number of licensed PI | 3 Number of registered PI

PAYMENTS WITH EMI & PI

Compared to 2019:

-25.4% (EMI)

+38.3% (PI)

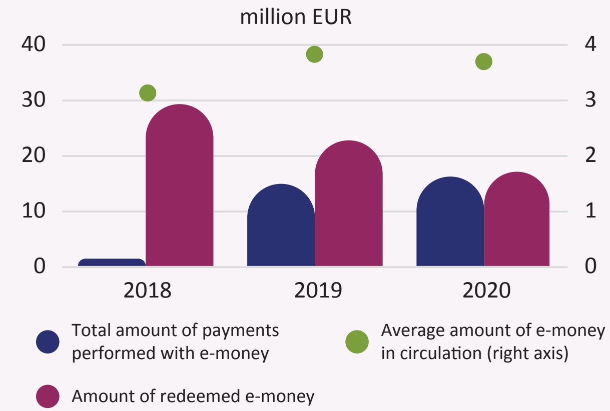


E-MONEY CIRCULATION (EMI)

Compared to 2019:

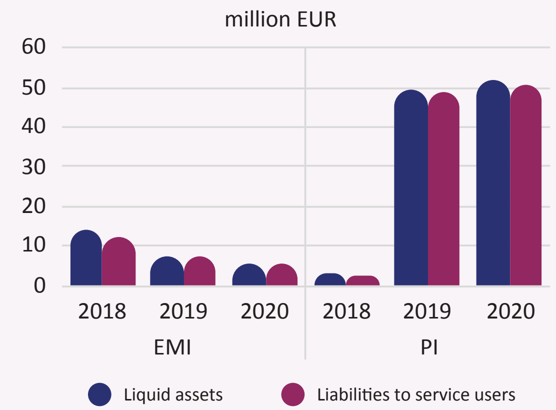
+8.6%

-24.4%



EMI & PI LIQUID ASSETS AND CURRENT LIABILITIES

Liquid assets > Current liabilities

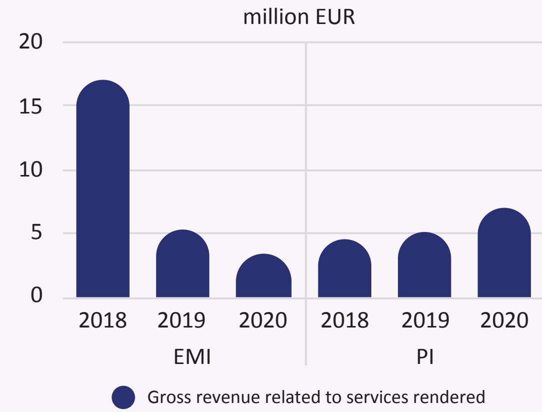


EMI & PI REVENUE FROM RENDERING SERVICES

Compared to 2019:

-36.7% (EMI)

+34.9% (PI)



In 2020, the PI and EMI sectors in Latvia demonstrated good resilience to the deteriorating economic situation under the influence of Covid-19. Both PI and EMI had been able to quickly relocate and operate remotely, while the on-site customer business models had to adapt to national constraints and observe the defined security measures, but the operation of such PI and EMI did not come to a halt.

At the end of 2020, there were seven PI operating in Latvia, of which three were registered and four were licensed, and eight EMI, six of which were registered and two were licensed. The total amount of payments made with PI and EMI in 2020 reached 295.5 million euros - which is 26% more than in 2019, despite the consolidation that continued in this sector.

The amount of payments made with e-money also increased by 9%. Despite the negative impact of Covid-19 and related restrictions, the PI and EMI sectors managed to maintain their business and adapt to the new operating conditions, rules and operating regime. The Covid-19 pandemic had a negative impact on the amount of e-money repurchased, i.e., its exchange for money: it decreased by 24%, although the amount of e-money in circulation had practically not decreased compared to the end of 2019. **In 2020, the gross revenue of PI and EMI from the provision of services reached 10.3 million euros, about the same as in 2019. The amount of liquid assets also remained almost unchanged compared to the previous year and fully covered the liabilities of market participants to the customers.**

FinTech or technology-based financial innovation companies are a good example of positioning in the financial sector during the pandemic. The business models of financial technology companies are naturally based on virtual operations and remote communication with customers, which was essential during Covid-19. By being able to provide digital services remotely in the areas of investments, lending and transfers, financial technology companies have strengthened their position compared to other banking and financial service providers with a low to medium level of digitisation and on-site or partly on-site service models.

There have been no disruptions in the operation of FinTech companies, as the business models are based on a more convenient customer experience. The rapid growth in demand for digital financial services has enabled FinTech companies to expand their services and provide access to financial services in emerging markets.

Even though the FCMC worked remotely, one licence was issued for the operation of EMI, one licence for the operation of PI, as well as one EMI was registered. From a supervisory point of view, no restrictions or any other additional requirements were introduced.

2.2.5. Supervision of investment service providers

At the end of the reporting year, the following persons had the right to provide investment services in Latvia:

3
investment firms licensed in Latvia

13
credit institutions registered in Latvia

9
investment managing companies registered in Latvia

2
subsidiaries of EU Member State credit institutions

> 550
investment service providers from the EEA countries according to the principle of freedom to provide services

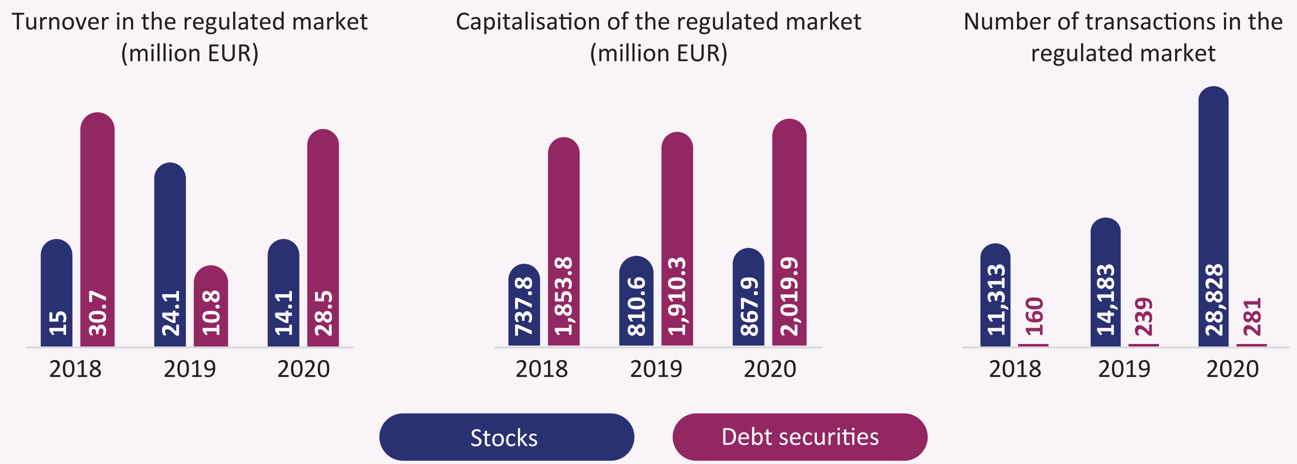
The focus of supervision of the provision of investment services in 2020 was on:

- seven meetings with responsible employees and management of market participants;
- in-depth inspection of two individual market participants (one in a credit institution, one in an investment management joint stock company);
- participation in the single prudential supervision exercise of ESMA, providing consultations in investments and portfolio management services;
- evaluation of reports submitted by the market participants;
- assessment of the conformity of the offered investment products to the customer;
- handling complaints about investment service providers (2);
- conflict of interest management issues;
- compliance assessment of market participants' officials and shareholders.

In 2020, the FCMC continued to work with potential investment firms- investment platforms- to facilitate the adjustment of their activities to the requirements of the Financial Instrument Market Law to take them under their supervision, thus ensuring investor protection.

Sanctions and corrective measures in the field of providing investment services were not applied in 2020, at the same time the FCMC controlled the elimination of shortcomings identified in the inspections of market participants. In 2020, administrative proceedings were initiated against one investment firm for violations in the field of provision of investment services identified in the inspection performed in 2019. In 2020, the decision in the administrative case had not been made yet.

2.2.6. Supervision of the financial instruments market



Supervision of the points of sale of financial instruments and the Central Securities Depository

The focus of supervision of the regulated market operator AS "Nasdaq Riga" (stock exchange) and the multilateral trading system or alternative market First North Latvia in 2020 was:

- Ensuring adequate trading in financial instruments
- Disclosure of pre-trade and post-trade information
- Supervision of trading in financial instruments
- Information technology system operational adequacy, incident prevention
- Maintaining an effective internal control system
- Non-discriminating treatment of market participants

Figure 7. **Focus of FCMC supervision of AS "Nasdaq Riga" and First North Latvia in 2020**

The supervisory focus of the Central Securities Depository- Nasdaq CSD SE- in 2020 was:

- Annual compliance assessment in accordance with Article 22 of Regulation (EU) No. 909/2014
- Regular off-site monitoring activities
- Permission to Nasdaq CSD SE to provide basic central securities depository services in Iceland
- Cooperation within the supervisory colleges of Nasdaq CSD SE with the supervisory authorities of Lithuania, Estonia and Iceland, central banks and *Latvijas Banka*

Figure 8. **The focus of the supervision of FCMC of the Nasdaq CSD SE in 2020**

In 2020, no sanctions and remedies were imposed on financial instrument trading venues, nor the central securities depository.

Supervision of issuers

The focus of the supervision of issuers in 2020 was:

- timely disclosure of regulated information;
- four in-depth reviews of annual reports and eight interim report reviews;
- identification of alternative performance indicators;
- disclosure of the corporate governance statement and the non-financial statement;
- approval of remuneration policy;
- handling of complaints against issuers (12);
- webinars and explanatory letters regarding the application of regulatory enactments;
- meetings with issuers' management, audit committee and auditors.

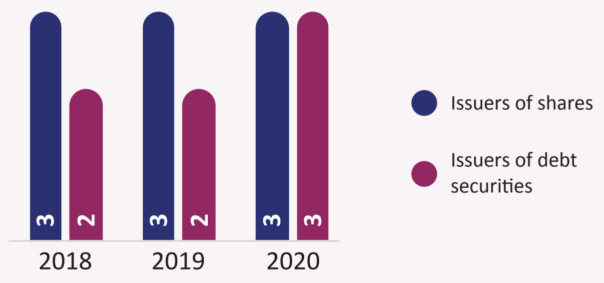


Figure 10. **Number of issuers in First North Latvia**

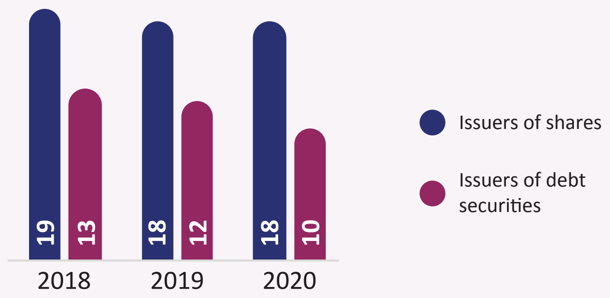


Figure 9. **Number of issuers in the regulated market**

Sanctions and corrective measures

In 2020, two administrative proceedings were initiated against the issuers for the non-timely disclosure of the audited annual report, interim report and financial information for a certain period. In one of the administrative cases initiated in 2020, the FCMC imposed a fine of 10 thousand euros on the issuer and also a fine of 500 euros to the member of the board of the issuer as a natural person responsible for the violation. In one of the administrative cases initiated in 2020, the decision was not yet made in 2020, but the FCMC adopted decisions in two administrative cases initiated in 2019. In one case, the FCMC imposed a fine of 10 thousand euros on the issuer, in the second case a sanction was applied - to provide information in a public statement about the issuer's violation and its nature.

No violations or significant deficiencies were identified in the audits of issuers' annual and interim reports. In five cases, clarifications were requested or it was indicated that certain shortcomings in future reports needed to be addressed.

Supervision of trading of financial instruments and investors’ activities

In 2020, the focus of supervision of trading in financial instruments and investors’ activities was on:

- providing day-to-day trading of financial instruments;
- examination of reports of suspicious transactions and orders submitted by the market participants (14);
- six in-depth inspections of suspicious transactions (market manipulation, use of inside information);
- cooperation and exchange of information with supervisory authorities of other countries;
- evaluation of concerted action of investors;
- making share repurchase offers;
- timely and correct submission of investor reports;
- handling of complaints about investors (3).

In 2020, the FCMC initiated two administrative proceedings for a failure to make a mandatory share repurchase offer. In one of the administrative cases regarding the concerted actions of several shareholders and the obligation to make a mandatory share repurchase offer, the FCMC entered into an administrative agreement with the persons, imposing a fine in the amount of 20 thousand euros and ensuring that the persons comply with the legal requirement regarding the mandatory share repurchase offer. In 2020, the decision in the second administrative case had not been made yet.

There were no administrative sanctions imposed for market manipulation or insider trading in 2020. In three cases, the FCMC sent letters of reprimand to investors, indicating that there were signs of market manipulation in their transactions. It called for an immediate end to practices that could mislead other investors about share prices, demand and supply.

For one of the inspections started in 2019 on the possible use of inside information in transactions with shares, in 2020 the FCMC sent materials to the State Police for the initiation of criminal proceedings.

A letter of reprimand was sent to one person in relation to non-compliance with the deadline for the manager’s notification under Regulation No. 596/2014 and to one person - a letter of reprimand in relation to non-compliance with the deadline for notification of the acquisition of a qualifying holding.

2.3. MLTPF risk supervision

The FCMC carried out **13 inspections** in the field of AML/CTPF

A fine of 1.7 million euros was imposed on **3 banks** for violations in the field of AML/CTPF, as well as legal obligations were determined aimed at eliminating the identified deficiencies and improving the internal control systems of banks

In the field of anti-money laundering and counter-terrorism and proliferation financing (AML/CTPF), the decision of the Financial Action Task Force (FATF) not to subject Latvia to enhanced supervision (not to include it on the "grey list") is the most important event in 2020, as well as the follow-up report of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval), which welcomes the improvement of Latvian legislation and compliance with the requirements of international law (40 FATF recommendations), thus confirming the effectiveness and irreversibility of reforms carried out by Latvia in the field of AML/CTPF.

In 2020, the FCMC paid special attention to strengthening the risk-based approach, both in applying the requirements of regulatory enactments to financial institutions and in planning and performing supervisory activities by the FCMC as the supervisory authority. The dialogue between the FCMC and market participants was significantly strengthened, both by organising training seminars and discussions, and by providing explanations and developing a manual for the application of AML/CTPF requirements in cooperation with the Finance Latvia Association.

Risk level	Risk management
The flow of funds from high-risk countries has decreased	Significantly improved regulatory enactments in the field of AML
The level of risk has decreased for the most important segments - credit institutions and payment institutions	Strengthened risk management tools and resources

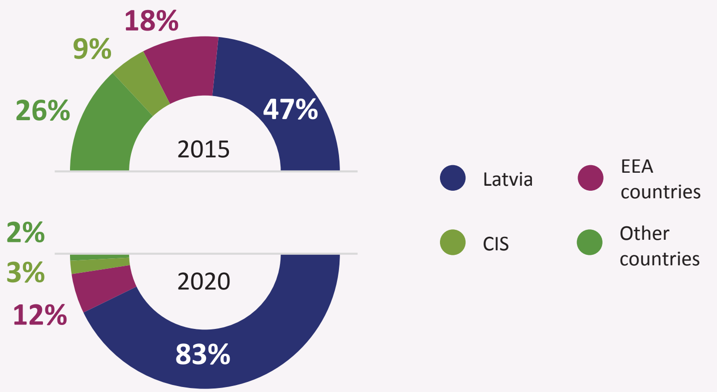


Figure 11. **Changes in the geographical structure of deposits of Latvian banks**

Risk assessment based supervision

The FCMC has improved the supervisory process of banks and financial institutions with the aim of ensuring the implementation of a risk-based approach in carrying out supervisory measures. Unlike the previous inspection approach, which was more based on the assessment of customer files, the new inspection approach provides for a comprehensive assessment of the adequacy and effectiveness of the bank's internal control system, based on an assessment of 10 key elements of the internal control system:

1. compliance of the MLTPF risk assessment performed by the bank with the risks inherent in the bank's operations and customer base, as well as the assessment of the MLTPF risk assessment methodology;
2. assessment of the MLTPF risk management strategy, its indicators and compliance with them, as well as the assessment of the management culture (tone from the top);
3. assessment of the structure, rights of employees, duties and responsibilities, adequacy and quality of qualifications and training, and the independence of the internal control system in the field of AML/CTPF;
4. assessment of the customer due diligence and transaction monitoring process;
5. assessment of the process for identifying and reporting suspicious transactions to the Financial Intelligence Service;
6. assessment of the adequacy and sufficiency of the information technology systems used for MLTPF risk management;
7. efficiency assessment of the internal audit activities in the AML/CTPF area;
8. evaluation of the cooperation with agents and services provided by third parties;
9. assessment of the whistleblowing process;
10. assessment of the compliance and sufficiency of internal regulatory enactments.

The new approach also provides for paying more attention to the planning process of initial inspection, so that the focus and priorities of inspections are set taking the main risks inherent to the bank into account.

Inspections and their results

In 2020, the FCMC conducted 13 inspections in banks in the field of AML/CTPF and concluded that, in general, the banks have taken significant measures to improve their internal control systems. In previous years, most of the inspections ended with the initiation of administrative cases and the imposition of fines, while in 2020 the FCMC only had to decide on the initiation of administrative proceedings or the application of sanctions in certain cases.

Taking into account the fact that banks are increasingly using customer remote identification, during inspections of banks in 2020 the FCMC verified how the requirements of the Cabinet of Ministers regulations on remote identification were ensured, and also found the best practices and identified shortcomings in the application of remote identification. The FCMC would use the information provided by the banks in developing recommendations for banks on the remote identification of customers.

In addition, banks and financial institutions regularly submit the procedures drafted for the development of a new product or service to the FCMC. After evaluating these procedures, the FCMC provides its recommendations for the elimination of shortcomings to ensure the most effective development and implementation of internal control systems.

In 2020, the FCMC imposed the fine of 1.7 million euros on 3 banks for violations in the field of AML/CTPF, as well as determined legal obligations aimed at eliminating the identified deficiencies and improving the internal control systems of the banks.

Strengthening the dialogue with market participants

In 2020, the FCMC, in cooperation with the financial sector, developed recommendations that serve as a practical guide for financial institutions in conducting customer due diligence and improving internal control systems. The aim of the recommendations is a common understanding by banks, financial institutions and supervisors of the application of legislation in relation to the prevention of financial crime, as well as the introduction of a risk-based approach.

The recommendations have been developed for the establishment of internal control system and customer due diligence for AML/CTPF and sanctions risk management. The recommendations explain and provide examples in the fields such as risk assessment, improvement of the internal control system and customer due diligence.

The dialogue on the development of recommendations, which has been successfully launched, will continue, with the handbook being constantly updated and supplemented. This is a way for the FCMC to provide the financial sector with comprehensive feedback on the findings of the inspections, as well as an opportunity for the FCMC and financial institutions to engage in a regular dialogue about using the risk-based approach in practice. Thus, resources will be devoted to achieving the main goal- the common fight against the use of services for MLTPF purposes.

The recommendations are available on the FCMC website (see https://www.fktk.lv/tiesibu-akti/vispareja/fktk-ieteikumi-un-vadlinijas/ieteikumi-noziedzigi-iegutu-lidzeklu-legalizacijas-un-terorisma-un-proliferacijas-finansesanas-noversanas-un-sankciju-riska-parvaldisanas-ieksejas-kontroles-sistemas-izveidei-un-klientu-izpetei/) and they are intended for employees of financial sector institutions, who work with the internal control system, customer due diligence and AML/CTPF issues.

2.4. Changes in the regulatory framework and application of macroprudential instruments

The Board of the FCMC re-approved the regulatory enactments in response to the Constitutional Court Judgment in the case 2019-09-03. 115 regulatory enactments were revised, of which:

70

were re-approved without amendments

44

were adopted with amendments, including recasting and merging several regulatory provisions into one regulatory enactment

1

regulatory enactment was declared expired

The FCMC made changes within the framework of regulatory requirements, mainly in relation to the legal acts issued by the EU institutions to ensure a harmonised framework in the EU single financial market.

Changes to regulatory requirements

In 2020, the FCMC continued to improve the legal framework governing the activities of the participants of the financial and capital market. The changes within the framework of regulatory requirements were mainly based on the legal acts issued by the EU institutions in order to ensure a harmonised framework in the EU single financial market.

In 2019, when assessing the legitimacy of the issuance of FCMC regulatory enactments, the Constitutional Court concluded that the FCMC had not obtained adequate legitimacy in the democratic process (because not all members of the Board of the FCMC were appointed by the Saeima) to approve the regulatory enactments. The Constitutional Court recognises such norms as issued ultra vires (outside the powers). In 2020, in accordance with the principle of good legislation and to further avoid disputes over the applicable regulatory enactments, save the resources of FCMC and State and prevent the impact on the reputation of FCMC, the historically issued and existing FCMC regulatory enactments were reissued.

Implementation of the requirements of the Capital Requirements Directive (CRD V[2]) and the Capital Requirements Regulation (CRR II[3]) in the regulatory enactments of the Republic of Latvia

On 20 May 2019, the updated Banking Package was published, which includes amendments to the Capital Requirements Directive and the Capital Requirements Regulation. CRR II is directly applicable, while in order to ensure the implementation of CRD V requirements in the Republic of Latvia, the FCMC developed amendments to the Credit Institution Law and the Financial Instruments Market Law, which were approved by the Saeima in April 2021. Certain requirements of CRD V will be implemented in the FCMC's regulatory enactments and other regulatory enactments. Among the most significant regulatory changes are:

- setting a leverage ratio of 3% to maintain financial stability, as the leverage ratio serves as a support mechanism for risk-based capital requirements and limits the formation of excessive leverage during economic upturns;

[2] Directive (EU) 2019/878 of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers, as well as capital conservation measures.

[3] Regulation (EU) 2019/876 of the European Parliament and of the Council 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. 648/2012.

• the introduction of a net stable funding ratio of 100% to ensure stable funding of credit institutions' balance sheets in the medium term;

• changes to the conditions for calculating large exposure limits, which provide for the application of higher quality capital to set limits on large exposures, i.e. Tier 1 capital in order to improve the ability of institutions to absorb losses;

• changes to the regulation of interest rate risk in the non-trading book and credit difference risk in the non-trading book in order to harmonise the approach and to develop a standardised methodology for assessing such risks and for the competent authorities to better identify those institutions that could incur excessive losses in non-trading book operations due to possible changes in interest rates;

• easing of capital requirements for lending to small and medium-sized enterprises (SMEs) and infrastructure projects in order to ensure optimal bank financing for SMEs, encourage investments in infrastructure projects and reduce risks for investors;

• in the field of AML/CTPF: improvements in the conditions for interinstitutional cooperation and exchange of information;

• changes in the procedure for the application of macro-prudential instruments (see the section "Application of macro-prudential instruments");

• setting the recommended capital requirements (P2G) to ensure that the equity of the credit institution is sufficient to cover potential losses as indicated by the results of stress testing (by the credit institution and the FCMC);

• changes to the conditions for the supervision of credit institutions at the level of the consolidation group regarding the authorisation and supervision of financial holding companies and mixed financial holding companies to become parent credit institutions in order to ensure that such managing companies can be directly responsible for ensuring compliance with the consolidated prudential requirements;

• changes in the requirements of the remuneration policy (will be implemented in the FCMC regulatory enactments), including for credit institutions to consistently comply with the conditions of the gender-neutral remuneration policy.

New regulatory framework for investment firms

On 26 June 2021, a new regulatory framework for investment firms (IF) entered into force as required by Directive No. 2019/2034[4], Regulation No. 2019/2033[5], as well as other related EU regulatory enactments. To implement the requirements of the directive, in 2020 the FCMC actively participated in the development of the draft Law on Investment Firms. It also takes over other IF regulatory requirements, which are currently included in the Financial Instrument Market Law and remain in force within the new regulatory framework. The requirements of the directive included in the draft law establish a new framework for the prudential supervision of IF. Those IF that are not systemically important, given their size and interrelation with other participants in the financial sector, are subject to a special prudential regime that differs from that of banks. Whereas, systemically important IF should continue to be subject to the current prudential framework according to Regulation (EU) No. 575/2013 and Directive 2013/36/EU. In relation to the implementation of requirements of Directive No. 2019/2034 amendments were also developed to the Credit Institution Law, Financial Instrument Market Law, Law on Investment Management Companies, Law on Alternative Investment Funds and their Managers, Law on Financial Conglomerates and Law on the Recovery and Resolution of Credit Institutions and Investment Firms.

Regulatory implications of Covid-19

In relation to the spread of Covid-19, the FCMC, like other European supervision authorities, in a letter to banks supported the flexible application of existing regulations encouraging banks to apply sustainable and socially responsible solutions to customers, who lost income due to economic constraints and failed to make loan payments on time. In accordance with the guidelines developed by EBA, the Finance Latvia Association established moratoriums for individuals and legal entities, under which until 30 September 2020 the customers could apply to the bank and postpone principal payments for up to 12 months for mortgages and six months for other loans without additional commission, only paying interest during the moratorium. To enable supervisors to monitor the application of moratoriums in banks and other support measures for customers outside the framework of the moratorium, as well as the quality of newly issued loans with state guarantees under Covid-19 mitigation programmes, in the summer of 2020 in the EU, inclu-

[4] 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/EU.

[5] 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.

ding in Latvia, new monitoring reports were introduced for the reporting of such loans. It is planned that these reports will be cancelled after the pandemic decreases. Also, at the beginning of the Covid-19 pandemic, the FCMC called on banks and insurance companies to refrain from dividend payments and share repurchases aimed at rewarding shareholders, as well as to apply prudent and sustainable variable remuneration policy and practice. The FCMC called on the institutions under its direct supervision to observe caution regarding the assumption of new liabilities, thus maintaining a sufficient level of equity to absorb potential losses, as well as to continue to provide issuing loans. **Currently, the recommendations are valid until 30 September 2021, and so far, all institutions under the direct supervision of the FCMC have refrained from paying dividends.**

In addition, in response to the Covid-19 pandemic, EU Regulation No. 575/2013[6] was amended. These amendments are applicable from 27 June 2020, and the most significant of them for the Latvian market is related to the calculation of the amount to be included in Tier 1 capital due to the application of International Financial Reporting Standard 9 to take the impact of the Covid-19 pandemic into account in the calculation of own funds.

At the end of 2020, the FCMC emphasised to banks the need to assess the quality of actual assets and to make provisions for expected losses accordingly to provide both the society and the supervisory authority with a true picture of the situation in the bank and its capital adequacy.

Application of macroprudential instruments

Given the negative impact of the Covid-19 pandemic on economic development, no new, more stringent macro-prudential requirements were imposed on the financial sector in 2020. The amount of the countercyclical capital buffer was maintained at 0%, and taking into account the fact that no significant changes in the systemic importance indicators of credit institutions were observed, also for the four identified other systemically important institutions (O-SII)[7]: AS "*Swedbank*", AS "*SEB banka*", AS "*Citadele banka*" and AS "*Rietumu Banka*" the set capital reserve requirements for O-SII were maintained at the previous level (respectively 2%, 1.75%, 1.5% and 1.25% of the estimated total exposure values in accordance with EU Regulation No. 575/2013).

The introduction of certain requirements arising from the Capital Requirements Directive (CRD V) in the Credit Institution Law, which will ensure the more effective application of macroprudential instruments in the future, should be also noted:

- in order to avoid overlapping of micro-prudential and macro-prudential requirements, it will no longer be possible to set additional second-pillar capital requirements for macro-prudential purposes - instead certain macro-prudential requirements are supplemented (in particular systemic risk capital buffers) to provide additional flexibility in their application;
- further it will be possible to set the systemic risk buffer at a more granular level for certain types or sub-types of exposures (for example, for exposures with natural persons, provided with residential mortgages or for exposures abroad);
- a clearer distinction between the purposes of applying the systemic risk buffer and the buffers of other systemically important institutions;
- improvements have been made in the conditions for activating macro-prudential instruments and cross-border mutual recognition (for example, the decision on setting the countercyclical capital buffer rate will henceforth only have to be taken when the size of the rate is changed, and not quarterly as before);
- changes have been made to the conditions for calculating the capital reserve requirement for globally systemically important institutions (G-SII).

Amendments have also been made to the Credit Institution Law to also ensure the application of borrower-orientated instrument[8] requirements to the credit institutions registered in other EU Member States that are entitled to provide financial services in the Republic of Latvia (through a branch or without it). These amendments will reduce the potential for regulatory arbitrage and improve the effectiveness of borrower-driven instruments by enhancing the resilience of borrowers, who have received loans not only from domestic but also from credit institutions in other Member States during downturns, and they will also improve the stability of the financial and capital market.

[6] https://www.fktk.lv/mediju-telpa/nozares-temati/makroprudenciala-uzraudziba/pretcikliska-kapitala-rezerve/.

[7] https://www.fktk.lv/mediju-telpa/nozares-temati/makroprudenciala-uzraudziba/sistemiski-nozimigas-iestades/.

[8] https://www.fktk.lv/mediju-telpa/nozares-temati/makroprudenciala-uzraudziba/uz-aiznemejiem-verstie-instrumenti/.

The most current EU first level legislative proposals in the field of financial services

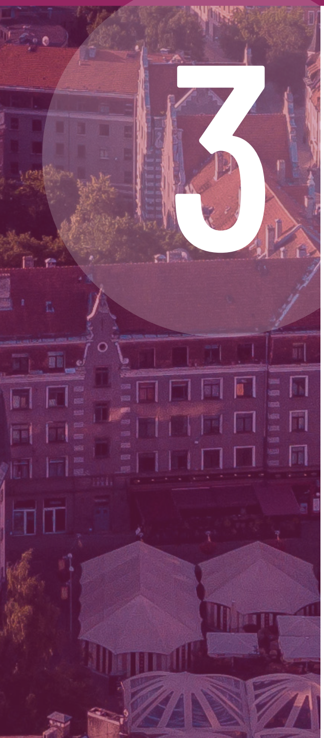
The FCMC actively followed the reform of the financial sector regulation. The most important are the amendments to Solvency II and the revision of the Directive on Alternative Investment Fund Managers, as well as the adoption of Regulation No. 2020/1503 on European crowdfunding service providers for business.

The European Insurance and Occupational Pensions Authority (EIOPA) completed work on a major package of **Solvency II review** document to the European Commission on 17 December 2020. The changes contained in the EIOPA's proposal affect all the relevant areas of insurance sector regulation, including the calculation of the solvency capital requirement, technical provisions, supervisory reports, disclosure of information, as well as the proportionality of the application of regulation. The Solvency II framework was complemented by new requirements regarding macro-prudential supervision, a single reorganisation and resolution regime for the EU insurers, and common EU requirements regarding the insurance guarantee schemes.

Continuing the work on the establishment of the capital markets union, **a review process of the Directive on Alternative Investment Fund Managers** was launched in 2020, within which the ESMA sent a letter to the European Commission on 19 August 2020 with proposals for regulatory improvements in various areas, including harmonisation of regulatory regimes for alternative investment fund managers and UCITS, delegation and content of management services, protection of investors' interests, introduction of liquidity management tools, calculation of leverage, reporting requirements.

On 22 October 2020, the European Commission prepared and published a consultation document on the revision of the Directive on Alternative Investment Fund Managers to obtain the widest possible stakeholder view on how to achieve the more effective regulation of alternative investment funds within the framework of the financial system. The public consultation phase ended on 21 January 2021, and the European Commission plans to prepare a proposal to amend the directive by the end of 2021.

Business environment favourable to innovative and secure financial services



The experts of the Innovation Hub provided support in 40 consultations for the financial companies

1 new applicant applied to the FCMC Regulatory Sandbox

From 1 November 2020, the Financial Innovation Department started work in the FCMC

In 2020, within the framework of FCMC reorganisation, increasingly important attention was paid to the development and support of financial technologies, which is one of the strategic directions of the FCMC's activities. Wider use of innovative technologies is one of the main tools to increase the efficiency and quality of the functions of the FCMC. At the same time, the FCMC thus develops its technological competencies for carrying out supervision, evaluating innovative market services and promoting development. The internal technological development of the FCMC also serves as a practical knowledge base for the development of these competencies.

To strengthen the development of innovation because of structural reforms, the Financial Innovation Department started its work on 1 November 2020, aiming to promote and develop the innovation environment in the financial market, thus promoting the development of the FinTech sector, developing and implementing regulatory technology or RegTech solutions and carrying out the supervision of non-banks (PI, EMI).

With a view to support and develop the FinTech sector, the FCMC's goal in cooperation with other state institutions is to create a FinTech friendly environment that would promote innovative financial services in Latvia. Support tools have been developed to achieve this goal: Innovation Hub and Regulatory Sandbox. In 2020, the experts of the Innovation centre provided support in 40 consultations for the financial companies. There was a strong interest in subjecting new services or business models to some regulation of the financial sector. There is a greater interest in the field of payments, with a particular emphasis on the requirements for the supervision of the regulated financial sector and the application and enforcement of these requirements in practice. The experts of the Innovation Hub evaluated and explained the potential problems of the ideas, which should be solved during the further development, as well as explained the requirements of the licensing issues. In addition, in 2020, one new applicant applied to the FCMC Regulatory Sandbox to perform RegTech tests on an AML/CTPF solution related to the analysis of customer AML/CTPF verification information, including account transaction information.

At the beginning of 2020, the FCMC conducted a survey of Latvian financial and capital market participants in order to identify the scope of innovative financial technologies used. 188 market participants were invited to participate in the survey, 26 of which indicated that they already use innovative solutions for the provision of financial services, and 19 of them have formed a special team for the implementation and development of innovative solutions. 11 respondents indicated that they plan to start using innovative financial services solutions in 2020.

Currently, there are two directions of innovations in the Latvian financial and capital market: one arises from the market regulation (Second Payment Services Directive, strict customer authentication, near-field communication (NFC), application programming interface (API)), while the other is based on the own initiative of financial and capital market participants (artificial intelligence, biometric data, big data, automated consulting, machine learning, etc.).

Analysing individual market segments, it is apparent that the largest share of market participants using FinTech solutions is in the credit institution segment. Almost all banks that participated in the survey have a team to develop or implement innovative financial technology solutions. Whereas the share of PI and EMI that use innovative financial solutions is small, despite the support provided by the state and the FCMC to this sector to promote innovation. **A survey conducted by the FCMC reveals that strong authentication solutions, application interface development with an aim to provide an open banking platform, biometric data and large data are the most frequently used innovations currently used by the Latvian financial and capital market participants.**

Development of professional and modern monitoring technologies

The year 2020 was significant not only for the fact that the FCMC completely switched to remote work mode, but also the implementation of the previous SupTech strategy was completed and the specific direction of SupTech for the supervisory authority was marked. The supervisory processes of the FCMC were also subject to challenges. Although on-site inspections were prohibited and supervision activities were carried out remotely in 2020, supervisors were able to ensure a continuous and high-quality monitoring process.

Within the framework of the previous SupTech strategy, several SupTech projects were implemented, which have become an important part of the FCMC's daily work, ensuring the efficiency of functions, as well as improving the quality of work. These include analytical solutions ro anti-money laundering monitoring, an audit documentation and management solution, and an internal collaboration platform for faster and more convenient information flow.

In 2020, work was completed on the development of a new data reporting system that complements functionality and improves the user experience. This system is an essential component of a common supervision data acquisition and processing solution. Supervisory data is critical for the performance of supervisory functions not only in the FCMC, but also in the EU centralised supervisory institutions to which the FCMC provides information. The FCMC not only ensures the receipt and processing of this data, but also provides a flexible opportunity for the market participants to use a more convenient and profitable way of preparing data. This is provided by a dual technical solution that allows data to be sent in both machine-readable data format XBRL and to prepare the same data in XLSX format, which the market participant can prepare manually or semi-manually, depending on its capabilities and preferences. This solution also has a newly introduced term, the meaning of which will become more and more relevant in the future - RegTech or regulatory technologies. Following these principles, new reports were also introduced in 2020.

To reduce the need for manpower resources, using RPA technologies (robotic processes), in 2020 automated data transfer processes were introduced, in which all automated quality checks have been performed on the data.

At the end of 2020, work was started on the development of a new SupTech medium-term (five-year) strategy, which will be one of the foundations for the development of the financial and capital market supervisory authority in Latvia, what services it will provide to the public and how competitive it will be at the regional level.

An effective financial sector crisis management and bank resolution mechanism

4

Resolution plans for all banks have been developed and are in line with the requirements: the cycle of developing resolution plans for the initial 12-month period has been completed for all 10 banks, and the existing resolution plan for 6 banks has been updated for the next 12 months

Strengthened readiness for potential crisis situations: an assessment of previous crises has been carried out and conclusions have been incorporated into internal documents and laws

The stress test programme has been completed and the conclusions have been taken into account

Payments to the Deposit Guarantee Fund and the Insured Protection Fund are fully secured. At the end of the year, the Deposit Guarantee Fund's account with the Bank of Latvia amounted to 121.5 million euros and total available funds, including available credit lines - 271.5 million euros

4.1. Changes to the resolution mechanism and protection systems

The Single Resolution Mechanism (SRM) 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, as well as implement the decisions adopted by the SRB. In 2020, three Latvian banks and one branch of the Member State-based bank with an 82.3% share in the total banking assets were subjected to direct SRB resolution:

	Share in total assets of banks, %	Share in bank loan portfolio in the domestic market, %	Share in bank deposits in the domestic market, %
Under the direct supervision of SRB	82.3	89.4	94.7
Under the direct supervision of FCMC	15.6	6.3	4.8
Other (branches under the jurisdiction of other national resolution authorities)	2.1	4.2	0.4

Table 1. **Subordination of banks to resolution authorities**

In order to ensure the efficient operation of the resolution function, the FCMC, as the resolution authority, annually evaluates the compliance of the resolution framework with the established requirements and best practices and identifies annual priorities. In the 2020 plan, the resolution priorities were:

- continuation of measures to ensure effective integration into the SRM;
- improvement of the resolution's internal regulatory environment in relation to the resolution planning process and the application of resolution tools in depth;
- implementation of the new requirements of Directive 2019/879 (BRRD II) and Regulation 2019/877 (SRMR II) at a national level.

Within the set priorities, in 2020 the FCMC fully participated in the projects and measures of the resolution planning cycle initiated by the SRB, as well as in working groups that developed guidelines for good practice of resolution and improved the resolution framework in accordance with work plans.

In 2020, all Latvian banks had developed resolution plans. 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, especially for the banks subject to resolution. The FCMC maintained an important role in the preparation of resolution plans for banks that are within the direct competence of the SRB. In 2020, the FCMC resolution experts continued taking an active part in the development process of the resolution plans for the Latvian banks and one branch of the Member State falling within the direct competence of the SRB. During the review of bank resolution plans, work continued on an in-depth assessment of the most appropriate resolution tools for each bank and the operational steps to implement them, working closely with banking professionals to ensure receipt of the necessary information for planning resolution, to identify obstacles to the resolution process and to take proactive measures.

Also, the FCMC continued the work on the development of resolution plans for other banks falling within the direct competence of the FCMC. In 2020, one resolution plan was developed anew. As a result, the initial 12-month resolution plan development cycle for all 10 banks was completed in 2020. For six banks, the FCMC experts updated the existing resolution plan for the next 12 months.

In 2020, developing resolution plans for the banks according to the SRB methodology, the minimum requirements for 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 the determination of the minimum requirements for own funds and eligible liabilities in line with the resolution plan strategy of the banks.

The FCMC as the resolution authority operates in a single system in a close cooperation with the SRB and resolution authorities of other Member States, so it is critical that the resolution processes and the application of the resolution tools are implemented within a regulatory framework coordinated at a maximum. To achieve this, in 2020 the FCMC continued to develop resolution policies and procedures, taking into account the EBA and SRB guidelines and best practices. In the reporting year, the FCMC resolution experts developed internal procedures:

- for the resolution planning process. The resolution planning procedure set out the actions to be taken in five stages of resolution planning:

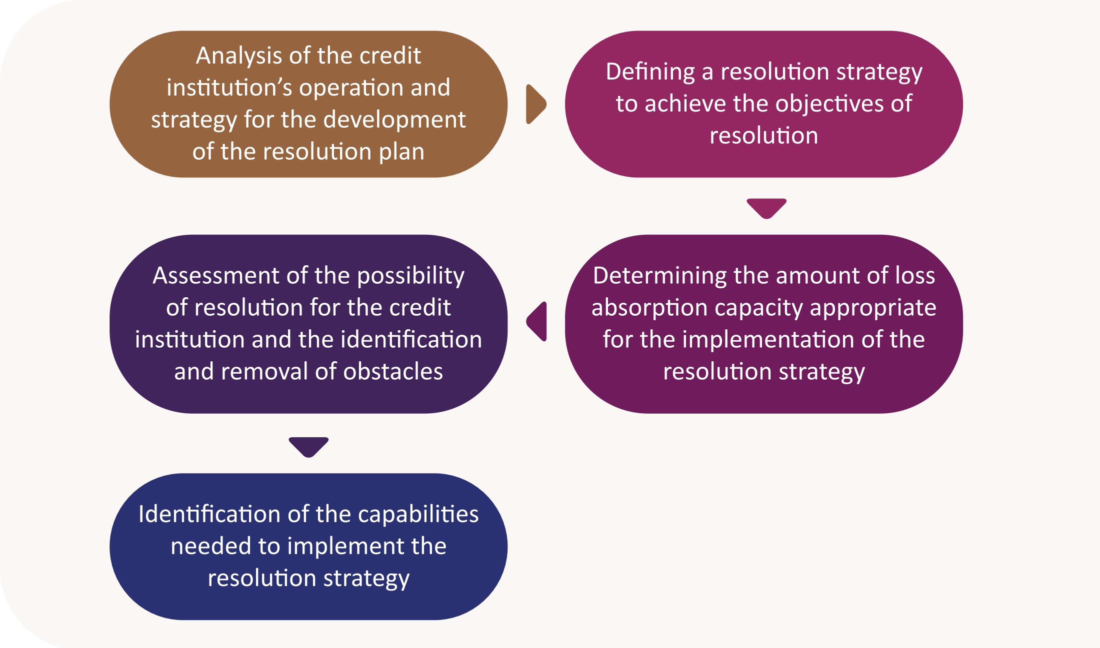


Figure 12. **Resolution planning process**

• for the application of resolution tools (sale of business and separation of assets). Consequently, in 2020, internal documents governing the application of all four resolution tools in the event of a resolution were developed, namely:

Establishment of a temporary institution

Carrying out recapitalisation

Sale of the company

Separation of assets

Figure 13. **Resolution tools**

In May of 2019, Directive 2019/879 or BRRD II was adopted, amending Directive 2014/59/EU or BRRD. Changes are directly related to the everyday resolution activities and are critical for strengthening the resolution framework. The deadline for the implementation of BRRD II was the end of 2020. Given the scale and complexity of the changes, the FCMC already started work on the implementation of BRRD II in 2019 and continued it throughout 2020. The intended amendments have been incorporated into the Law on the Recovery and Resolution of Credit Institutions and Investment Firms, the Credit Institution Law and the Financial Instruments Market Law.

The SRB, in close cooperation with the national resolution authorities (including the FCMC), is responsible for calculating the annual ex-ante contribution to the Single Resolution Fund (SRF), that is made by each institution in accordance with the provisions of the SRB Regulation and for managing and using the SRF funds. 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 funds of the SRF are formed from the contributions of the Member State banks (including Latvian banks), aimed at gradually achieving (by 2024) the amount comprising 1% of the covered deposits in all credit institutions in all involved Member States. **According to the calculations made by the SRB, in 2020 Latvian banks transferred 4.8 million euros to the SRF and since 2015, Latvian banks have contributed 38.7 million euros to the SRF.**

4.2. Improving 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, one of the priorities of FCMC in 2020 was enhancement of the crisis management process by means of an effective and coordinated crisis management mechanism.

In 2020, internal processes were revised and improved, which ensure the 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.

Taking into account the significant share of Nordic banks in the Latvian financial system, Latvia participates in the work of the Nordic-Baltic Cross-Border Stability Group. The Nordic-Baltic Cross-Border Stability Group consists of the ministries of finance, central banks, and supervisory and resolution authorities of eight Nordic and Baltic countries. Nordic and Baltic countries, within the scope of the group, have agreed to organise regular crisis simulation exercises.

4.3. Guarantee system

The structure of financial stability in Latvia is composed of:

- The Deposit Guarantee Fund (DGF);
- Fund for the Protection of the Insured (FPI);
- The protection system of the customers of the financial instruments market (investors).

Deposit Guarantee Fund

In 2020, the average applicable adjustment ratio applicable to the banks was 125.40%, but to savings and loan associations – 90.29%, meaning that the banks paid in 25.40% more than they would have had to pay of the amount of the covered deposits according to the base rate, while the savings and loan associations – on average, 9.71% less. Deposit-takers paid 18.3 million euros into the DGF for 2020.

	Amount	Share, %
Total number of depositors with covered deposits	**2,017,002**	**100**
including residents	1,898,742	94.1
including non-residents	118,260	5.9
Balance of covered deposits, in thousand EUR	**9,346,724.40**	**100**
including residents	7,713,170.20	82.5
including non-residents	1,633,554.20	17.5

Table 2. **Deposits of Latvian deposit takers as at 31 December 2020**

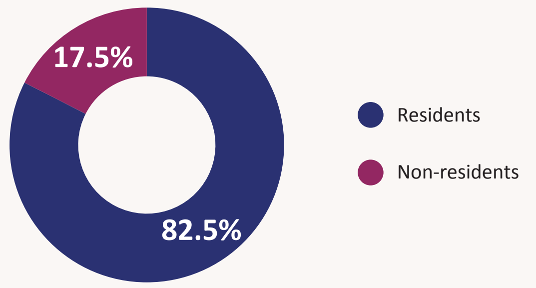


Figure 14. **The share of the total covered deposit balance amount of Latvian deposit takers (of Latvian credit institutions, excluding credit institution branches in Latvia, and savings and loan associations) as of 31 December 2020.**

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

In 2020, GC was paid:

- in the amount of EUR 82 thousand to the depositors of *Latvijas Krājbanka* AS in liquidation;
- in the amount of EUR 4,596 thousand to the depositors of *ABLV Bank* AS in liquidation;
- in the amount of EUR 11,274 thousand to the depositors of *PNB Banka* AS in liquidation.

	Latvijas Krājbanka AS in liquidation			*ABLV Bank* AS in liquidation			*PNB Banka* AS in liquidation		
	number of depositors	amount, EUR thousand	amount share, %	number of depositors	amount, EUR thousand	amount share, %	number of depositors	amount, EUR thousand	amount share, %
Rights to GC	287	795.6	100	22,199	477,849.5	100	60,030	270,409.2	100
Disbursed GC	15	84.6	10.6	14,091	449,302.8	94.0	45,383	259,253.5	95.9
Unpaid GC	272	711.1	89.4	8,108	28,546.7	6.0	14,647	11,156	4.1

Table 3. **Ensuring the disbursement of GC payable to the depositors by 31 December 2020.**

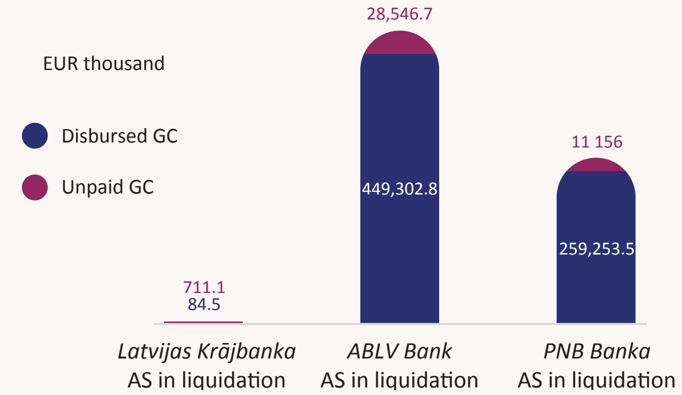


Figure 15. **The number of depositors of *Latvijas Krājbanka* AS in liquidation and *ABLV Bank* AS in liquidation and AS *PNB Banka* in liquidation entitled to GC, broken down by: disbursed and unpaid GC as at 31 December 2020.**

In 2020, 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 DGF account with the Bank of Latvia was EUR 121.5 million and total available funds, including available credit lines - 271.5 million euros.

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 2020 and the independent auditor's report thereon are available on the FCMC website at:https://www.fktk.lv/par-mums/gada-parskati/.

Disbursements of guaranteed compensation to the depositors of AS *Trasta Komercbanka*

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

- the provision of Section 25 of the Deposit Guarantee Law that the GC 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 GC in full.

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

	AS "*Trasta Komercbanka*"		
	number of depositors	amount, EUR thousand	amount share, %
Rights to GC	9,993	58,798.0	100.0
Disbursed GC	3,011	58,714.5	99.9
Unpaid GC	6,982	83.5	0.1

Table 4. **Ensuring the disbursement of GC to the depositors of AS *Trasta Komercbanka*, as at 31 December 2020.**

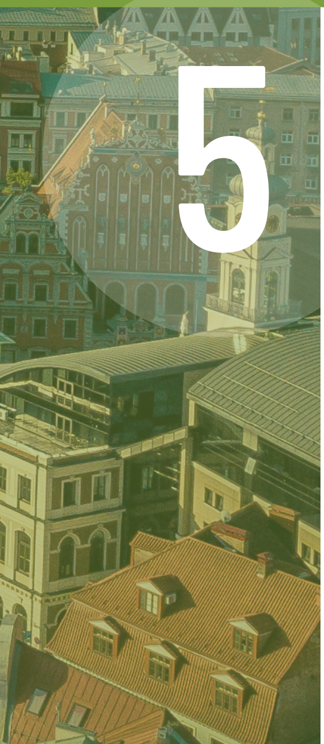
Payment of guaranteed compensation to the depositors of LABA Savings and Loan Association

On 14 July 2020, the FCMC revoked the licence issued to LABA Cooperative Savings and Loan Association (LABA) on 20 October 2005 to operate a savings and loan association, and as of 14 July 2020, deposits were no longer available to LABA depositors. The FCMC, applying the regulation specified in the Deposit Guarantee Law, made a decision to make GC payments starting from 23 July 2020 to *LABA* depositors from DGF funds through the FCMC. According to *LABA* accounting data, 58 depositors are entitled to 169.6 thousand euros. At the end of 2020, GC was paid to two depositors in a total of 140.8 thousand euros.

Fund for 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 12.3 thousand euros for the disbursement of GC. As at 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 2020, 19.4 million euros was accumulated in the FPI.**

Professional and responsible organisation with effective corporate governance and processes



5

Great organisational changes were made: the FCMC's organisational structure was changed and the institution's governance and processes were improved.

6 committees were established as collegial and coordinating permanently functioning institutions.

There were 55 meetings of the FCMC Board, 257 decisions were made, and 23 meetings of the Financial and Capital Market Consultative Council were held.

The FCMC was represented in six EU supervisory and resolution institutions, and also participated in other organisations and international forums. The FCMC provides representation and opinions on the financial sector regulation, supervision, resolution and protection system, as well as on AML/CTPF issues in cooperation organisations and institutions.

Actual total budget execution expenditure was 10 783 thousand euros, or 9.5% less than planned.

The internal auditor performed audits on the supervisory data processing process, the bonus allocation process, the job evaluation process and the salary determination process. 19 recommendations were made.

3 whistleblower submissions were received, which in the opinion of the submitters were about possible or actual violations in the financial and capital market sector; in addition, 7 whistle-blowing reports were received in accordance with the requirements of the FCMC regulations.

25 employees were made redundant and 19 employees were recruited. Average number of employees was 173.

5.1. Objective, timely and clear communication

Objective, timely and clear communication in the form of dialogue is one of the priorities of the FCMC strategy for 2019–2023. In 2020, the FCMC ensured public access to the wide array of information on the website, and ensured operative information flows on topical issues through the media; as well as implemented several activities related to promoting financial literacy. A lot of attention in the communication was paid to the analysis of the impact of Covid-19 on the Latvian financial sector, work of the FCMC in the field of AML/CTPF, as well as the promotion of a common understanding of AML/CTPF regulatory requirements, their application in practice and strengthening the risk assessment approach.

External communication

In 2020, the volume of FCMC publication decreased compared to the previous year. This can be explained by the fact that Covid-19 issues were on the media agenda.

The range of topics of the publications was wide, and in the first half of the year more attention was paid to the implementation of international recommendations in the field of AML/CTPF. From the second quarter onwards, the impact of Covid-19 on the financial sector was assessed in the publications. The topics of the publications also included the analysis of financial sector performance indicators, the planned merger of the FCMC with the Bank of Latvia, the development of a manual for the establishment of an effective internal control system of financial institutions and customer due diligence , as well as the activities of financial fraudsters.

With the spread of Covid-19, the FCMC carried out its functions remotely, providing full information in the e-environment. In 2020, the FCMC website was visited by an average of 11–12 thousand users per month. The FCMC also continued to communicate on social media, maintaining a dialogue with the public on the microblogging site “Twitter”. At the end of 2020, the FCMC account had 2,876 followers. The FCMC also expanded its range of communication channels. The FCMC site, created on the professional networking platform “LinkedIn” in 2020, has become an important channel for communication with financial industry professionals, reaching 2,540 followers during the year.

In the reporting year, comments and explanations were provided to the Latvian and foreign mass media representatives; and also regular interviews of FCMC management were organised in the Latvian media, thus ensuring a broad explanatory framework that gradually contributed to the change of understanding in the media environment regarding the FCMC, its work in managing changes in the financial sector, the impact of Covid-19 on the functioning of the financial sector, as well as the introduction of a risk-based approach.

Corporate communication

In 2020, a significant role in the external communication implemented by the Communications and Financial Literacy Division 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 and Financial Literacy Division was also involved in the activities of the financial sector strategic communication activities, 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 ensured with respect to the input of the FCMC into implementation of Moneyval and FATF recommendations in the Latvian financial sector, explaining the fields of competence of the FCMC, the accomplishments therein, and the changes pertaining thereto. In addition, in the field of corporate communication a lot of attention was paid to informing and explaining the requirements in the field of AML/CTPF, thus promoting a common understanding and balance in the implementation of the requirements of the risk-based approach.

In 2020, active strategic dialogue continued with the organisations and entrepreneurs of various sectors, as well as foreign organisations, to explain the achievements of the FCMC and to identify issues to be addressed in co-operation with 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.

Special attention was paid to the development of the capital market, within the strategic dialogue, listening to the views of capital market participants on their previous experience, development plans, regulatory framework and other aspects of the capital market, while inviting capital market participants to submit their proposals for strengthening and developing the Latvian capital market. In 2020, a survey of existing, former and potential issuers was conducted and a review of the Latvian capital market was prepared.

Financial Literacy

In 2020, the focus in the field of financial literacy was on the following tasks:

- to set up a working group to develop a financial literacy strategy for the next seven years;
- to evaluate the current situation in the field of financial literacy in Latvia;
- to evaluate in depth the financial literacy of the Latvian population in the field of investments;

• to monitor the impact of Covid-19 on the financial sustainability of the population, as well as the ability to identify financial fraudsters.

In June 2020, a working group for the development and implementation of the Financial Literacy Strategy 2021–2027 was established under the leadership of the FCMC, whose priority was to evaluate what has been done so far, as well as the overall situation in the field of financial literacy in Latvia and to develop a strategy for the next seven years. The Financial Literacy working group has been working for many years, but in 2020 it was expanded to include representatives of the public, non-governmental and private sectors, as well as creating a group of experts that provides an opportunity to go into more specific issues.

By evaluating the current situation in the field of financial literacy, it was concluded that the Latvian Financial Literacy Strategy 2014–2020 had played a significant role in the development of the field, as well as participation in international organisations and establishment of a Financial Literacy working group. The Financial Literacy Index and the Household Financial Stability and Sustainability index, which provide an opportunity to assess changes in the population knowledge, attitudes and behaviour, were positively assessed. It was also concluded that research on the financial literacy of the Latvian population on various topics should be continued. The evaluation proposed linking the financial literacy strategy to other national planning documents, taking the knowledge of behavioural economics into account, and focusing not only on financial literacy but also on attitude and action.

At the end of 2020, the financial literacy of the Latvian population in relation to investments in the capital market was analysed. It was concluded that the level of financial literacy determines whether a person would decide to invest and what results would be achieved. Making investments is also influenced by the level and quality of education, financial literacy in the family, risk tolerance, age and cognitive ability in general. It was concluded that awareness of investment services is low; moreover, a survey on the financial literacy of the Latvian population in 2019 revealed that only 3% of respondents have sought expert advice on investment issues.

During Covid-19, the biggest challenges in terms of financial literacy were created because of the activities of financial fraudsters with the aim of defrauding inhabitants of finances and data. The FCMC regularly informed the public about the activities of fraudsters and unlicensed service providers both in the “Alerts” section of the FCMC website and on the social media “Facebook” and “Twitter”.

The FCMC also paid attention to the financial sustainability of the population during the crisis, which appeared to be generally satisfactory. During Covid-19, inhabitants have reduced their spending and become more cautious about borrowing. The data of the financial literacy survey of the Latvian population conducted at the end of 2019 show that the financial safety net (savings in the amount of at least three months’ income) was created by about a third of the Latvian population, and with this they were better prepared for the crisis situation. At the same time, it can be seen that during the crisis, the population invested more money than before, which shows that at least part of the Latvian population had sufficient free funds available. During 2020, compared to the previous year, the amount of household deposits in Latvian banks increased by 1 billion euros (+12%). During 2020, there was an increase in State-funded pension plans (+11%), private pension plans (+8%), investment funds (+4%), and a particularly large increase was observed in household investments in shares (+44%). At the same time, the amount of household investments in life insurance with savings decreased (-9%).[9]

As a result of the process of restructuring the FCMC structure that took place in 2020, as of 1 November 2020, the FCMC has established a Communications and Financial Literacy Division consisting of three experts.

5.2. Change of corporate culture and structure, establishment of committees

In 2020, the FCMC carried out great organisational changes, as a result of which the organisational structure of the FCMC was changed and the institution’s governance and processes were improved.

The changes were made with an aim to:

- define clear areas of responsibility, balanced development of segments;
- optimise processes, review functions, save costs;
- to promote proactivity, cooperation, performance improvement;
- to promote faster decision-making, better quality flow of information;
- to develop future knowledge and skills;
- to change the focus from hierarchy and strict control to the person, trust and personal responsibility, from reactive to proactive action.

[9] Statistical data compiled by the FCMC and the Bank of Latvia.

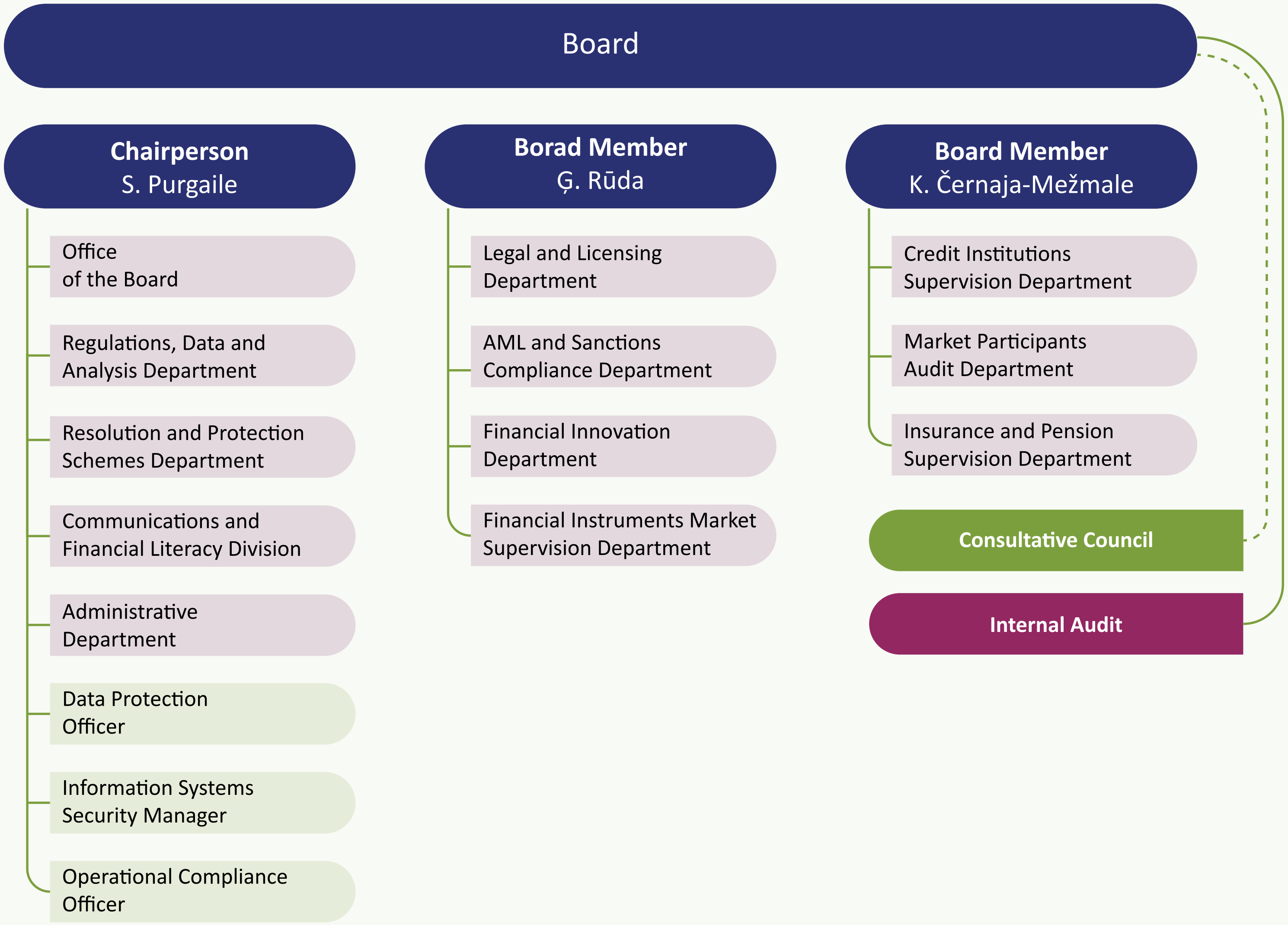


Figure 16. **Structure of the FCMC, valid from 01.11.2020**

In 2020, nine structural units were closed, optimising and reallocating resources to the new structural units. With the definition of the new organisational structure, each member of the Board has a defined area of responsibility, equal attention is paid to all market segments and fragmentation or the number of small structural units is reduced.

In 2020, as a result of structural changes in the horizontal cooperation mechanisms with an aim to ensure proper governance and accountability, six committees were established - collegial and coordinating independently functioning institutions. The mandate of the committees is determined by the Board and approved in the regulations of the committees.

The main benefits from setting up committees are:

- improved decision-making process;
- facilitated horizontal cooperation;
- in-depth expertise and discussion forum;
- increased quality of draft decisions.

Management Committee

The Management Committee unites the directors of all FCMC departments, and its purpose is to ensure the administrative and operational management of the FCMC's work.

Supervisory Committee

The Supervisory Committee promotes the achievement of the FCMC's objectives in the field of supervision of financial and capital market participants, providing a comprehensive view of the framework for the supervision of financial and capital market participants and promoting the use of a common approach to the implementation of the supervisory process in all sectors, including AML/CTPF and sanctions, as well as consideration of issues within the competence of the Committee in the FCMC Board.

Licensing and Sanctions Committee

The purpose of the Licensing and Sanctions Committee is to ensure an independent, uniform and effective approach to licensing and sanctioning from those exercising the supervision function.

Regulation Committee

The purpose of the Regulatory Committee is to promote achieving the FCMC's objectives in the field of regulation development and improvement, as well as the consideration of issues within the competence of the Committee by the Board of the FCMC.

Financial Innovation Committee

The purpose of the Financial Innovation Committee is to ensure the creation of an innovation culture in the FCMC by implementing innovative business processes and supporting technologies, to promote effective information exchange and decision-making in the field of financial innovations at the FCMC, as well as to ensure the development of SupTech supporting supervisory processes, based on a common understanding of financial technologies and their risk management in the FCMC.

Crisis Management Committee

The purpose of the Crisis Management Committee is to ensure the management and functioning of the crisis resolution system of Latvian financial market participants, communication management and coordination of the parties involved in the crisis management process, as well as the facilitation of considering the issues within the competence of the committee by the Board of the FCMC.

All these committees commenced their work in 2020.

5.3. International cooperation

An important and comprehensive direction of the FCMC's activities is international relations, within which the FCMC maintains regular close contacts and actively cooperates with supervisory authorities of other countries (including in the field of AML/CTPF), resolution and protection system institutions (guarantee funds), as well as with European financial sector supervisors and resolution authorities.

In the field of international cooperation, the year 2020 was also a year under the influence of Covid-19. International co-operation became highly digital, as it was impossible to ensure the expansion and maintenance of a network of direct contacts or on-site negotiations, which had previously been an integral part of international co-operation.

As in previous years, at the international level, the activities of the FCMC focused on the cooperation and exchange of information with supervisory and resolution authorities of other countries, as well as participation in the Single Supervisory and Resolution Mechanism and in the work of European System of Financial Supervision (EBA, EIOPA, ESMA, European Systemic Risk Board (ESRB)). The FCMC also provided support to ministries and other state institutions, contributing to the representation of Latvia's interests and the preparation of opinions on issues relevant to the financial market- participating in working groups of the EU Council, the European Commission and the Organisation for Economic Co-operation and Development (OECD), as well as preparing information on financial sector regulation, supervision and resolution issues for various reports and reviews on Latvia, such as co-operation with the European Commission, OECD, International Monetary Fund (IMF), the European Bank for Reconstruction and Development, rating agencies and other formats.

During the reporting year, the FCMC continued co-operation, exchange of information and representation of Latvia's interests in the Nordic-Baltic Cooperation Forum, the European Forum of Deposit Insurers (EFDI), Moneyval, Group of Banking Supervisors from Central and Eastern Europe (BSCEE) and the International Organization of Securities Commissions (IOSCO).

Because of Covid-19, the specifics of current issues and planned work changed both in the work of European financial sector supervisors and on a global scale. During the year in the international forums a lot of attention was paid to work on support measures related to solving the problems caused by Covid-19, which was also a timely topic in the meetings of working groups and committees where the FCMC represented Latvia's interests. Also, in 2020, the withdrawal of the United Kingdom as a major financial market player from the EU remained relevant, working internationally to ensure the continuity of financial services and concluded customer service agreements and the conclusion of the necessary licensing processes for financial market participants by the end of the transition period, which was 31 December 2020. During the year, active work was also carried out on sustainability and green finance issues, as well as on draft EU legislation in the field of digital finance. The alignment of the EU regulatory and supervisory framework and the promotion of convergence between the EU Member States in the fields of AML/CTPF, credit institutions, financial instruments and capital markets, insurance and pensions sector, as well in the field of resolution also remained relevant.

Due to global events, the IMF's Latvian financial sector assessment programme launched in autumn 2019, which was planned to be concluded by mid-2020, has been suspended for an indefinite period of time, and due to travel restrictions and other more IMF-related projects related to support measures to address the Covid-19 crisis, work on the assessment of the supervision of the Latvian financial sector was suspended for an indefinite period of time.

In addition to participation in various EU and international institutions and organisations, the FCMC also provides international cooperation on the basis of concluded bilateral cooperation and information exchange agreements with supervisory, protection system (guarantee funds) and resolution authorities of other countries. Supervisor and resolution colleges have also played an important role in exchanging experience and information.

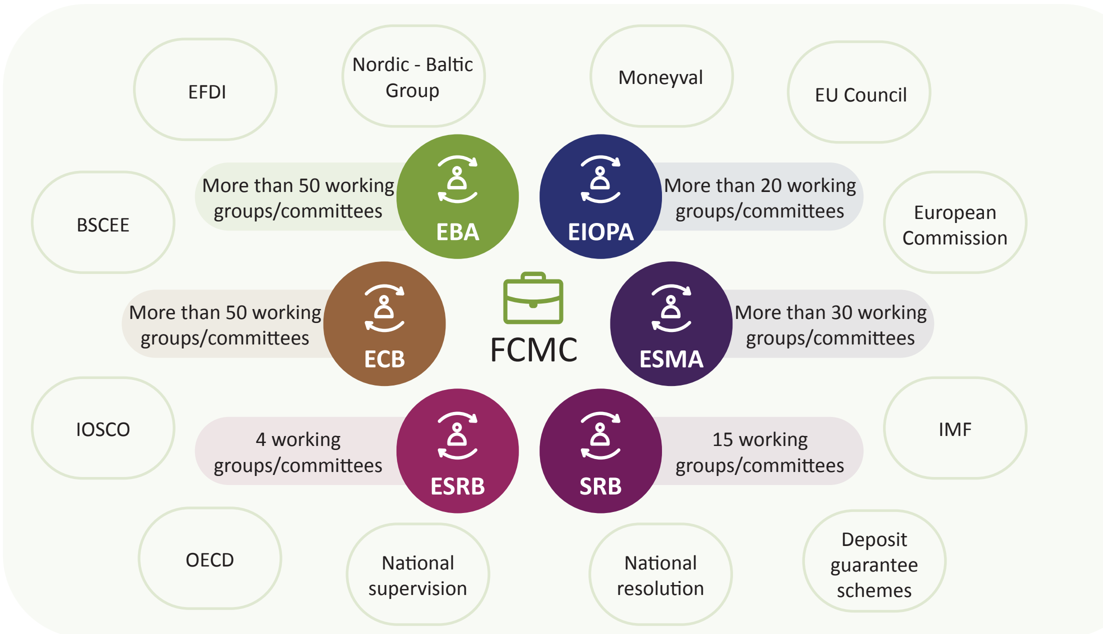


Figure 17. **Representation of the FCMC in working groups and committees of financial sector supervisory and resolution authorities**

5.4. Professional, responsible and development-orientated staff

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 relation to the internal reorganisation that took place within the FCMC in 2020, the restructuring resulted in the establishment of 10 departments, the Office of the Board and the Communications and Financial Literacy Division, as well as the appointment of four independent experts. Internal and external competition was announced for the selection of five new department directors.

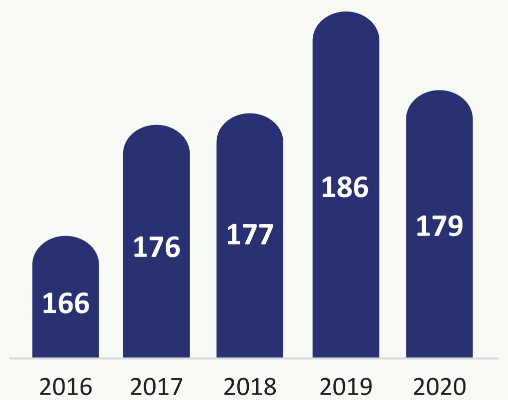


Figure 18. **Changes in the number of FCMC employees**

Staff turnover was 14% in 2020 (25 employees were released and 19 new were recruited). The average number of employees, including those on long-term leave, was 173 employees in 2020.

On 31 December 2020, the FCMC employed 179 employees:

- 148 (82%) were engaged in performing principal activities and 31 (18%) were engaged in performing support functions;
- 130 (73%) were civil servants and 49 (27%) were employees;
- all employees were engaged in performing intellectual work.

In 2020, 89% (161) of employees of the FCMC had been employed by the FCMC for more than one year, while 11% (18) of employees had been employed by the FCMC for less than a year. 21% (37) of employees had been employed by the FCMC for 19 years, i.e. as of the establishment of the FCMC (in 2001).

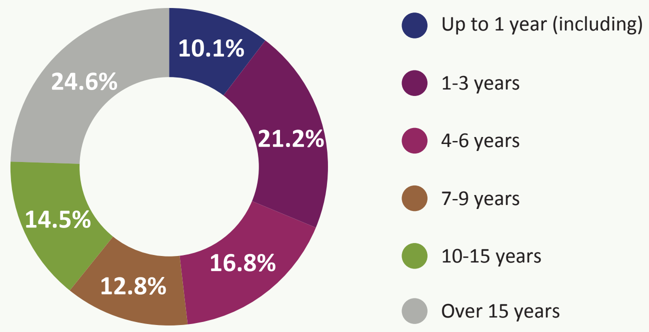


Figure 19. **Breakdown of staff by length of service at the FCMC**

In 2020, 72% (129) of all FCMC employees were women, whereas 28% (50) were men. The age structure of the staff in 2020 was characterised by the following indicators: up to 30 years- 12 employees; from 31 to 40 years- 70 employees; from 41 to 50 years- 63 employees; from 51 to 60 years- 27 employees; over 61 years- seven employees. In 2020, the average age of the FCMC staff was 43 years old.

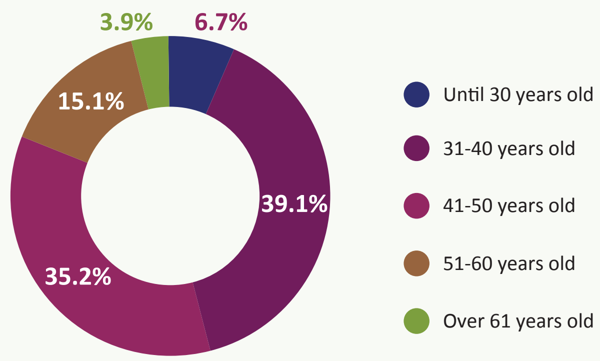


Figure 20. **Age structure of FCMC employees**

Improving staff qualifications

Given the situation of Covid-19, the FCMC staff training process had to be adapted to the new circumstances by offering staff remote training via online platforms. FCMC employees had to accept new challenges and be able to continue to enhance their professional knowledge on online platforms.

61% (109) of FCMC employees continued to develop their professional knowledge in the field of financial and capital market supervision (supervision and auditing of credit institutions, financial instruments market supervision, insurance and pension fund FinTech, SupTech and RegTech development, financial and capital market regulation), as well as personnel management and accounting related training, personal data protection and corruption and conflict of interest risk training.

15% (26) of FCMC employees (representatives of the Anti-Money Laundering and Sanctions Department) continued to improve their knowledge in the field of raising AML/CTPF efficiency, practical application of AML/CTPF requirements in the financial sector, organisation and performance of AML/CTPF inspections, prevention of proliferation financing, analysis of transport documentation, as well as other seminars and conferences in the AML/CTPF field. Several FCMC employees continued to improve their professional knowledge in the international professional certification programmes ACAMS and ICA.

The well-being of employees is important for the FCMC, so training was organised on topics such as emotional factors and their protection mechanisms in the work environment, improvement of communication and cooperation competence in high work intensity conditions, personal branding, as well as the opportunity to participate in a two-month wellness programme.

5.5. Risk management

Risk management in the FCMC is focused on the implementation of the mission of FCMC, sustainable development and achievement of the goals defined in the strategy, promoting improvements in work organisation, maintaining high efficiency and quality of work performance. The “Risk management policy” approved by the Board of FCMC sets out the objectives and basic principles of risk management.

In 2020 the FCMC:

- continued to focus on the ability to maintain the residual risks inherent to the processes at an acceptable level;
- continued the ongoing work on the implementation of a risk-based culture;
- paid special attention to the management of risks related to structural changes, the spread of Covid-19 infection, remote work and the work environment, ensuring the continuity of the FCMC’s operations.

The national emergency and restrictions imposed to limit the spread of Covid-19 infection, as well as changes in the FCMC’s work organisation by remotely organising work have not adversely affected the FCMC’s operations, and the FCMC has been able to ensure the full performance of its functions and tasks.

5.6. Received whistleblowers’ reports

A whistleblower may file a report to the FCMC on possible or actual violations in accordance with the requirements of the Whistleblowing Law and the FCMC’s Normative 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. The most important difference between these two regulatory enactments of different hierarchies is that a person, who provides information in accordance with the Whistleblowing Law, must present his or her application in such a way that it has legal force. In turn, the FCMC’s Regulations were issued on the basis of various norms of law governing the financial and capital market and provide for reporting violations of a particular type, therewith fulfilling the requirements of the EU regulatory framework, and also permit reporting in the form of an e-mail or even anonymously (i.e., there is no requirement to make the application mandatory in accordance with the conditions for the preparation of documents).

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

According to the requirements of the Whistleblowing Law, in 2020 the FCMC received three whistleblower submissions, which in the opinion of the submitters were about possible or actual violations in the financial and capital market sector. In two cases, the reports were forwarded to another institution according to their competence. While, in accordance with the requirements of the FCMC regulations, in 2020 the FCMC received seven whistleblowing reports. In four cases, the examination of the reports continues in 2021.

The majority (50% of cases) of the reports submitted provided information on possible breaches of the AML/CTPF. Compared to 2019, when a total of six reports were submitted, there had been an increase in reports in 2020 (10 reports). The FCMC observed that the interest in reporting violations was greater than the number of submitted reports, as individuals not only used the specially established reporting channel, but also general forms of communication such as the central FCMC e-mail, post and e-address in Latvija.lv.

5.7. Internal audit

The internal audits of FCMC are performed in accordance with the International Standards for the Professional Practice of Internal Auditing and the Code of Ethics of the Institute of Internal Auditors, as well as the internal regulatory enactments Internal Audit Policy and Internal Audit Procedure. The compliance of the internal audit operation with these standards is assessed every five years by a qualified external evaluator. The last assessment was completed in 2019, which resulted in an Overall Compliance evaluation, as well as 19 recommendations for improvement, of which 16 were implemented in 2020. The implementation of three recommendations will continue in 2021.

In 2020, the internal auditor performed audits on the supervisory data processing process (ECBS/SSM audit), the bonus allocation process, the job evaluation process and the salary determination process. As a result of the audits, 20 recommendations were provided, incl. one high-priority recommendation, five medium-priority recommendations and 14 low-priority recommendations. In 2020, audits were also launched in the area of licensing and provision of remote access (ESCB/SSM audit), as well as audits on the imposition of sanctions and corrective measures. The three audits mentioned above will continue in 2021. The internal auditor has established and maintains a system for monitoring the implementation of audit recommendations. In 2020, 23 audit recommendations or 57.5% of the number of recommendations provided in previous audits were implemented.

In 2021, the internal auditor provided the Board of the FCMC with an overview of the internal audit activities in 2020, including execution of the audit plan, an overview of the internal audit operation strategy for 2017–2019, as well as a general opinion on the FCMC's internal control system, incl. risk management systems, effectiveness and proposals for its improvement.

In accordance with the requirements of Article 27 of the Law on the Financial and Capital Market Commission, the FCMC financial statements are audited by an independent sworn auditor. The audit of the financial statements for 2020 was performed by SIA "Baltic Audit".

5.8. Financing of the activity of the FCMC

In 2020, the activity of the FCMC was fully financed from the payments by participants of the financial and capital market. During the reporting year, within the scope of the budget for financing the FCMC activity, the FCMC also managed the DGF and the FPI, as well as administered the contribution of the financial stability fee (FSF) to the State budget and contributions to the SRF at the European level. The FCMC carried out the administration of the DGF and FPI, as well as the FSF and SRF within the approved budget. Means from these funds are not deducted for the purposes of their administration for the benefit of the FCMC.

	Actual performance in 2019, euros	Actual performance in 2020, euros	Budget for 2020, euros	Budget perfor-mance for 2020, %	Share of the actual perfor-mance in total in 2020, %
REVENUE (+)	**12,760,731**	**12,668,470**	**11,972,060**	**105.8**	**100**
PAYMENTS BY THE PARTICIPANTS OF THE FINANCIAL AND CAPITAL MARKET	12,745,565	12,655,862	11,952,060	105.9	100
REVENUE RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	9,851,465	9,631,053	9,112,450	105.7	76.0
Payments by credit institutions	9,593,886	9,372,332	8,888,000		
Payments by savings and loan associations	42,674	42,098	44,880		
Payments by payment institutions	129,944	155,720	118,400		
Payments by electronic money institutions	84,961	60,903	61,170		
REVENUE RELATED TO THE SUPERVISION OF THE FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	962,365	976,054	861,690	113.3	7.7
Payments by participants of the financial instruments market	628,348	630,745	542,090		
Payments by private pension funds	334,017	345,309	319,600		
REVENUE RELATED TO THE SUPERVISION OF INSURANCE	1,931,735	2,048,755	1 977,920	103.6	16.2
Payments by life insurance companies	356,941	530,110	353,580		
Payments by other insurance companies	1,519,573	1,464,238	1 564,340		
Payments by insurance brokers	55,221	54,407	60,000		
OTHER REVENUE	15,166	12,608	20,000	63.0	0.1

	Actual performance in 2019, euros	Actual performance in 2020, euros	Budget for 2020, euros	Budget perfor-mance for 2020, %	Share of the actual perfor-mance in total in 2020, %
EXPENSES (-)	**10,762,659**	**10,783,332**	**11,911,309**	**90.5**	**100**
Salary for work, other payments to employees, and national social insurance mandatory contributions	8,042,699	8,231,194	8,697,505	94.6	76
Employee insurance	37,168	37,362	39,698	94.1	0.3
Improving professional qualifications of the staff	141,838	67,830	210,686	32.2	0.6
Telecommunications, communications, and information	161,898	160,641	175,964	91.3	1.5
Information to the general public, internal and external communication	81,031	113,719	96,225	118.2	1.1
Maintenance and operational expenses	887,015	945,564	973,834	97.1	8.8
Services for the provision of supervision	138,158	145,611	251,970	57.8	1.4
International cooperation	1,083,434	796,791	1,245,427	64.0	7.4
Amortisation/depreciation of capital investments	207,285	233,124	220,000	106.0	2.2
Changes to the provisions for vacations	(24,308)	36,444	-		
Recovered expenses for previous periods	6,441	(22,791)	-		
Negative interest on account balance		31,329	-		
Accrued loss		6,514	-		
RESULT	**1,998,072**	**1,885,138**	**60,751**		

Table 5. **Financing of the activity of the FCMC, 2019-2020**

The actual financing of the FCMC for 2020 declined by 0.7%, as compared to 2019.

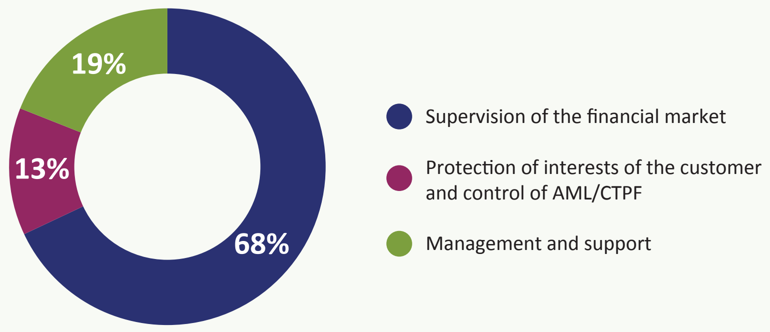


Figure 21. **Distribution of the FCMC work resources in 2020**

The financing of the FCMC was fully planned from the contributions by market participants. It was planned that 76.2% of all payments by market participants would be sourced from monetary financial institutions, 7.2% from financial instruments market participants together with private pension funds, but 16.6% of payments would be 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 105.7% of the planned, thus ensuring contributions into the FCMC budget in the amount of 76.1% of the total financing by market participants in 2020.

In 2020, the total expenditure incurred by the FCMC was 10,783 thousand euros, 9.5% lower than budgeted (EUR 11 911 thousand). **The execution of budget expenditures was influenced by several factors, the most significant of which were the structural changes made in 2020, including changes in the distribution of FCMC positions, as well as measures taken to strengthen the use of internal resources and the efficiency of processes**, including investments in information technology solutions. The spread of Covid-19 and the determination of restrictions reduced the total cost of business trips, training and the general administrative expenses.

In 2020, the largest costs of operational provision of the FCMC were comprised of the expenses on the remuneration of employees of the FCMC (76.3%).

Salaries and similar paymentsv	**6,642,041**
including bonuses	242,346
including supplements	61,334
including remuneration to the FCMC Board	326,867
National social insurance mandatory contributions	**1,589,153**
including the national social insurance mandatory contributions on the remuneration of the FCMC Board	78,742

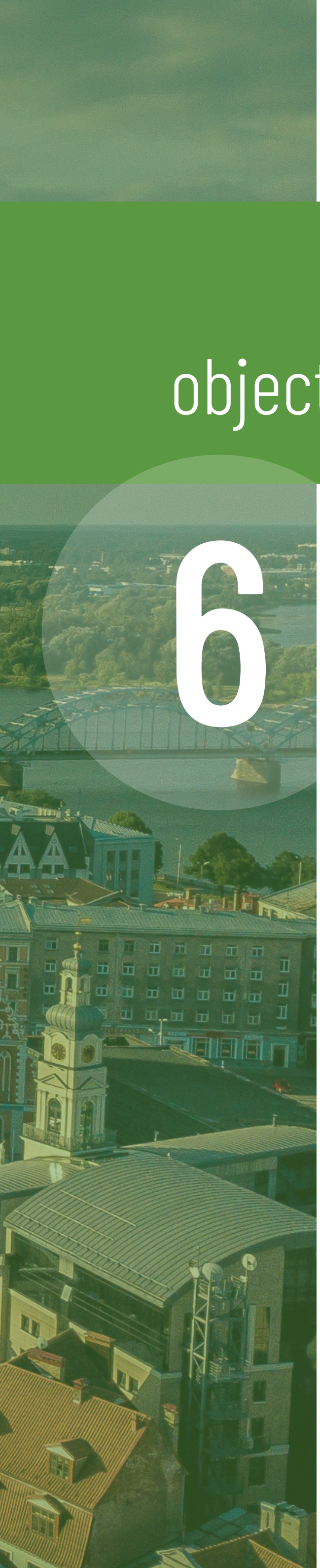
Table 6. **Breakdown of FCMC staff remuneration in 2020, in EUR**

In 2020, the FCMC represented Latvia in eight European and global level organisations supervising financial markets and supervision coordination organisations, the membership of which cost 5.82% more than in 2019.

	2019	2020	Changes in 2020/2019
Payments to the EU organisations	641,786	688,295	7%
Payments in international organisations	57,280	51,430	-10%
Total	**699,066**	**790,110**	**5.82%**

Table 7. **Membership fees paid by the FCMC to the EU and global organisations in 2019-2020, in EUR**

The approved financial statements of the FCMC for 2020, the financial statements of the DGF and FPI for 2020, as well as independent certified auditor’s reports on them are available on the FCMC website: https://www.fktk.lv/par-mums/gada-parskati/.



6 The main objectives for 2021

FKTK padome ir noteikusi šādus prioritāros darbības virzienus 2021. gadam:

- Focus on the development of all sectors
- Monitoring of Covid-19 situation
- Sustainable finance
- Strengthening a risk assessment-based approach to AML/CTPF
- Creating an inclusive, sustainable innovation environment
- Development of Latvian capital market
- Promotion of efficiency, activity, openness
- Promotion of corporate culture

Figure 22. **FCMC's priority directions of activity in 2021**

Taking the strategy of FCMC and priorities for 2021 into account, specific structural and individual goals were set, the main of which being:

In the field of sustainability:

• Active involvement in the development of financial sustainability regulatory framework.

• Communication with the financial sector about the expectations and priorities of supervisors.

In the field of financial innovations:

• Promoting the digital economy and developing the FinTech environment.

• Provision of innovation infrastructure (FinTech, RegTech, SupTech).

• Inviting payment institutions to apply for a licence in Latvia.

• Promoting the work of the Innovation Hub and the Regulatory Sandbox.

• Ensuring a fair and legal environment by bridging the gap between innovation and existing regulation (fields of investment, co-financing and cryptographic assets).

• Introduction of new technologies in the supervisory work.

In the field of AML/CTPF:

• Assurance of improvement of supervisory quality.

• Assurance of a common understanding between market participants on the application of requirements.

In the field of capital market:

• Implementation of a 10-step programme for the development of the Latvian capital market (the programme is integrated into the Financial Sector Development Plan).

• Discussion cycle for better corporate governance.

• Promoting closer co-operation between the Baltic States.

• Active strategic dialogue, inter-institutional cooperation.

• International cooperation and representation of interests in the European institutions.

In the field of promotion of efficiency, activity and openness:

• Implementation of values, introduction of Peero recognition technology.

• Improvement of work performance evaluation.

• Strengthening the management and team.

• Improvement of project management system.

• Promoting the responsibility of business owners.

• Unifying the supervisory approach.

• Improving proactivity, initiative and performance.

• Development and implementation of SupTech strategy.

• Implementation of internal communication strategy (I am an informed, educated, involved and motivated employee).

FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

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