



2021

annual and
activity report

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Abbreviations used in the annual report

FPI – Fund for the Protection of the Insured

BSCEE – Group of Banking Supervisors from Central and Eastern Europe

O-SII – other systemically important institution

DSTI – debt service-to-income ratio

DTI – annual debt-to-income ratio

EIOPA – European Insurance and Occupational Pensions Authority

EBA – European Banking Authority

ECB – European Central Bank

EEA – European Economic Area

EFDI – European Forum of Deposit Insurers

EC – European Commission

EMI – electronic money institution

EU – European Union

ESAP – European Single Access Point

ESRB – European Systemic Risk Board

ESMA – European Securities and Markets Authority

FCMC – Financial and Capital Market Commission

GC – guaranteed compensation

GDP – gross domestic product

NPL – non-performing loan

IOSCO – International Organisation of Securities Commissions

LTV – loan-to-value ratio

CCU – cooperative credit union (cooperative savings and loan association)

CMU – Capital Markets Union

PI – payment institution

DGF – Deposit Guarantee Fund

MLTPF – money laundering and terrorism and proliferation financing

AML/CTPF – anti-money laundering and combatting terrorist and proliferation financing

NRF – National Resolution Fund

CIS – Commonwealth of Independent States

OECD – Organisation for Economic Cooperation and Development

CCyB – counter-cyclical capital buffer

IMF – International Monetary Fund

SREP – Supervisory Review and Evaluation Process

SRF – Single Resolution Fund

SRM – Single Resolution Mechanism

SRB – Single Resolution Board

SSM – Single Supervisory Mechanism

Foreword of the Chairperson of the FCMC



Santa Purgaile
Chairperson of the FCMC

The year 2021 was active for the FCMC, outlining the vector of development in all segments of operation. At the end of 2020, as a result of the change project, we started working according to the new organisational structure, with particular areas of responsibility and subordinate structural units assigned to each member of the FCMC Board. In the new structure, equal attention is paid to all financial and capital market segments, and new segment supervision heads have started working. Jointly, we have reviewed the previous FCMC processes, paying more attention to more efficient work and improving horizontal cooperation between the departments. In the reporting year, we paid a lot of attention to preparing higher quality decisions and the faster adoption thereof. The above changes have promoted the transformation of the style of work of the FCMC - it has become more open and more focussed on proactive conduct and issues of the development of the financial and capital market segments. These changes have also been noticed and highly appreciated by the market participants and cooperation partners.

Latvia's capital market is a sector where the results of the undertaken course of development were felt most rapidly. Along with the new forums of Latvia's capital market, being held at the beginning of 2021 and 2022, we have implemented a 10-step programme for the development of Latvia's capital market, and we are truly pleased to observe positive dynamics - entry of new issuers in the market. In 2021, we paid special attention to good corporate governance, by organising a cycle of discussions and establishing the Latvian Corporate Governance Award.



In 2021, we continued assessing the impact of the Covid-19 pandemic and restrictions related thereto. Following a significant drop in 2020, last year a steep improvement in profitability was observed in the banking sector. The growth of deposits continued, in light of limited consumption possibilities and caution. In turn, asset quality indicators show that the impact had generally been smaller than initially forecast. At the same time, uncertainty remained high and, along with other factors, weighs on domestic corporate lending, which has been protractedly weak enough already.

The Covid-19 situation clearly marked the need to ensure a much higher level of digitisation, necessary for expanding various remote solutions both in the field of financial services and in everyday supervisory work. This issue

has also been worked on, and the progress is really large; besides, the launched changes would also continue in the future.

Over the period of recent years, the FCMC has performed active work and continues to work actively in the field of prevention of financial crimes, ensuring effective measures to prevent Latvian financial institutions from being used for money laundering and other unauthorised activities. The FCMC has considerably enhanced the supervisory approach, in order to achieve high efficiency and standards in supervision of the financial sector. Up to now, the largest stumbling block for financial institutions had been that of inappropriate internal control systems; this is why the enhancement thereof is the focus of both the FCMC and the market participants themselves.

The FCMC has developed a new approach to inspections, reducing the administrative burden on financial institutions and their cooperation with customers, making inspections commensurate to the risk level of each financial institution, as well as ensuring the faster achievement of results. The new approach provides for carrying out a comprehensive assessment of the adequacy and efficiency of internal control systems of financial institutions.

In general, the level of risk in the Latvian financial sector has considerably decreased in the most important segments – credit institutions and payment institutions. Banks have taken significant measures for enhancing internal control systems. This is also demonstrated by the results of the FCMC inspections.



The beginning of 2022 and the war in Ukraine caused by Russia's aggression has marked a new major area of activity for the financial sector – ensuring the fulfilment of sanctions. Previous accomplishments in the MLTPF and sanctions risk management formed a stable basis for the Latvian financial sector to be ready for new challenges. When communicating with Baltic and Nordic supervisors, as well as other EU supervisory authorities, it can be seen that we are often a step ahead and asked to give advice.

Sustainability issues are more and more actively included on the agenda of the FCMC; therefore, along with taking part in the development of the legal framework, the FCMC has also developed and introduced its own sustainability strategy. Concurrently, during dialogues with market participants, we have also invited the financial sector to more actively consider the inclusion of sustainability issues in their activity strategies and everyday processes.

In 2021, considerable attention in the work of the FCMC was paid to promoting the financial literacy of the Latvian population. In cooperation with our partners from the public, private and non-governmental organisations' sector, the Financial Literacy Strategy for the Latvian Population for 2021-2027 was developed and the cooperation memorandum was signed with 20 institutions, undertaking to implement that which is planned in the Strategy. The financial literacy brand "Naudasprasme" (Money Literacy) has been developed and introduced, in order to help the population to better recognise trustworthy content in the field of financial literacy. Starting from 1 January 2022, the financial literacy function has been delegated to the Bank of Latvia, taking the first practical step towards the integration of the FCMC in the Bank of Latvia.

Intensive work on integration at various levels of administration of both authorities already started in 2021, along with the adoption of the new Law on the Bank of Latvia. The plan is clear and the tasks and timeframe within which they have to be accomplished are established in detail. There is a lot of work and tasks are complicated, but I do believe that we would be able to accomplish them as well as possible. At the same time, it must be noted that this is also a complicated period for the FCMC, because ensuring the integration process is additional work to be performed in parallel to the performance of our core functions.

In addition to integration in the Bank of Latvia, in 2022, we have set another five operational priorities, currently being actively worked on by the management and experts by fully ensuring all supervisory processes and implementing the work plan in accordance with the set priorities.



Vision, mission, values

1

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 the 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.



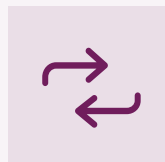
Development

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.

Consistent and professional supervision of the financial sector

2

2.1. Topicalities of licensing in 2021



Slight changes in the composition of participants of the financial and capital market were observed in the reporting year.



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

In 2021, changes have taken place in the following segments of market participants.

Banks

On 19 October 2021, the FCMC made a decision to allow AS “Rigensis Bank” to carry out reorganisation, by re-registering it as a commercial company whose activities are not related to the activities of a credit institution. The licence of AS “Rigensis Bank” for the activities of a credit institution became null and void concurrently with the adopted decision on the reorganisation permit.

Branches of EU Member State banks

In 2021, applications from two EU member state supervisory institutions were received for the opening of the branches of credit institutions under their supervision in Latvia. On 1 September 2021, AB “TF Bank” Branch in

Latvia (Sweden) started its operation. AB “PayEx Sverige” Branch in Latvia (Sweden) is registered in Latvia, but has not yet commenced its operation.

Cooperative credit unions

In 2021, changes also took place in the CCU sector. Licence was withdrawn from two companies – CU “RUCAVAS KRĀJAIZDEVU SABIEDRĪBA” and CCU “NĪGRANDE”, on the basis of decisions adopted at general meetings of their members.

Licence was issued to one new company – CCU “VIDZEMES KAPITĀLS”.

Investment management companies

On the basis of the application of the investment management stock company (IPAS) “PNB Asset Management”, on 8 June 2021 the company had its licence cancelled.

EEA-based providers of investment management services

On 14 May 2021, a licence was issued to *Spółka Akcyjna "Towarzystwo Funduszy Inwestycyjnych PZU"*.

Investment firms

Service providers whose commercial activity is related to trading credit claims of the loans issued by loan originators on the web platforms, for example, AS "Mintos Marketplace", AS "TWINO Investments", SIA "DN Operator", SIA "Viainvest", must obtain a licence of a credit institution or an investment firm in accordance with the requirements of the Credit Institutions Law or the Financial Instruments Market Law, or must carry out the adjustment of their commercial activity according to the type and essence of the provision of the crowdfunding service. In 2021, the referred to companies received a licence for the operation of the investment firm.

In turn, the licence of the investment firm AS IBS "Amenda Markets" was cancelled in 2021, based on its application on the closure of commercial activity (dissolution).

EU-based investment firms

In 2021, AS "AK JENSEN NORWAY" opened its branch in Latvia, which commenced providing investment services in the Republic of Latvia by providing portfolio management services.

Private pension funds

In 2021, the FCMC issued a licence to AS "Indexo Atklātais Pensiju Fonds" for the operation of a private pension fund.

Insurance brokers

In 2021, five insurance brokerage companies were registered: SIA "FIB", SIA "Reinsons un partneri", SIA "RED insurance brokers", SIA "Perks", SIA "Mindi Insurance".

Payment institutions (registered)

In 2021, the entry of SIA "E LATS" was cancelled in the PI register. These changes were due to the desire of the company itself to transform its operations.

Payment institutions (licensed)

In 2021, a PI licence was issued to SIA "SEMFOPAY" for it to be able to continue developing the provision of payment services not only in the local market, but also in all EU and EEA countries, and, therewith, its entry in the PI register was cancelled.

Electronic money institutions (registered)

In 2021, the registration of two EMIs was cancelled – SIA "My Pay", because it had not commenced its operation as an EMI since its registration in the EMI register and had no liabilities towards the clients, and SIA "Dāvanu karte", which had adopted its decision to already terminate the issue of electronic money in 2019 and had no more liabilities towards the clients, including, electronic money holders.

Electronic money institutions (licensed)

In 2021, one new EMI was licensed – SIA "Mintos Payments".

Licensed alternative investment fund managers

On the basis of the application of the investment management stock company (IPAS) "PNB Asset Management", on 8 June 2021 the licence of the company was cancelled.

Registered alternative investment fund managers

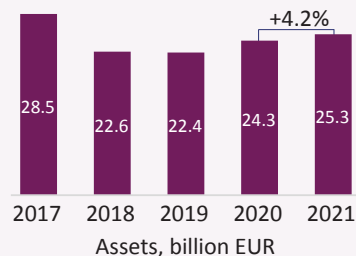
In the financial and capital market, interest remains with regard to the possibility to begin operation as a registered alternative investment fund manager. In 2021, six new alternative investment fund managers were registered: SIA "AJP Capital", SIA "Capitalia Fund Management", SIA "Hanseatic alternative investments AIFP", SIA "Livonia Partners GP AIFP", SIA "NCH Baltics AIFP" and SIA "Realto AIFP".

2.2. Prudential and operational compliance monitoring

2.2.1. Prudential supervision of the credit institutions sector

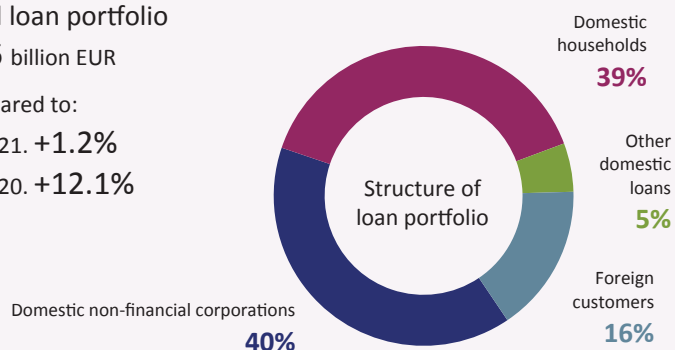
NUMBER OF BANKS AND TOTAL ASSETS

12 banks
4 branches of EU banks
Total assets
25.3 billion EUR

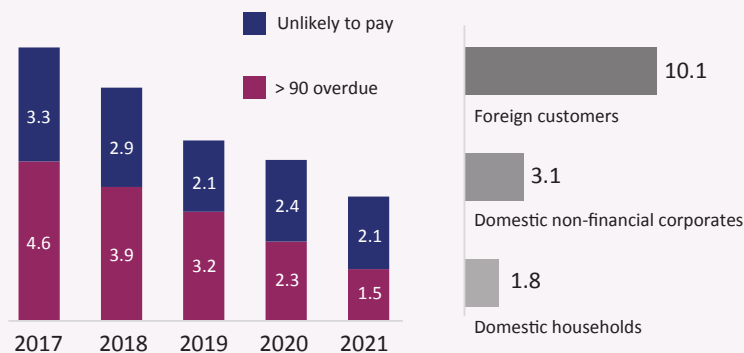


LOAN PORTFOLIO

Total loan portfolio
14.6 billion EUR
Compared to:
09.2021. +1.2%
12.2020. +12.1%

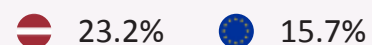


Share of non-performing loans, %

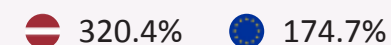


PRUDENTIAL RATIOS

CET1 capital ratio

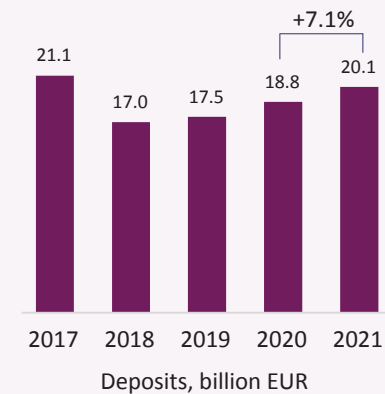
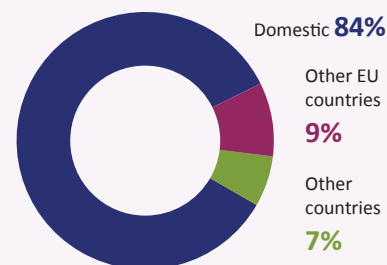


Liquidity coverage ratio



DEPOSITS

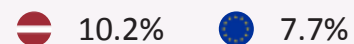
Total deposits
20.1 billion EUR



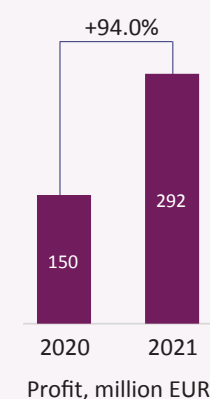
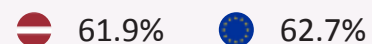
PROFITABILITY

Total banking sector profit
292 million EUR

Return on equity (ROE)



Cost-to-income ratio (CIR)



The FCMC regulates and oversees the sector of the Latvian commercial banks in close co-operation with the ECB within the scope of the SSM and with the European Supervisory Authorities, 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 2021, 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 institutions' supervisory priorities set in 2021

In 2021, the FCMC continued ensuring a comprehensive supervisory process of credit institutions, with a special focus on the assessment of the impact of the Covid-19 pandemic.

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 EBA, at the beginning of 2021 the FCMC identified the following priorities in the supervision of credit institutions.

Strategy, business model and profitability	Internal governance and sustainability	Credit risk and adequacy of provisions
with a focus on the bank's business models, fulfilment of strategies and recovery capacities	with a focus on the bank's stress testing approach, sustainability risk management and MLTPF risk management	with a focus on the impact of the Covid-19 pandemic and NPL management

Figure 1. FCMC credit institutions' supervisory priorities

The supervisory measures plan of 2021 developed according to the selected supervisory priorities included several on-site and off-site activities at the level of both individual credit institutions and the sector at large, including the following activities.

Priorities	Activities
Strategy, business model and profitability	<ul style="list-style-type: none"> • Assessment of shifting individual business models of banks (incl. profitability) • Assessment of shifting individual business models of banks in the market horizontally • Dialogue with the banks on the fulfilment of the strategies (in the context of COVID-19) • Horizontal analysis of recovery plans • Assessment of strategies of the banks
Internal governance and sustainability	<ul style="list-style-type: none"> • SREP follow-up activities • Focus on COVID-19 risk and NPL management • Focus on compliance and MLTPF risk management • Horizontal assessment of stress test programmes • ESG risks – initial status evaluation
Credit risk and adequacy of provisions	<ul style="list-style-type: none"> • Fulfilment of the NPL strategies (for high-NPL banks) • On-site credit risk inspections • In-depth off-site credit risk horizontal inspection • Regular COVID-19 dialogues with the banks • Horizontal inspection of the credit risk stress tests

Figure 2. Credit institutions' supervisory measures plan of the FCMC in 2021

In the field of **strategy, business model and profitability**, an in-depth evaluation of progress of the banks in the process of transforming business models was carried out. Special attention was also paid to the viability, sustainability and profitability of the banks, inter alia, under the influence of the Covid-19 pandemic. The FCMC continued active dialogues with the banks, ensuring regular mutual communication and facilitating the transparency and efficiency of the supervisory process.

Work continued in the field of **internal governance and strengthening risk management functions** by evaluating the MLTPF risk management process and improvement thereof in the banks. At the same time, a brand new risk management area was outlined, which pertains to the sustainability risks. By understanding the significance and topicality of sustainability risks both in the short run and in the long run, the FCMC commenced working on integrating the framework of management of these risks into supervisory processes.

Within the scope of **credit risk** management, greater attention was paid to the evaluation of the impact of the Covid-19 pandemic on asset quality, as well as the quality of credit risk management in the banks. This evaluation encompassed both standard activities within the scope of the SREP and horizontal inspections and dialogues with market participants.

Impact of the Covid-19 pandemic

Latvia's approach to the application of regulatory requirements to banks so far has provided the banks with adequate capital and liquidity reserves, which served as a safety buffer in times of stress and crisis. At the same time, the banks themselves have taken care of the ability to absorb potential negative effects, if necessary, by retaining dividends and leaving the profits at their disposal in 2021.

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, as far as possible, minimise the negative effects of the consequences caused by the Covid-19 pandemic.

Together with the coordinated action of the government for mitigating the negative effects of the Covid-19 pandemic, it ensured the resilience of the credit institution sector to shocks caused by the pandemic. In total, the credit institution sector preserved its profitability with upward dynamics, as compared to 2020, and, despite unfavourable economic circumstances, no significant changes were observed in asset quality.

Supervisory Review and Evaluation Process

Risk-based supervision is still one of the key principles of supervision. Under this principle, the FCMC, using information disclosed in the reports received from 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. The SREP results are taken into account, when determining the common equity capital requirements for covering the risks inherent to the banking activity or potential risks, and ensuring special liquidity requirements.

Risk assessment, within the scope of the SREP, is carried out on a rating scale from "1" to "4"; and in 2021, 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 2021, 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 of banks, via a supervisory dialogue on the SREP results. Risk assessment, within the scope of the SREP, is being carried out based on the analysis of quantitative indicators characterising the risk level and their thresholds in accordance with the ECB methodology, analysis of its risk management information arising out of the on-site inspections, thematic and horizontal inspections, as well as information at the disposal of the FCMC on the compliance with the regulatory requirements in the credit institutions, detected internal control system flaws, quality of the capital and liquidity adequacy assessment processes, and the assessment of the recovery plans.

Assessment of the impact of the Covid-19 pandemic on each of the SREP elements also remained the focus of the FCMC in 2021, along with the evaluation of the progress of implementation of the qualitative recommendations set within the SREP process of 2020. The FCMC has also developed several qualitative requirements and recommendations in 2021, thus continuing to support the improvement of the banks’ internal control system and strengthening of shock-resilient operations, mainly focussing on **internal governance, credit risk management, capital adequacy planning and operational risk, incl. MLTPF risk management**.

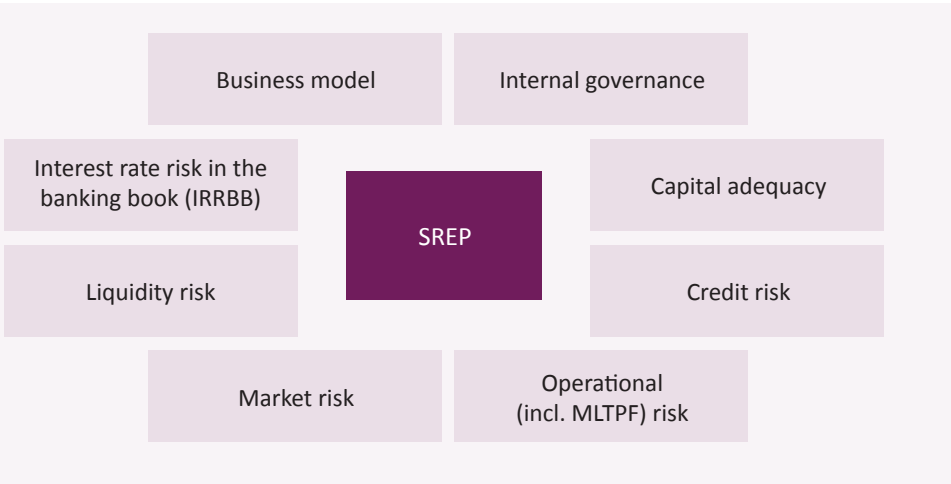


Figure 4. SREP elements

In 2022, the SREP still focussed on the viability and sustainability of banks’ business models, as well as 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 focusses on the assessment of services, changes in the interest and tariff policy, client attraction dynamics, stability of counterparties (cooperation partners), availability of distribution channels, integration of innovative solutions in the operation of credit institutions.

Less significant credit institutions have made progress in transforming their business models and are reorientating to new market niches with more sustainable development prospects, thus achieving greater resilience to the potential adverse effects of geopolitical risks. One of the types of optimising business models is consolidation. 2021 stood out with two credit institutions merger to form a group – a process to be completed in 2022. One credit institution has left the sector, by performing reorganisation.

Single Supervisory Mechanism

4 November 2021 marked the seventh anniversary of the establishment of the SSM of the ECB – the European system of banking supervision. Together with the ECB, national competent authorities from the Eurozone countries operate within the SSM (European Eurosystem’s central banks and national supervisory authorities). The FCMC is also part of the SSM, having three main operational goals.



Figure 5. Goals of the ECB SSM

At the end of 2021, there were 115 significant banks under the direct supervision of the ECB, whereas 2,192 less significant banks were under the direct supervision of national competent authorities.

In 2021, three Latvian banks were under the direct supervision of the ECB – AS “Swed-bank”, AS “SEB banka” and AS “Citadele banka”. The supervision of these banks is being implemented, with the ECB and FCMC staff participating in the joint supervisory teams, which form the basis for the framework of the everyday supervision of significant banks.

In 2021, the FCMC continued to supervise less significant banks and, in cooperation with both the ECB and other national competent authorities, facilitated the enhancement of common guidelines and guidance notes for more and more effective and high-quality supervision of these banks.

Also in 2021, FCMC experts regularly took part in the committees and work groups set up by the ECB, contributing to the development and enhancement of the ECB’s single supervision methodology, as well as further coordination of the statutory regulation within the framework of the European Banking Union. The ECB SSM, together with other supervisors in Europe, also continued to ensure individual supervisory processes and activities, adapted to the Covid-19 pandemic situation, ensuring that the supervisory work is duly focussed on the ability of the banks to overcome the adverse impact caused by the Covid-19 pandemic.

Participation in the decision making of the ECB SSM

Through the member of the Supervisory Board nominated by the FCMC’s Supervisory Board taking part in the ECB Supervisory Board, the FCMC also participates in the process of adopting SSM decisions, adopting the decisions on both all of the significant banks under the direct supervision of the SSM and the methodological issues determining the procedure for the implementation of the banking supervision process in the Eurozone as a whole.

In 2021, the ECB SSM adopted 2,362 supervisory decisions. Similar to previous years, about half of these decisions were approved at meetings of the ECB’s Supervisory Board, but the other half – through written procedures.

Most of these decisions were related to the fit and proper assessments of bank officials (55%), internal models (13%), national powers decisions (12%), equity (11%), reports (5%) and significant holding procedures (4%).

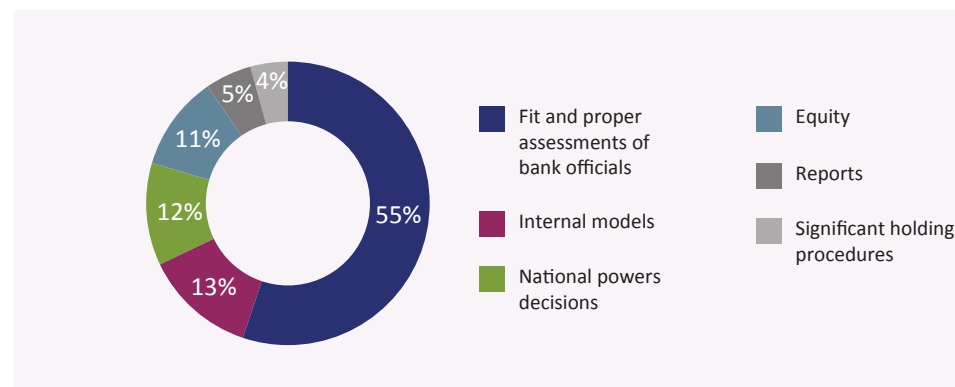


Figure 6. Structure of the ECB’s SSM decisions taken in 2021

A total of 17 meetings of the ECB’s Supervisory Board were held in 2021 and all of them in light of the Covid-19 pandemic situation, have been organised remotely. The FCMC experts assessed and provided their view on the issues to be reviewed both at the Supervisory Board meetings and within written procedures.

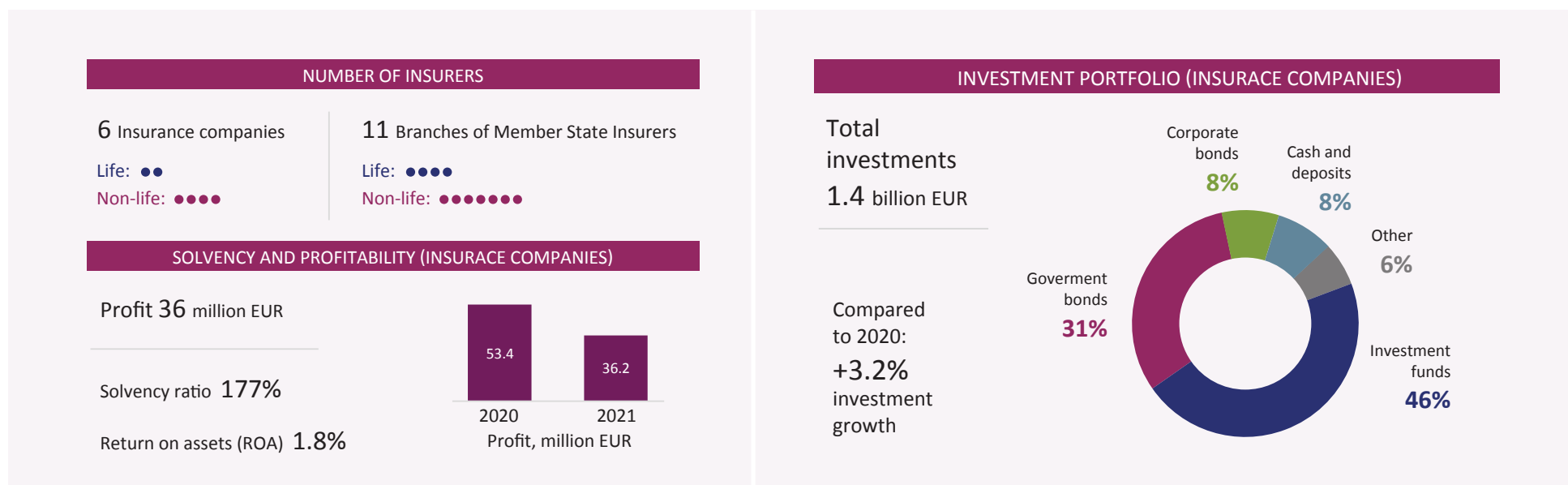
Supervisory measures applied to cooperative credit unions

In 2021, CCU supervision 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 CCUs for covering such losses, as well as by carrying out on-site inspections. During the reporting year, FCMC experts carried out four on-site inspections aimed at assessing the financial standing of the CCUs, management performance, quality of assets, income and cost structure, as well as the compliance of their activities with the requirements of laws and regulations.

In 2021, the FCMC took part in the open discussion – forum “Where can Latvian regional entrepreneurs get money from: pros and cons of cooperative credit unions and other alternative financiers” – where the availability of funding in regions was discussed. The FCMC invited the Association of Latvian Cooperative Credit Unions (uniting 26 CCUs) to discuss this topic, at the same time, also inviting, in mutual cooperation with the Credit Association (uniting seven CCUs), to achieve a single understanding as regards the improvement of the regulatory framework of the CCUs.

In implementing the supervision of the activities of the CCUs, in 2021, the licences of two unions were cancelled, based on the decision of the unions themselves. In 2021, the FCMC issued a licence for the operation of the CCU to one union.

2.2.2. Supervision of the insurance sector



At the end of 2021, there were six insurance companies operating in Latvia – two life insurance companies and four non-life insurance companies – as well as 11 branches of the member state insurers. There were 79 insurance brokers included in the Latvian Register of insurance intermediaries – five insurance brokers more than a year before.

In assessing the results of 2021, it can be seen that the insurance sector in Latvia has recovered from the impact caused by the Covid-19 pandemic and the underwritten premiums exceed the pre-pandemic level of 2019 by 5% already. In 2021, the insurers in Latvia underwrote premiums of a total of 587 million euro (6.6% more than in the previous year). The growth in insurance premiums was observed in the majority of non-life insurance types, with the amount of premiums, compared to the previous year, increasing by 6.1%, as well as in life insurance, where the amount of underwritten premiums grew by 7.8%. The growth of the insurance sector in the global context is demonstrated by the dynamics of premiums underwritten by insurers registered in Latvia, including

those underwritten abroad. The total amount of premiums in 2021 reached 849 million euro (4.8% more than in 2020).

At the same time, in light of the growth of economic activity and comparatively high inflation level, the number of disbursed compensations in Latvia in 2021 also grew by 3.3%, reaching 354 million euro. In turn, throughout the entire territory of their operation in Latvia and abroad the insurers disbursed 541 million euro (6.5% more than in the previous year).

The financial result of insurance companies in 2021 had a positive sign, with all six insurance companies in total closing the year with a profit of 36.2 million euro. The solvency capital requirement compliance ratio of insurance companies registered in Latvia also remained stable above the minimum requirements and reached 177.2% at the end of 2021 (the lower permissible limit of the ratio is 100%) – 3.7 percentage points higher than at the end of 2020.

As the insurance market participants transformed their activities under the impact of the Covid-19 pandemic in accordance with the principle of remote service provision and increasingly used digital means of communication, the importance of cyber risk has grown, currently also being one of the most important aspects of attention of the supervisory authorities at the European level. In 2021, 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 2021, three on-site inspections were carried out: general inspections of two insurance companies, 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 supervisory measures were also taken, including the off-site inspection of insurers regarding the practice of insurers in the management and monito-

ring of insurance products, considering the circumstances caused by the Covid-19 pandemic, as well as off-site inspection regarding the practical application and compliance with the requirements of Section 24 of the Insurance and Reinsurance Distribution Law for insurers and insurance brokers. Evaluation of information obtained within the scope of the inspection shows that insurers and insurance brokers, in general, fulfil the requirements of Section 24 of the Insurance and Reinsurance Distribution Law. The FCMC organised a meeting with the market participants, in order to negotiate the results of the performed inspection in the joint discussion, provide information regarding good practice in the insurance distribution process, as well as to discuss the questions and unclear issues related to the fulfilment of requirements.

By maintaining a dialogue with the insurance sector, the FCMC continued the tradition of annual meetings, organising strategic meetings with the management of insurance companies, in order to discuss the FCMC's strategic priorities, planned supervisory measures and sustainability issues, as well as to communicate the results of risk assessment carried out by the FCMC to the insurance companies. The FCMC also engaged in a number of activities initiated by the Latvian Insurers Association with respect to issues relevant to the insurance sector.

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

Private pension funds

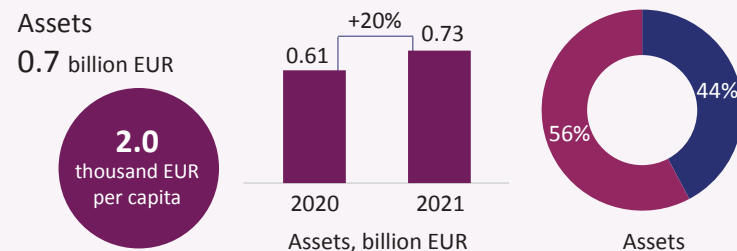
NUMBER OF FUNDS AND THEIR MEMBERS

7 Private pension funds: 39% of economically active population 0.4 million members
6 opened, 1 closed

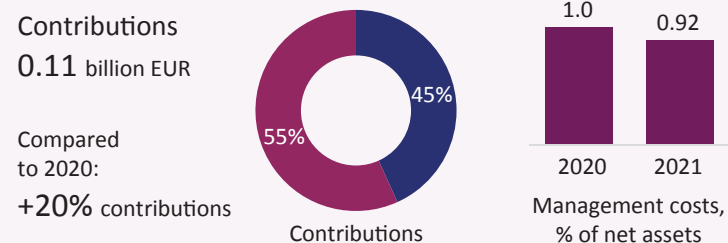
21 Pension plans

Active	Balanced	Conservative
10	10	1

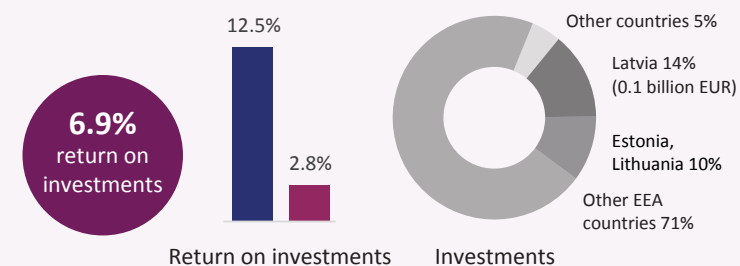
ASSETS



CONTRIBUTIONS TO PLANS AND MANAGEMENT COSTS



INVESTMENTS GEOGRAPHICAL DISTRIBUTION AND RETURN ON INVESTMENTS



State funded pension scheme

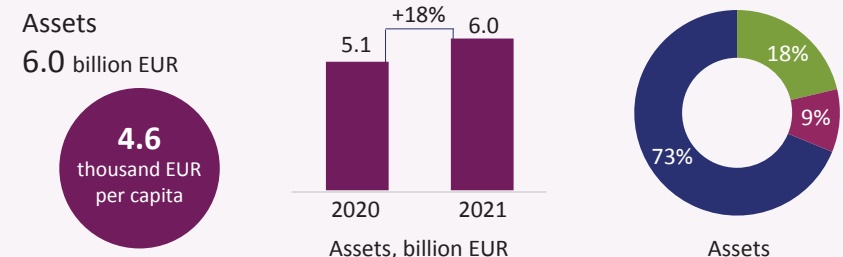
NUMBER OF FUNDS AND THEIR MEMBERS

7 Asset managers 1.3 million members

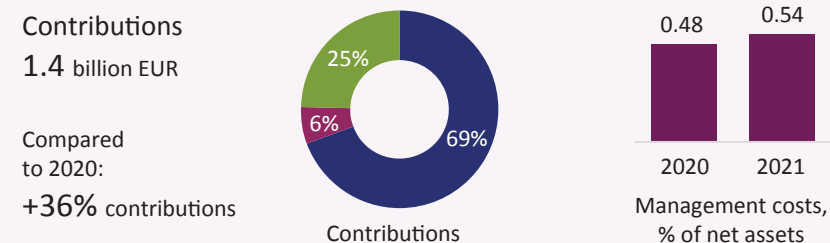
28 Investment plans

Active	Balanced	Conservative
15	10	3

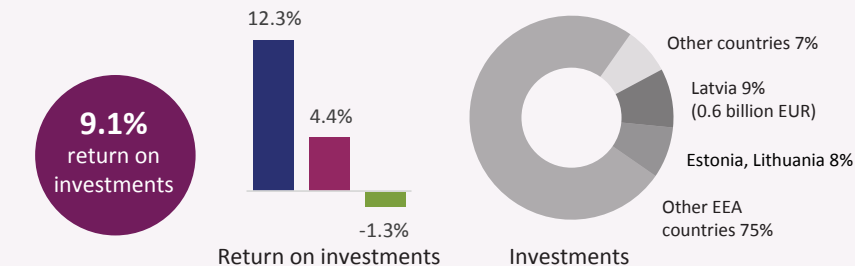
ASSETS



CONTRIBUTIONS TO PLANS AND MANAGEMENT COSTS



INVESTMENTS GEOGRAPHICAL DISTRIBUTION AND RETURN ON INVESTMENTS



Investment funds

NUMBER OF INVESTMENT MANAGEMENT COMPANIES & INVESTMENT FUNDS

10 Investment management companies

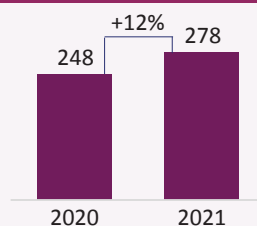
22 Investment funds



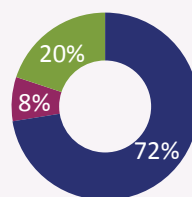
ASSETS

Assets

278 million EUR



Assets, million EUR



Assets

INVESTMENTS, ITS STRUCTURE AND RETURN ON INVESTMENTS

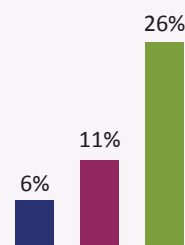
Investments

255 million EUR

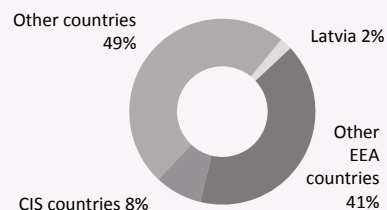
Comparing to 2020:

-1% investments

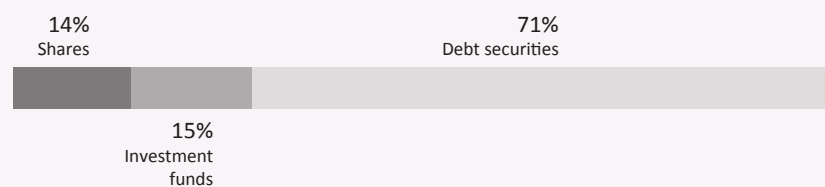
Return on investments



Geographical distribution of investments



Structure of investments by types of instruments



Alternative investment funds

NUMBER OF INVESTMENT MANAGEMENT COMPANIES & INVESTMENT FUNDS

28 Alternative investment management companies

28 Alternative investment funds

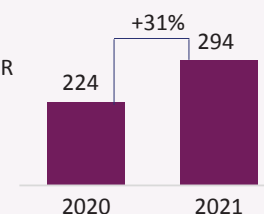
Comparing to 2020: +5



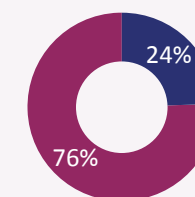
ASSETS

Assets

294 million EUR



Assets, million EUR



Assets

INVESTMENTS, ITS STRUCTURE AND RETURN ON INVESTMENTS

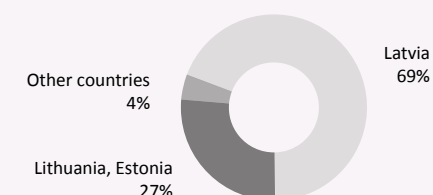
Investments

271 million EUR

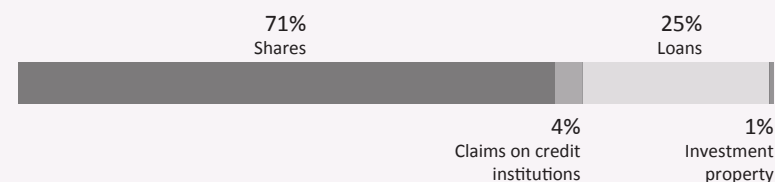
In comparison to 2020:

+27% investments

Geographical distribution of investments



Structure of investments by types of instruments



The main emphasis in the implementation of the common strategy of the FCMC 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.

At the end of 2021, there were 10 investment management companies in Latvia, of which seven companies managed 28 investment plans of the state funded pension scheme with total assets of 6.0 billion euro and four companies managed 22 investment funds with total assets of 276.9 million euro.

In 2021, six new alternative investment fund managers were registered. It is the largest growth since the amendments were introduced to the Law on Alternative Investment Funds and Managers Thereof, providing for considerable allowances for the supervisory framework of registered alternative investment fund managers, aimed at reducing the administrative burden, as well as facilitating the development of the sector at large. In turn, the number of funds managed by alternative investment fund managers grew by 16 and, at the end of 2021, 27 funds were actively operating. Out of all alternative investment funds registered in 2021, 11 funds are registered as real estate investment strategy funds, three are private capital investment strategy funds, while two funds have another strategy determined.

At the end of 2021, there were six open pension funds and one closed pension fund operating in Latvia, managing a total of 21 pension plans with total assets of 731.5 million euro. The growth of the number of pension funds and plans is attributable to the issuance of the licence to one new pension fund, as well as the registration of five pension plans.

In accordance with the assessment of the risk profile of each financial market participant, several on-site and off-site supervision measures were taken. In 2021, an on-site inspection of one investment management company took place, within the scope whereof the conformity of the internal control system established by the asset manager was assessed, as well as the identification and management of material risks, paying special attention to liquidity risk management and ensuring business continuity under the circumstances of the crisis caused by the Covid-19 pandemic. One general on-site inspection also took place in the field of private pension funds, assessing the organisational processes, outsourced services, internal audit, main risks, asset manager, custodian bank, and other important aspects.

In 2021, the FCMC carried out a comprehensive off-site thematic inspection in investment management companies, assessing the conformity of the remuneration policy to

external and internal regulatory enactments. Investment management companies, in developing and introducing the remuneration policy, in general, observe the key requirements and guidelines of the FCMC regulations. Nevertheless, in order to promote sound governance, especially as regards the availability of information to be disclosed to investors and participants of investment and pension plans, the need to improve separate aspects of the remuneration policy was pointed out to the investment management companies and they performed the improvements within the specified time.

In 2021, in response to the ESMA initiative, a thematic inspection was carried out regarding the adequacy of the fees of open investment funds under the management of four investment management companies within the framework prescribed by the regulation, aimed at preventing the application of unreasonable fees, thus promoting an increase in the trust of investors in financial markets and reducing the costs related to the acquisition of financial products. Conclusions of the inspection as regards several aspects related to the adequacy of the fees of investment funds – process of determination of fees applicable to investment funds, regular assessment and revision of the fee level, involvement of the internal audit and compliance function in the control over the referred to processes – form the basis for further supervisory measures in the field of adequacy of fees of investment funds.

One of the courses of development of financial market participants in 2021 was the promotion of sustainable investments. To inform financial market participants about the need for and meaning of sustainable investments now and in the future, as well as about the requirements set for the fund manager regarding the disclosure of information according to the regulation in the field of sustainability, in cooperation with the Latvian Private Equity and Venture Capital Association, a seminar “Good Practice and Requirements for Private Equity Fund Managers in the Field of Sustainability” was organised.

In 2021, measures related to money literacy were implemented in the pension sector. Thematic publications were distributed, and the first “European Retirement Week in Latvia” was held, concluding it with an online discussion “My pension from the first salary already”.

To promote mutual cooperation, information exchange and shaping uniform understanding regarding the development of the relevant sector, in 2021, the FCMC organised meetings with the management of investment management companies, licensed alternative investment fund managers and a manager managing the European venture capital funds. During these meetings, the strategic development goals and problems of market participants were discussed. At the same time, the FCMC provided information about the result of the performed risk assessment of the companies and the supervisory measures planned for 2022.

Impact of the Covid-19 pandemic on the investment and pension sector

The FCMC, by performing market supervision measures related to the circumstances caused by the Covid-19 pandemic, 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 2021 continued to prove the importance of the long-term investment aspect in the accumulation of pension sa-

vings. Although the volatility of the pension system's investment portfolios was higher than usual at the beginning of the impact of the Covid-19 pandemic, over the period of 2021, it stabilised, demonstrating the importance of evaluating the return of long-term provisions, as short-term fluctuations affecting the portfolio balanced out over the long term. 2021 ended with a positive average return of 6.9% for the 3rd pension pillar, and with an average return of 9.1% for the 2nd pension pillar.

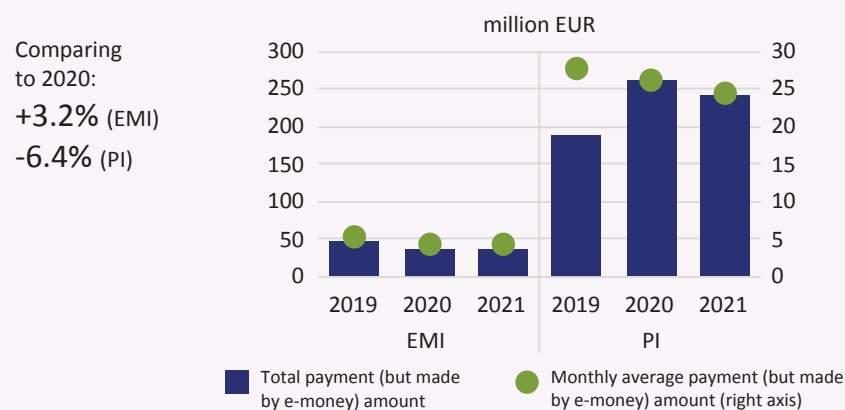
2.2.4. Supervision of payment institutions and electronic money institutions

NUMBER OF EMI & PI

7 EMI -1 during the year

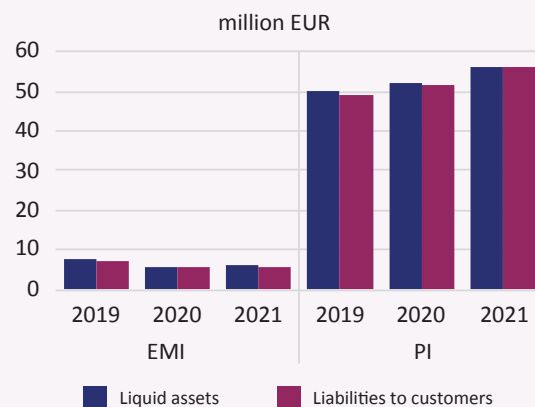
6 PI -1 during the year

EMI & PI PAYMENTS



EMI & PI LIQUID ASSETS & LIABILITIES TO CUSTOMERS

Liquid assets >
Liabilities to
customers

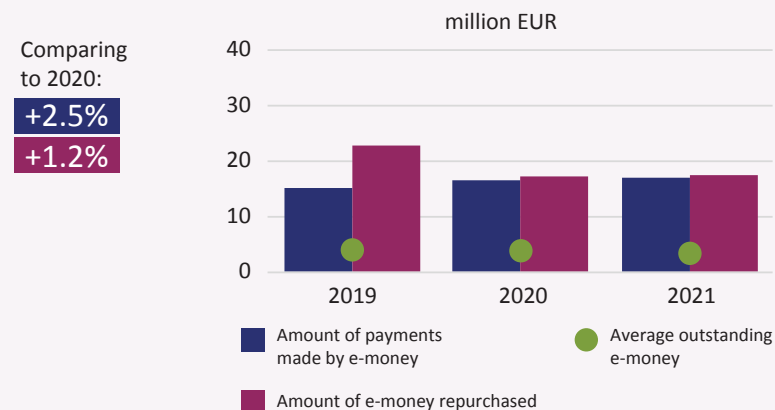


EMI & PI LICENSES

3 licensed EMI 4 registered EMI

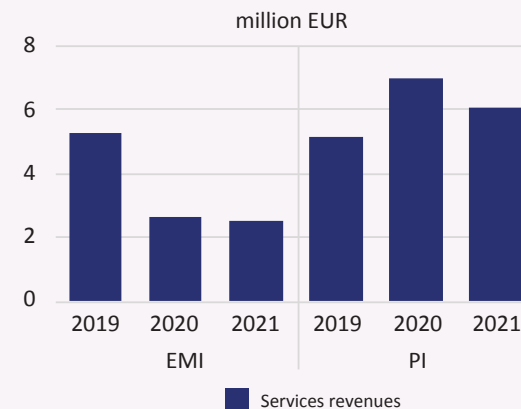
5 licensed PI 1 registered PI

TURNOVER OF E-MONEY (EMI)



EMI & PI SERVICES REVENUES

Comparing to 2020:
-4.4% (EMI)
-12.6% (PI)



The total amount of payments made by PI and EMI in 2021 achieved 295.6 million euro, which was 5% less than the year before. This decrease is mainly attributable to the impact of the Covid-19 pandemic. In turn, the balance of funds of PI and EMI customers reached 61.6 million euro at the end of 2021 (7% more than at the end of 2020) and fully covered the liabilities of PI and EMI towards their customers.

At the end of 2021, there were six (incl. one registered and five licensed) MI and seven (three licensed and four registered) EMI in Latvia, out of which three licensed MI and three EMI – one registered and two licensed – performed active operation. Even though the FCMC was still working in remote mode in 2021, over the year a licence was issued to one new EMI, as well as to one PI, previously having the status of a registered institution. In general, a growing interest regarding the receipt of a PI or EMI licence in Latvia was also observed in 2021.

In 2021, the consolidation of the PI and EMI sector and market rearrangement continued. There were market participants, who ceased providing services (one PI and one EMI ceased their operation, and a registered institution status was cancelled for one EMI). This enabled the existing market participants to develop their operation and increase the volume of provided services, by filling in the vacant market niches.

Even though PI and EMI, whose operational model provides for on-site service provision, felt the impact of Covid-19 due to the restrictions set in the country, their operation did not come to a halt. Market participants adapted to the situation and also sought alternative directions for the development of services.

In 2021, in the field of supervision the inspection of operation of one licensed PI took place, but mainly off-site supervisory measures were taken, including:

- remote meetings with the management and responsible employees of PI and EMI;
- analysis of the submitted activity reports;
- control over the fulfilment of the set requirements;
- assessment of the requested information;
- PI and EMI risk assessment, etc.

In 2021, no sanctions or corrective measures have been applied in the field of the provision of payment services and electronic money services.

In 2021, the FCMC actively operated in the field of promoting the development of the PI and EMI sector. Several events were organised (online seminars and discussions), where the FCMC experts discussed various topics related to the operation of PI and EMI with the PI and EMI sector representatives, inter alia, licensing process, compliance of various business models with the requirements and regulatory enactments and issues related thereto, as well as development possibilities of the PI and EMI sector. The number of consultations provided in the FCMC Innovation Hub grew and the dialogue with sector representatives was developed.

2.2.5. Supervision of investment service providers

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

7

investment firms
licensed in Latvia

12

credit institutions
registered in Latvia

9

investment management
companies registered
in Latvia

2

branches of
EU Member State
credit institutions

>600

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

In 2021, the FCMC continued to work actively with investment platforms, which, by adapting their business model and operation to the requirements of the Financial Instruments Market Law and other requirements related to the financial instruments market, had filed their applications for the receipt of the licence for an investment firm. In 2021, a licence for the provision of investment services and non-core investment services was issued to four investment platforms, also providing for a transitional period, during which loans issued by investment loan originators by means of an assignment agreement are gradually being replaced by offering investment in financial instruments. In 2021, a licence of an investment firm for the provision of investment portfolio management services and investment advice was issued to one more company.

The focus of supervision of the provision of investment services in 2021 was on the following issues:

- seven meetings with responsible employees and management of market participants;
- four enhanced due diligence inspections of individual market participants (three in credit institutions, one in an investment management company);
- participation in the single prudential supervision exercise of the ESMA regarding the observance of product management requirements;

- evaluation of reports submitted by the market participants;
- assessment of the conformity of the offered investment products to the customer;
- handling of a complaint about investment service providers;
- conflict of interest management issues;
- conformity assessment of market participants' officials and shareholders.

Sanctions and corrective measures

In 2021, The FCMC entered into an administrative agreement with one investment firm regarding violations in the field of the provision of investment services identified in the inspection performed in 2019. A fine of 34,000 euro was imposed on the investment firm and a fine of 2,900 euro was imposed on the Chairperson of the Management Board of the investment firm.

In 2021, no other sanctions or corrective measures have been applied in the field of the provision of investment services. At the same time, the FCMC followed up on elimination of drawbacks detected during the inspections of market participants.

2.2.6. Supervision of the financial instruments market

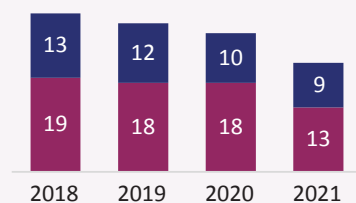
Regulated market

NUMBER OF ISSUERS

22 issuers

9 bond issuers

13 equity issuers

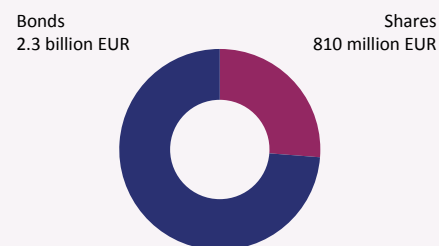


CAPITALIZATION

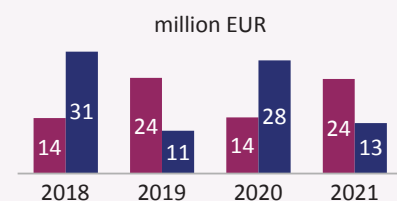
Market capitalization
3.1 billion EUR

In comparison
to 2020:
+6.9%

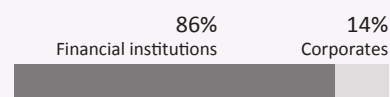
-6.7% shares
+12.8% bonds



TURNOVER



Turnover of debt securities
by issuer segment



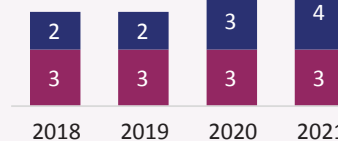
Alternative market

NUMBER OF ISSUERS

7 issuers

4 bond issuers

3 equity issuers

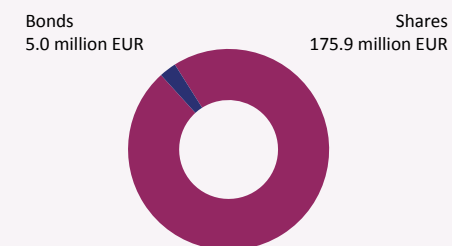


CAPITALIZATION

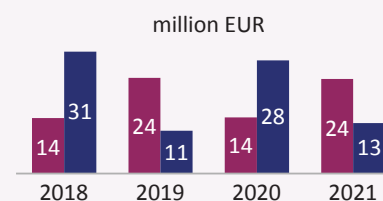
Market capitalization
180.9 million EUR

In comparison
to 2020:
+117.1%

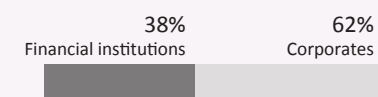
+117.3% shares
+111.6% bonds



TURNOVER



Turnover of debt securities
by issuer segment



NUMBER OF TRADES

52 097 (76%)
Regulated market

16 892 (24%)
Alternative market

Shares

439 (73%)
Regulated market

161 (27%)
Alternative market

Bonds

Supervision of the trading venues of financial instruments and the Central Securities Depository

The focus of supervision carried out by the FCMC over the regulated market operator AS “Nasdaq Riga” (stock exchange) and the multilateral trading system or alternative market First North Latvia in 2021 was:

- ensuring adequate trading in financial instruments;
- disclosure of pre-trade and post-trade information;
- supervision of trading in financial instruments;
- operational adequacy of information systems, incident prevention;
- maintaining an effective internal control system;
- non-discriminatory treatment of market participants;
- cooperation in the supervision of issuers and introduction of new products.

The supervisory focus of the Central Securities Depository – Nasdaq CSD SE – in 2021 was:

- annual operational conformity assessment (evaluation) in accordance with Article 22 of Regulation No. 909/2014¹ (operational risk, business continuity risk, legal risk, evaluation of securities settlement system operation, financial stability, recovery plan, internal control system, governance, etc.);
- regular off-site supervisory measures (assessment of submitted statements, assessment of reports and other information, meetings with the responsible employees of Nasdaq CSD SE);
- cooperation within the supervisory colleges of Nasdaq CSD SE with the supervisory authorities of Lithuania, Estonia and Iceland, central banks and the Bank of Latvia.

Sanctions and corrective measures

There were no sanctions or corrective measures imposed on the trading venues of financial instruments or the central securities depository in 2021.

Supervision of issuers

The focus of the supervision of issuers in 2021 was:

- timely disclosure of regulated information;
- in-depth reviews of annual reports and interim report reviews;
- disclosure of the corporate governance statement and the non-financial statement;
- remuneration reports;
- identification of alternative performance indicators;
- webinars and explanatory letters regarding the application of regulatory enactments;
- meetings with the representatives of the management of issuers, audit committee and auditors thereof.

Sanctions and corrective measures

In 2021, two administrative proceedings were initiated against the issuers for the non-timely disclosure of the audited annual report, interim report and financial information. In one of the administrative cases, the FCMC imposed a fine of 25,000 thousand euro on the issuer, as well as a fine of 2,500 euro and 500 euro on the members of the management board of the issuer as natural persons responsible for the violation. In the second administrative case, the FCMC imposed a fine of 5,000 thousand euro on the issuer. In one case, the FCMC made a decision and later entered into an administrative agreement with the issuer, by imposing a fine of 25,000 euro on the issuer for violations with respect to the preparation of the insider list. In another initiated case regarding market manipulation or publishing misleading information, the FCMC made a decision and later entered into an administrative agreement with the issuer, by imposing a fine of 25,000 euro on the issuer and a fine of 33,347.16 euro on the member of the management board of the issuer, as well as excluded the shares of the issuer from trading on First North Latvia.

No violations or significant deficiencies were identified in the audits of issuers' annual and interim reports.

In two cases, the FCMC sent letters of reprimand to the issuers regarding a failure to timely publish the remuneration reports and failure to timely publish the opinion of the management board on the share repurchase offers.

¹ Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving the settlement of securities in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012.

Supervision of trading in financial instruments and investors' activities

In 2021, the focus of supervision in 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;
- in-depth inspections of suspicious transactions (market manipulations, insider trading);
- 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.

Sanctions and corrective measures

In 2021, in one administrative case initiated in 2020 for the failure to make a mandatory share repurchase offer, the FCMC entered into an administrative agreement with the shareholders, imposing a fine on them in the amount of 100,000 euro and ensuring that the persons comply with the legal requirement regarding the making of the mandatory share repurchase offer.

There were no administrative sanctions imposed for market manipulation at trading venues or insider trading in 2021. In four cases, the FCMC sent a letter of reprimand to the investor, indicating that features of market manipulation were observed in transactions performed by them, and requesting to immediately cease any activities that might mislead other investors regarding stock price, demand and supply.

Letters of reprimand were sent to two persons in relation to non-compliance with the deadline for the manager's notification under Regulation No. 596/2014², and in one case the FCMC made a decision to specify information about the person responsible for the violation in a publicly available notification.

10-step programme for the development of the capital market

On 19 January 2021, Latvian Capital Market Forum 2021 "Today's Decisions = Future Opportunities" was held online, in which the FCMC presented a 10-step programme for the development of Latvia's capital market, encompassing measures for increasing the role of the State, expanding the possibilities of the issuers and promoting investment activity.

The 10-step programme for the development of Latvia's capital market has been drafted, considering the stagnating condition of Latvia's capital market and its broad, though unused opportunities. The 10-step programme includes the proposals of the existing and potential market participants, ministries, investors, investment banks, the EU institutions and the FCMC.

The drafted 10-step programme for the development of Latvia's capital market was integrated into the Financial Sector Development Plan for 2021-2023, appointing the institution responsible for the fulfilment of measures, timeframe for fulfilment of the tasks, results to be achieved and the procedure for supervision of the fulfilment of the plan.

The 10-step programme for the development of Latvia's capital market is available for viewing here:

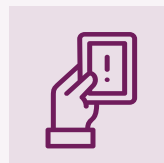
https://www.fktk.lv/wp-content/uploads/2021/01/10_soli_LKT_attistibai_LV.pdf.

² Regulation (EU) No. 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

2.3. MLTPF risk supervision



23 FCMC inspections in
the field of AML/CTPF



warning for 1 bank,
decision on fines for 2 banks

6.6
million euro

Total fine for violations in
the field of AML/CTPF

MLTPF risk supervision

The active work performed by the FCMC in the previous years in the field of MLTPF risk management was positively assessed by the IMF, which, in its report of 2021, pointed out the significant progress achieved by Latvia in strengthening the field of MLTPF risk management. In 2021, the FCMC continued strengthening MLTPF risk management, setting building the quality and efficiency of supervision and strengthening the dialogue with market participants as key priorities.

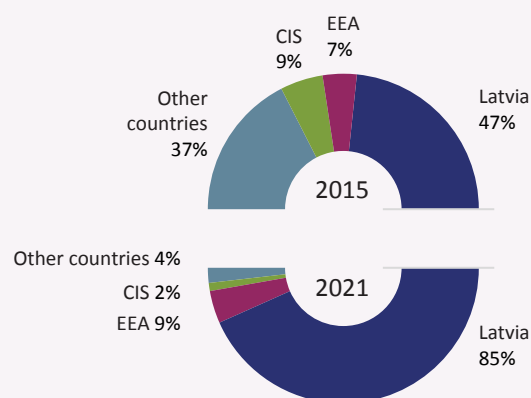
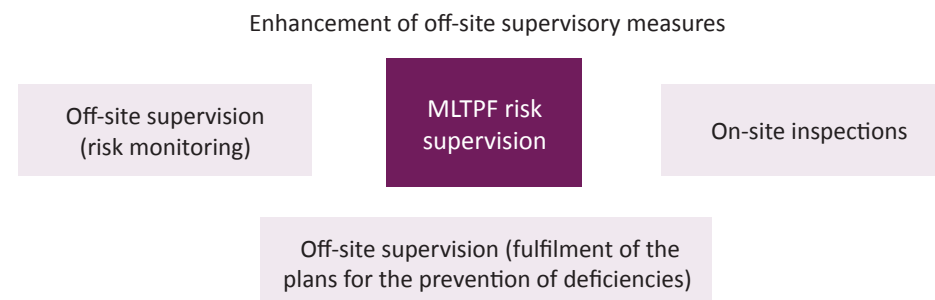


Figure 7. Changes in the geographical structure of deposits made in Latvian banks

In 2021, the FCMC paid special attention to enhancing off-site supervisory measures – for example, plan for the prevention of deficiencies for improving the supervisory processes and enhancing the methodology for the assessment of banking risks and their management. The dialogue between the FCMC and market participants was significantly strengthened both by organising training seminars and discussions (for example with public organisations, entrepreneurs) and by providing explanations and significantly supplementing a manual for the application of AML/CTPF requirements in cooperation with the Finance Latvia Association.

Risk-based supervision



To ensure risk assessment-based supervision, it is important to not only carry out inspections in financial institutions, but also to ensure regular risk monitoring, which helps both to identify the need for inspections and to determine the scope of the necessary inspection, for it to be focussed on the main risks. Therewith, in 2021, the FCMC considerably enhanced the methodology for assessing MLTPF risks. In order to assess the MLTPF risks, the FCMC is making use of all available information and data sources; for example, information obtained within both on-site and off-site supervision (incl. follow-up inspections, regular reports on MLTPF risk changes, targeted surveys, publicly available information, customer complaints, etc.). The results of the MLTPF risk assessment are being integrated into joint supervisory process and represent one of the factors that can influence the supervisory priorities.

Initial MLTPF, Sanctions risk level	Efficiency of MLTPF, Sanctions risk management (ICS)	Calibration of the ICS
Customer risk	Results of on-site inspection	Reputation
Geographical risk	External audit report	Thematic reviews
Product and service risk	TNP plan fulfilment	TF/PF case reports
Supply channels risk	Survey	Collaboration
Risk appetite		Customer complaints
		Restrictions set to the bank
		Other adjustments

Figure 8. MLTPF risk assessment elements

Inspections and their results

In 2021, the FCMC conducted 23 inspections (five on-site full inspections, seven on-site targeted inspections and 11 off-site targeted inspections) in banks in the field of AML/CTPF. Three on-site targeted inspections were conducted with a focus on the field of international sanctions.

In 2021, the FCMC expressed a warning to one bank and imposed a fine of 6.6 million euro on two 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, as well as expressed a warning to the official of the bank in one case. At the same time, a duty was imposed on all penalised banks to develop plans

of measures for the prevention of identified deficiencies, and the FCMC took measures for supervision of the fulfilment of these plans.

In addition, in 2021, the FCMC imposed a fine of 91 thousand euro on two financial institutions (investment management company and investment firm) for violations in the field of AML/CTPF, determined legal obligations aimed at eliminating the identified deficiencies and improving their internal control systems, as well as imposed a fine on the responsible official in one case.

Banks and financial institutions regularly submit the developed procedures 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 deficiencies in order to, as a preventive measure, ensure the most effective development and implementation of internal control systems.

Strengthening the dialogue with market participants

The FCMC, in cooperation with the financial sector, considerably supplemented the recommendations that serve as a practical guide for financial institutions in conducting customer due diligence and improving internal control systems. Recommendations were supplemented both with new chapters, for example, regarding international sanctions risk management, and with new practical examples and instructions on issues where it is essential to ensure a uniform understanding of market participants and the application of requirements.

The aim of the recommendations is to ensure a uniform understanding both on the part of banks and other financial institutions, and on the part of supervisors of the application of legislation in relation to the prevention of financial crime, as well as the introduction of a risk-based approach. Recommendations are available on the website of the FCMC and are intended for the employees of financial sector institutions working with internal control system, customer due diligence and AML/CTPF issues.

In 2021, 11 training sessions and discussions were ensured for the subjects of supervision, entrepreneurs and the non-governmental sector regarding the topical issues of the MLTPF risk and sanctions risk management and internal control.

In light of the expansion of the EU sanctions against Belarus, two discussions were organised regarding the topicalities of Belarus sanctions within the scope of public and private partnership, being a new initiative and a way for more effective information exchange with the market participants regarding the particular persons and sanctions risks.

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



The Covered Bonds Law in effect
from 23 June 2021

5

O-SIIs identified in Latvia

0%

The size of CCyB remains
unchanged

In 2021, the FCMC continued to improve the legal framework governing the activities of the participants of the financial and capital market, by implementing the requirements of the EU directives and guidelines issued by the EU institutions, ensuring the application of a directly applicable EU legal framework, as well as by improving the macroprudential legal framework and applying instruments set therein.

New covered bonds regulation

The Covered Bonds Law, developed by the Ministry of Finance, in cooperation with the FCMC and Finance Latvia Association, took effect on 23 June 2021, replacing the mortgage bonds regulation and implementing the requirements prescribed by the EU primary legislation³. Covered bonds are secured (most often by residential loan portfolio) debt securities issued by credit institutions, in order to secure the effective attraction of low-risk long-term funding. Together with introducing similar regulation in Estonia in 2019, the new law marks one more step towards shaping a pan-Baltic capital market in accordance

with the memorandum of understanding between the Baltic states on the establishment of a pan-Baltic capital market signed in 2017.

The FCMC developed two new (as well as adjusted another two already effective) regulations related to the Covered Bonds Law, which took effect on 29 June 2021. The FCMC's "Regulations on the Documents to be Submitted and Information to be Included Therein for Adoption of the Decision on the Permit to Implement Covered Bonds Programmes and Review of Notification and on the Procedure for the Review of the Documents" have been developed, in order to ensure that the FCMC has access to all the necessary information, to be able to assess the ability of a credit institution (issuer) to implement the covered bonds programme, in line with the requirements prescribed by the Covered Bonds Law. The new FCMC's "Regulations on the Selection of a Candidate for the Office of the Special Administrator, Procedures for Assessing the Suitability Thereof and Information Necessary for the Assessment" ensures that the FCMC can conduct the transparent selection of a special administrator candidate, if special cases prescribed by the Covered Bonds Law occur, in which the FCMC must take a decision on appointing of the special administrator to manage the covered bonds programme in place of the credit institution (issuer).

³ Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU; law adopted on 27 May 2021.

Changes in the regulation in the field of remuneration

On 31 December 2021, the FCMC's "Regulations on Remuneration Policy and Practice" took effect, introducing requirements for the remuneration policy and practice arising out of Directive 2019/878⁴ and the EBA guidelines on sound remuneration policies. The new regulations prescribe a requirement to ensure gender-neutral remuneration policy and practice, introduce amendments to the definition of functions having an impact on the risk profile, as well as to identify the functions having an impact on the risk profile in subsidiaries subject to sector-specific remuneration policy requirements, if professional activities of the persons in these functions have a material impact on the total risk profile of a consolidation group. The new norms provide for setting a longer period for the deferral of disbursement of the variable part of remuneration to the functions having an impact on the risk profile and to grant 50% of the variable part of remuneration in a non-monetary form – shares of an institution or instruments pertaining to the shares, or equivalent instruments, concurrently prescribing a proportionate threshold, when such requirements are not applied. Henceforth, it will also be a duty of credit institutions to make information on remuneration policy public and to observe certain requirements for the volume of information to be disclosed, procedures for the preparation and disclosure thereof in accordance with directly applicable EU legal acts, as well as, starting from the reporting period from 1 January 2021, submit to the FCMC information about remuneration and practice, by filling out the reporting template developed by the EBA.

New requirements in the field of credit risk management

In order to improve the quality of lending and loan monitoring in the banking sector, thus in the long run reducing the volume of distressed loans and possible losses from such loans, as well as to correspondingly improve the profitability of the banks and strengthen financial stability, the FCMC has developed the amendments to **"Regulations on Credit Risk Management"**, which took effect on 1 January 2022, implementing the EBA Guidelines on Loan Origination and Monitoring. The new amendments supplement the requirements previously set by the FCMC in the loan granting and monitoring processes, to ensure sound creditworthiness assessment, promote objective decision-taking on loan granting, as well as facilitate cautious evaluation and monitoring of collateral over the entire lifecycle of the loan. The regulations also introduce new requirements as regards incorporating environmental, social and governance factors (ESG) into credit risk man-

agement processes of the banks, inter alia, strategic planning, lending practice and evaluation of collateral.

New regulations for credit institutions on outsourcing arrangements

On 6 July 2021, the FCMC's "Regulations on Outsourcing Arrangements" took effect, prescribing the requirements to be complied with by credit institutions for the use of outsourcing. The FCMC developed these regulations for the purposes of enhancing the administration of the process of receipt of outsourcing and introducing uniform practice in cases when an institution delegates the performance of its functions to the outsourcing provider, as well as implementing the principles laid down in the EBA Guidelines on Outsourcing Arrangements. According to the new requirements, credit institutions must assess whether the function which is planned to be delegated to an outsourcing provider is critical or important. The new regulations also prescribe the requirements to be included in the outsourcing contract, policy and procedures, provide for the establishment of the outsourcing register, performance of risk assessment, as well as set the requirements for the supervision of functions delegated to outsourcing providers. In addition, by 1 March 2022, credit institutions had to carry out the re-assessment of the functions delegated to outsourcing providers and already concluded outsourcing contracts, to ensure compliance with the requirements of the regulations, and it was also stipulated that the established outsourcing registers must be submitted to the FCMC by 15 March 2022. It is recommended to also apply the new regulations to the PI and EMI licensed in the Republic of Latvia, if they use outsourcing for the performance of their functions.

Requirements developed for information on the projections of pension disbursements to be included in the report on the supplementary pension of the private pension funds

Each private pension fund, which has entered into a collective participation agreement with the employer for the participation of its employees in the relevant pension scheme, shall prepare the report on the supplementary pension for each pension scheme participant, also including therein information on the projections of disbursements of the pension with respect to the projected supplementary pension at the end of the accu-

⁴ Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2003/6/EC as regards exempt entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers, as well as capital conservation measures.

mulation period. To facilitate the uniform and accurate preparation of such information, the FCMC developed “Regulations on the Procedure under which a Private Pension Fund Prepares Information on the Projections of Disbursements of the Pension in the Report on the Supplementary Pension”, which took effect on 31 December 2021. The regulations prescribe general requirements and key principles, as well as indicators to be taken into account, when preparing information on the projections of disbursements of the pension at the end of the accumulation period, inter alia, uniform macroeconomic indicators and their sources, indicators characterising the operation of the relevant pension scheme and individual data of the pension scheme participants used for calculations of the projections. To ensure that the participants of the 3rd pension pillar receive information about the projected accumulated pension, the regulations incorporate uniform requirements for the preparation of projections regarding the disbursement of pensions. The new requirements will be applied starting from the report on the supplementary pension for 2022, to be prepared and made available to the pension scheme participants in 2023. It is recommended to apply the regulations to any pension fund, which, at least on an annual basis, prepares the report for each pension scheme participant, as well as to managers of State-funded pension scheme assets, when preparing information for the participants of the funded pension schemes.

Requirements adjusted for the preparation of reports of insurers

To ensure more accurate preparation of information to be used for informing the public about the amount of premiums underwritten and compensations disbursed in the Republic of Latvia, the FCMC has elaborated the requirements for the submission of a quarterly report of insurers, introducing amendments to “Regulations for the Preparation of Public Quarterly Reports of Insurers” and “Regulations for the Preparation of Reports of Insurers and Reinsurers”, which took effect on 9 June 2021. The amendments stipulate that henceforth information about the premiums written and claims paid shall also be specified in a breakdown of the services provided by insurers in other Member States via branches or by using the principle of freedom to provide services, without opening a branch. Such changes were introduced, because a significant part of premiums written and claims paid by separate insurance companies is comprised of the services, which they provide in other Member States via branches or by using the principle of freedom to provide services, without opening a branch. In addition, there is also a requirement set for the insurer and a branch of the Member State insurer, in the case of liquidation or reorganisation, to submit the FCMC the report on the status on the day before the commencement of liquidation or reorganisation. The FCMC will publish the data sub-

mitted by the insurer and a branch of the Member State insurer, who has commenced liquidation or reorganisation, on the FCMC’s website, providing information about the total volumes of operation of the insurance market.

Lifting of the general profit allocation restriction set under the impact of the Covid-19 pandemic

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. Therefore, in 2020, none of the banks disbursed dividends, but allocated the assets to strengthening capital. In September of 2021, the ECB and the ESRB, in light of reducing uncertainties caused by the Covid-19 pandemic in the global financial markets and macroeconomic forecasts at that time, confirming the recovery of the national economy, resolved not to further extend the recommendations previously issued by them regarding limiting dividend payments. By way of continuing to support the common approach of EU countries towards dividend payments, share repurchase and remuneration policy, the FCMC also resumed the previously implemented practice, at the same time separately assessing the situation in each credit institution and insurance company under the direct supervision of the FCMC, as well as applying a prudent, forward-looking approach, based on the assessment of business model sustainability and risks of an institution, as well as maintaining a stable capital base.

Application of macroprudential instruments

Given that the negative impact of the Covid-19 pandemic on economic development is still observed, in 2021, like in the year before, in general, no new, more stringent macro-prudential requirements were imposed on the financial sector. As the financial cycle indicators remained at a low level, the size of the CCyB⁵ was not changed (0%). In turn, taking into account the changes in the systemic importance indicators of credit institutions, **AS “BlueOr Bank” was identified as the fifth O-SII⁶** in the financial sector of the Republic of Latvia, prescribing the O-SII capital buffer requirement to it in the amount of 0.25% of the total exposure value calculated in accordance with Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No. 648/2012. The O-SII capi-

⁵ <https://www.fktk.lv/mediju-telpa/nozares-temati/makroprudenciala-uzraudziba/precikliska-kapitala-rezerve/>

⁶ <https://www.fktk.lv/mediju-telpa/nozares-temati/makroprudenciala-uzraudziba/sistemiski-nozimigas-iestades/>

tal buffer requirements of the four previously identified O-SII – AS “Swedbank”, AS “SEB banka”, AS “Citadele banka” and AS “Rietumu Banka” – were correspondingly set in the amount of 2%, 1.75%, 1.50% and 1%. Compared to the previously set requirements, the amount of the O-SII capital buffer requirement of AS “Citadele banka” was increased by 0.25%, whereas those of AS “SEB banka” and AS “Rietumu Banka” – reduced by 0.25%. Given the negative impact of the Covid-19 pandemic on the national economy and high uncertainty regarding epidemiological and economic development, a transitional period was prescribed for the application of the increase of the O-SII capital buffer requirement of AS “Citadele banka” and initially prescribed buffer requirement of AS “BlueOr Bank”, and the banks will have to start fulfilling these requirements from 2023.

On 1 January 2022, the amendments to the FCMC’s “Regulations on Credit Risk Management” took effect, also providing for the application of requirements of the borrower-based instruments⁷ to credit institutions registered in other EU Member States, which are entitled to provide financial services in the Republic of Latvia (with or without a branch). These amendments will reduce the potential for regulatory arbitrage and improve the effectiveness of borrower-based 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.

The latest EU primary legislation proposals in the field of financial services

The FCMC continues to actively follow the changes in the EU primary regulation of the financial sector. The most important of the currently topical proposals for amendments are the planned amendments to CRD⁸ and CRR⁹, in order to complete the implementation of the international supervisory standards *Basel III*, commence the implementation of the CMU action plan, providing the development of the draft regulation for the establishment of the ESAP, as well as the review of Solvency II and resolution requirements for insurers.

Basel III final is a proposal published by the Basel Committee on Banking Supervision in 2017, aimed at promoting the resilience and ability of the banking system to finance the national economy and address the gaps in the banking regulation identified after the global financial crisis (2008-2010). In October 2021, the EC published a proposal for amend-

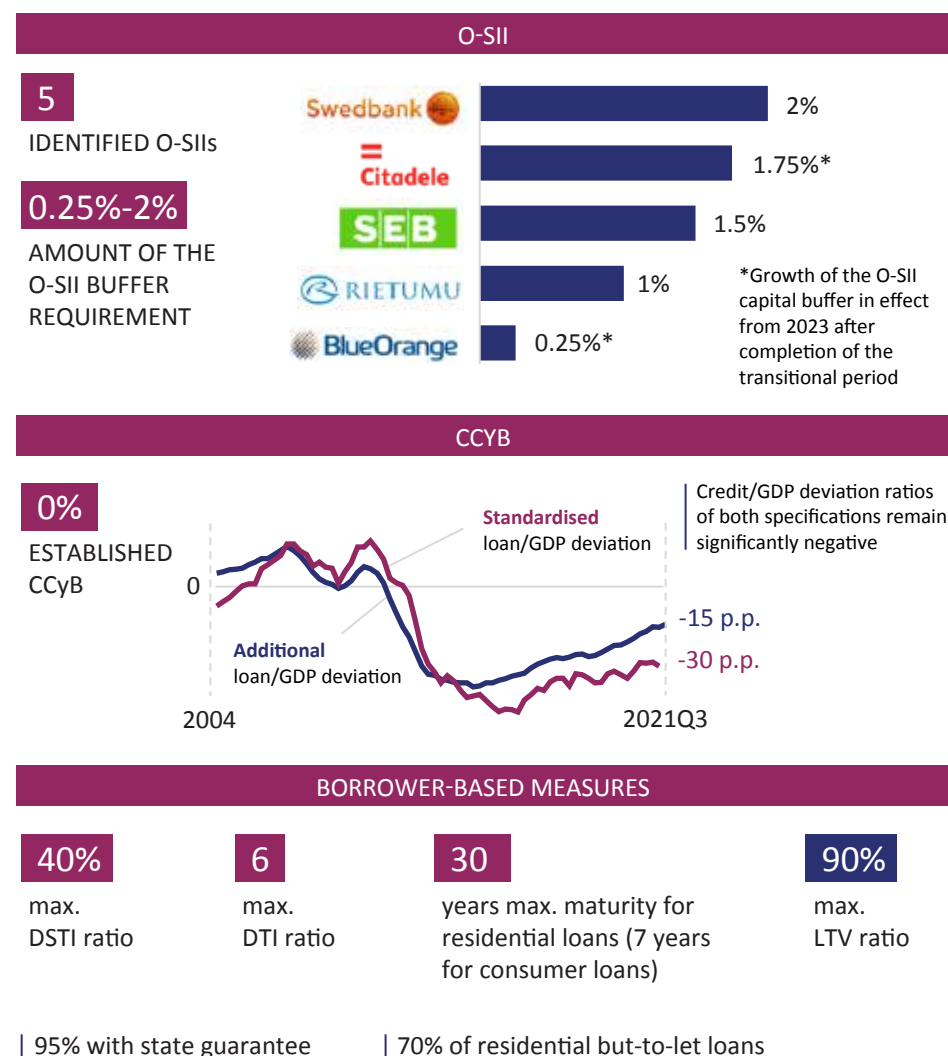


Figure 9. The most important established macroprudential supervision instruments

⁷ <https://www.fktk.lv/mediju-telpa/nozares-temati/makroprudenciala-uzraudziba/uz-aiznemejiem-verstie-instrumenti/>

⁸ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

⁹ Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No. 648/2012.

ments to CRD and CRR, expected to take effect in 2025. The proposal introduces a new requirement – **output floor for internal models** – prescribing the limit up to which the output obtained by the credit institution by the internal model may differ from the standardised risk degree set by the regulation for the purposes of calculating capital requirements. Considerable changes also pertain to a standardised and internal ratings-based credit risk calculation approach, credit risk value adjustment, operational risk evaluation methods, as well as the calculation of capital requirements for market risk in the trading book. In addition to the implementation of the Basel III Final reform, the EC proposal also contains new requirements for a credit institution in the environmental, social and governance (ESG) field, as well as changes within the framework of supervision, crisis management and deposit guarantees of the branches of third-country credit institutions.

In order to promote the implementation of the first CMU Action Plan adopted on 24 September 2020¹⁰ and to ensure centralised access to publicly available information relevant in the field of financial services, capital markets and sustainability, on 25 November 2021, the EC published the CMU proposal package, consisting of the ESAP Regulation¹¹, as well as amendments to the Regulation on European long-term investment funds, the Regulation on markets in financial instruments and the Directive on alternative investment fund managers. The proposal for ESAP Regulation provides for supplementing the existing framework of information disclosure requirements, ensuring public access to information which the enterprises and other entities are required to publish in accordance with the EU regulatory enactments, incl. the Regulation on prospectus, Regulation on short selling, Regulation on market abuse (market abuse regulation), Regulation on taxonomy, Directive on transparency, Directive on takeover bids, Directive on audit, etc. A possibility is provided for any entity (incl. small and medium enterprise and non-listed entity) to voluntarily submit to the ESAP financial, sustainability or any other relevant information. Within the scope of the ESAP, this information shall be compiled by special purpose vehicles established for this, the list of which will be posted and maintained by the ESMA on its website. It is planned to provide access to ESAP information for free (at the same time providing for the rights of the ESMA to apply the fee to the users requesting an excessive scope of information, or for the provision of information subject to frequent updates). It is not planned to apply any complicated conditions for access to data in the ESAP, in order to use them and to do it repeatedly. It is planned to open the ESAP at the end of 2024, gradually supplementing the available functionality during the transitional period till 2026. The purpose of amendments to the Regulation on European

long-term investment funds is to promote investments in long-term assets via alternative investment fund managers and to balance out the interests of various investors, focusing on the protection of such investors, who are not professional investors, at the same time making the product more attractive. The Directive on alternative investment fund managers, in turn, is being reviewed, in order to achieve additional funding possibilities for commercial companies, by developing the involvement of alternative investment funds in lending activities and setting uniform requirements for such funds. The purpose of amendments to the Directive on alternative investment fund managers is to promote the application of liquidity management instruments, by also introducing common requirements for more effective liquidity risk management under complicated market conditions, to improve regulation in cases of the delegation of functions of alternative investment fund managers and in the field of the protection of interests of investors.

In the field of insurance, on 22 September 2021, the EC published a proposal for comprehensive amendments to the Solvency II Directive, as well as for the new Directive on the recovery and resolution framework of insurance and reinsurance companies¹². The purpose of amendments to the Solvency II Directive is to promote the input of insurers in the provision of funding for overcoming the adverse effects of the Covid-19 pandemic in the EU national economy, to strengthen the operation of the CMU and to facilitate the allocation of funds for the implementation of the European Green Deal. It is planned to strengthen the stimuli for the insurers to be involved in the provision of sustainable funding of longer terms, to improve requirements regarding risk sensitivity, minimise the impact of excessive short-term market fluctuations on the solvency of insurers, as well as to improve the proportionality approach to the application of requirements. Additionally, it is planned to improve the quality, consistency and coordination of supervision of the insurance sector across the EU, strengthen the protection of policyholders and beneficiaries (incl. in cases when the insurer becomes insolvent) and to improve the ability to respond to the potential accumulation of systemic risk in the insurance sector. In turn, the Directive on the recovery and resolution framework of insurance and reinsurance companies is planned to be implemented for the purposes of ensuring that the insurers and supervisory authorities, across the EU are better prepared for significant financial complications. It is also planned to include requirements in the Directive for resolution planning and resolvability assessments, resolution tools and rights of supervisory authorities, ensuring the resolution of cross-border groups, as well as for applicable sanctions.

¹⁰ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions “A capital Markets Union for people and businesses – new action plan” (COM(2020) 590 final).

¹¹ Proposal for a Regulation of the European Parliament and of the Council establishing a European single access point providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability.

¹² Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of insurance and reinsurance companies and amending Directives 2002/47/EC, 2004/25/EC, 2009/138/EC, (ES) 2017/1132 and Regulations (EU) No. 1094/2010 and (EU) No. 648/2012.

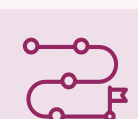
Business environment favourable to innovative and secure financial services



The experts of the Innovation Hub provided support in 54 consultations for the financial companies.



44 out of 125 Latvian financial market participants interviewed are using innovative solutions for the provision of financial services.



The FCMC has developed and has been implementing the *SupTech* strategy for 5 years.



Licensing guides are developed for the providers of crowdfunding, payment and e-money services.

3

Innovation

In 2021, the FCMC continued to promote the development of financial technologies or the FinTech environment, provide support to new and existing financial enterprises, create an innovative and friendly environment in the sector of financial services, as well as to elaborate on the regulatory framework. According to the data of the FCMC's survey, in 2021, 44 out of 125 market participants indicated that they are already using a certain innovative solution for the provision of financial services; furthermore, 15 of them have formed a special team for the implementation and development of innovative solutions.

Digital transformation in the financial sector is carried out by systemic banks and separate FinTech enterprises. There are two directions of inno-

vation observed: one arises from the market regulation (Second Payment Services Directive (PSD2), near-field communication (NFC), application programming interface (API)), while the other is based on the own initiative of financial and capital market participants (biometric data, artificial intelligence, big data, automated consulting, machine learning, etc.). Banks have implemented application programming interfaces, contactless payments and biometric solutions; nevertheless, investments in advanced innovation are insufficient. Cloud computing is being used two times less (14% of respondents) than on average in the EU. 50% of small financial institutions are not planning to introduce innovations in the nearest future. To become more customer-orientated, banks would have to more actively adapt innovations such as artificial intelligence, big data and cloud analytics, increase the budget intended for information technologies and at the same time carefully manage the cyber risks pertaining to the third-party service providers.

Information systems security management

The operation of financial institutions becomes increasingly more digitised and increasingly more dependent on the security of information systems. In 2021, the FCMC conducted a number of security checks of information systems of market participants, especially in the use of new technologies. At present, together with the EU supervisors, work is in progress on the draft of the Digital Operational Resilience Act (DORA). To ensure the uninterrupted availability of critical financial services to the public in Latvia in the case of a threat to the national security, in 2021, the FCMC approved “Regulations on the Management of Critical Financial Sector Services”. The regulations identify the critical service providers, set the requirements for the scope of critical services and uniform requirements for critical services’ continuity plans.

FCMC support in the field of *FinTech*

In 2021, the FCMC continued to develop the *FinTech* environment by expanding the operation of the support tools – Innovation Hub and Regulatory Sandbox. Compared to the previous year, the number of consultations provided by the Innovation Hub to existing and new enterprises and idea authors planning to develop innovative financial services in Latvia grew by 30%. In the Innovation Hub, the FCMC experts provide consultations in the field of licensing, supervision, AML/CTPF and other fields. In 2021, the majority of consultations were on the provision of payment services (29%) and crowdfunding (24%).

18% of consultations provided in the Innovation Hub in 2021 were in the field of regulatory technologies or *RegTech* – the enterprises develop the MLTPF risk management solutions, help to automate the processes of customer due diligence and assessment in financial institutions and verify the reputation, as well as assist in establishing credit risk assessment models. Certain interest is also observed regarding the provision of crypto asset services (13% of consultations).

In 2021, the FCMC expanded the operation of the Innovation Hub by introducing regular thematic events and creating a dialogue with market participants in the fields of payment services, crowdfunding and financial technologies. In 2021, several hundreds of financial sector experts attended the seminars organised by the FCMC. In addition, the FCMC experts also shared their knowledge and experience in other events related to *FinTech* sector.

To incentivise the development of *FinTech* market, in 2021, the FCMC reviewed the licen-

sing process and introduced a new approach – pre-licensing assessment. To improve the understanding of the licensing process, licensing guides for crowdfunding and payment and e-money service providers have been developed and made available on the FCMC website.

In 2021, the establishment of the common crypto-asset regulation for MiCA (Markets in Crypto-assets) continued on the EU level. The regulation will promote cooperation between the countries and will ensure larger regulatory certainty for market participants. The new virtual asset regulation will help to ensure a high level of consumer and investor protection, market integrity and financial stability, as well as to apply the AML/CTPF requirements in relations between the participants involved in virtual asset transactions.

SupTech strategy and the implementation thereof

2021 was the first year after the reorganisation of the information technology function of the FCMC. It resulted in the establishment of the line of development and maintenance of the supervisory technologies or *SupTech*, also corresponding to the most up-to-date trends in related EU organisations. The main purpose of structural changes is to directly prioritise the improvement of efficiency and quality of the work of the financial and capital market supervision.

One of the first activities was the establishment of a medium-term (five-year) *SupTech* strategy. The strategy is subordinated to the overall strategy of the FCMC. *SupTech* strategy defines the mission of *SupTech*, prescribing the focus on the main customer groups of the FCMC (incl. the customers of the financial and capital market participants), in order to implement the protection of their interests and facilitation of their possibilities in an understandable, convenient, effective, proactive and sustainable manner.

Strategic tasks defined herein below already prescribe the directions, in which the annual development projects are to be implemented. The strategic tasks take into account that a significant scope of information exists to be analysed within the supervisory process, which, moreover, has a tendency to grow constantly. This requires introducing efficient and modern analytical tools for the processing of both structured data and text.

The FCMC is increasingly involved in international cooperation with related organisations, and this, in turn, imposes a duty to also be equivalent in technological terms and to introduce or integrate information systems, prescribed by the projects and cooperation directions implemented by the EU in a centralised way. Thus, significant resources must be constantly devoted to this direction.

One more of the most significant *SupTech* strategic directions is the introduction and development of technologically equipped services (*RegTech*) in the activities of the financial and capital market participants.

Development focus and priorities of *SupTech* in 2021

Considering the integration of the FCMC and the Bank of Latvia planned to take place in 2023, technologies activities in relation to this process have already been commenced in 2021. The main purpose of these activities is to ensure the continuity of supervisory activity, optimisation of overlapping activities and systems, as well as development of new information systems, which would ensure the operation of the Bank of Latvia after integration.

Considering the objectives of the new *SupTech* strategy, attention was paid to the introduction of new technologies. The first step is the comprehension, assessment and practical testing of such technologies. To ensure it, the FCMC innovation laboratory (iLab) was established, being an organisational platform for exploring new processes and technologies, closely cooperating with the FCMC employees of various profiles (the experts of both the field of information technologies and various supervision services) and external cooperation partners.

One of the certain directions of future development is using cloud computing services, because it is also the course of development for a large part of manufacturers of significant technologies and systems. This means that, without the introduction of cloud computing services, the development of supervision is actually not possible, either. Therefore, in 2021, activities and projects were implemented in mastering and introducing cloud computing technologies; however, it cannot be accomplished in a short term, therefore projects in this direction would also continue in the next years.

To improve the efficiency of the activities of the FCMC, in 2021, the project management framework has been reviewed and a new framework has been implemented, which will help to both better manage the project portfolio and to implement the projects themselves. It is the FCMC's initiative that involves all employees and also continues in 2022.

Technology and innovation

In 2021, the FCMC continued to develop an efficient and standardised financial and statistical data management system both for the receipt of data and for a more feasible use thereof for ensuring supervisory processes. To ensure a uniform environment, the FCMC is using the XBRL data format not only for the receipt of the EU centralised reports, but also for ensuring local reports. To improve the service, the FCMC introduced report taxonomy repository, which is freely available to the financial and capital market participants. The publicly available register of market participants on the FCMC website was also ensured as machine-readable data.

Key projects

In total, 48 projects of various scopes were implemented in 2021. The most significant of them is the updated AML/CTPF supervision solution, ensuring swift and detailed detection of AML/CTPF violations. Supervisory Information System was introduced in the everyday supervisory processes. It was a supplement to the already introduced documentation and management process of the on-site audits, enabling the audit and other supervisory processes to be made even more transparent and efficient. To improve data safety and the comfort of service for the financial and capital market participants, a new information system for the receipt of data was introduced.

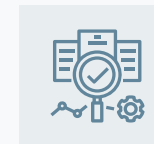
iLab: initiatives and implemented projects

Innovation in the development of operation of the FCMC is not a goal in itself, but rather a tool for improving quality, possibilities and efficiency. To ensure the practical implementation of innovations and, at the same time, not to spend unacceptably large resources, the innovation laboratory of the FCMC was established – iLab. In 2021, four iLab projects have been implemented (one of them was completed in 2022). In these processes, each of which lasted three months, voice processing, cloud computing business intelligence and network analytics solutions have been assessed. As a result, one of the explored technologies is incorporated into the current project plan and the process of development and introduction has been commenced. In turn, two more technologies were identified as being subject to updating in the project portfolio in the medium term.

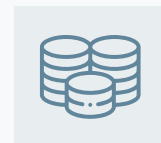
An effective financial sector crisis management and bank resolution mechanism



In 2021, 12 resolution plans have been updated, including resolution plans of 9 banks under the direct competence of the FCMC.



A dry-run of the operation of the resolution instrument – bail-in tool – has been performed.



In 2021, Latvian banks transferred 4.6 million euro to the SRF and since 2015, Latvian banks have contributed 43.3 million euro to the SRF.



Payments to the DGF and the FPI have been ensured to a full extent. At the end of the year, 166.7 million euro were held in the DGF account in the Bank of Latvia, and 19.3 million euro – in the FPI account.

4

4.1. Changes to the resolution mechanism and protection systems

The SRB carries out the functions of a resolution authority over Latvian banks, as well as the cross-border banking groups 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 2021, three Latvian banks and one branch of a Member State-based bank with an 81.9% share in total banking assets were subjected to direct SRB resolution.

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 and goals. In the 2021 plan, the resolution priorities were:

- to achieve the immediate application of the resolution process in particular situations (to continue the operationalisation of resolution instruments);
- to ensure the updating of resolution plans and approval of the decisions on minimum requirements for equity and eligible liabilities;
- to ensure timely contributions to the SRF.

Within the set priorities, in 2021 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 resolution practice and improved the resolution framework in accordance with work plans. In 2021, the dry-run of the operation of the resolution instru-

ment – bail-in tool – was performed, in order to assess the effectiveness of the existing regulation, identify country-specific features and correspondingly enhance the internal processes. As a result, several improvements have been introduced in the internal processes of the FCMC, inter alia, regulations for selecting a candidate for the position of a special manager of a credit institution have been developed, laying down the procedure, under which the FCMC, by implementing resolution activities, appoints a special manager in accordance with the requirements of Section 42 of the Law on Recovery and Resolution of Credit Institutions and Investment Firms.

In 2021, all Latvian banks had developed resolution plans. Based on the resolution plans developed in the previous years, in the reporting year, more detailed development and improvement of the resolution plans was continued, especially for 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 2021, 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 a Member State bank falling within the direct competence of the SRB. During the review of the bank resolution plans, an in-depth assessment of the most appropriate resolution tools for each bank and the operational steps to implement them continued, working closely with banking professionals to ensure the receipt of the necessary information for planning resolution, to identify obstacles to the resolution process and to take proactive measures.

In 2021, 12 resolution plans have been updated, including resolution plans of 9 banks under the direct competence of the FCMC.

In 2021, 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 SRB, in close cooperation with the national resolution authorities (including the FCMC), is responsible for calculating the annual ex-ante contribution to the SRF, made by each institution in accordance with the provisions of the Single Resolution Mechanism

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 at least 1% of the covered deposits in all credit institutions in all involved Member States. According to the calculations made by the SRB, in 2021 Latvian banks transferred 4.6 million euro to the SRF and since 2015, Latvian banks have contributed 43.3 million euro 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 the FCMC in 2021 was to continue the enhancement of the crisis management process by means of an effective and coordinated crisis management mechanism.

In 2021, 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 introduce the necessary amendments to 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. This Group consists of the ministries of finance, central banks, and supervisory and resolution authorities of eight Nordic countries 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:

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

Deposit Guarantee Fund

According to the requirements of Section 6 of the Deposit Guarantee Law, the FCMC performs the stress test of the DGF on a regular basis. In 2021, the reviews of the list of the CCU GC receivers have been performed. The ability of 27 CCUs to prepare the list of depositors and submit information requested by the FCMC in the set form and timeframe was verified. During the stress test, the FCMC provided support to all CCUs with explanations regarding the preparation of information to be requested and after the completion of the test sent a letter, requesting the introduction of improvements in the internal control system.

In 2021, the inspection of the GC cross-border disbursement function has been implemented, as well. At this stage of the stress test, an external participant was also involved – Lithuanian Deposit Guarantee Fund (VĮ "Indėlių ir investicijų draudimas"). The goal of the test was to evaluate the effectiveness of cross-border cooperation and information exchange in accordance with the conditions of the cooperation agreement concluded between the Funds. Taking into account the stress test results, improvements of internal processes were performed.

The average applicable adjustment coefficient for banks in 2021 was 122.09%, but for the CCU – 93.49%. It means that the banks contributed, on average, 22.09% more than they would have to contribute from the amount of covered deposits according to the base rate, while the CCU – on average, by 6.51% less. Deposit-takers paid 20.4 million euro into the DGF for 2021.

During the reporting year, the FCMC ensured the GC disbursements via AS "Cita-dele banka" (the disbursing bank) to the depositors of AS "Latvijas Krājbanka" in

liquidation (hereinafter – LAS "Latvijas Krājbanka"), AS "ABLV Bank" in liquidation (hereinafter – LAS "ABLV Bank") and AS "PNB Banka" in liquidation (hereinafter – LAS "PNB Banka") in the amount prescribed by the Deposit Guarantee Law.

In 2021, GCs were disbursed:

- in the amount of 189 thousand euro to the depositors of LAS "Latvijas Krājbanka";
- in the amount of 2,230 thousand euro to the depositors of LAS "ABLV Bank";
- in the amount of 2,911 thousand euro to the depositors of LAS "PNB Banka".

In 2021, the FCMC ensured the accumulation and management of the funds of the DGF, and at the end of the year, the amount held in the NGF account with the Bank of Latvia was 166.7 million euro.

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 2021 and the independent auditors' report thereon are available on the FCMC website at: <https://www.fktk.lv/par-mums/gada-parskati/>.

GC disbursement to the depositors of AS "TRASTA KOMERCBANKA"

The FCMC made the decision to instruct AS "TRASTA KOMERCBANKA" to perform the GC disbursements from the bank's own assets, considering:

- the provision of Section 25 of the Deposit Guarantee Law that the GC from the assets of the deposit-taker and of the DGF may be disbursed through the deposit-taker regarding whom unavailability of deposits has set in;
- the fact that, upon setting in of the unavailability of deposits, AS "TRASTA KOMERCBANKA" had sufficient assets to disburse the GC to all its depositors, which were entitled to the GC in full.

Therefore, no assets of the DGF had been used to disburse the GC to the depositors of AS "TRASTA KOMERCBANKA".

On 4 March 2021, the depositors of AS "TRASTA KOMERCBANKA" lost their claim rights to the DGF regarding the GC disbursement, because five years had lapsed since the day when the FCMC detected the unavailability of deposits of AS "TRASTA KOMERCBANKA"

(Section 3, Paragraph four of the Deposit Guarantee Law), except for the GC to the depositors, whose rights to receive the GC have been reinstated as of 4 March 2021 in accordance with the requirements of Section 19, Paragraph four of the Deposit Guarantee Law or considering the conditions of Section 3, Paragraph four of the Deposit Guarantee Law. The number of such depositors is 103 and the sum total of GCs – 239 thousand euro. These depositors can still receive the GC till 3 March 2026.

GC disbursement to the depositors of “LABA” Cooperative Credit Union

On 14 July 2020, the FCMC cancelled the licence issued to “LABA” Cooperative Credit Union (“LABA”) on 20 October 2005 to operate a credit union, 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 disbursement starting from 23 July 2020 to “LABA” depositors from DGF funds through the FCMC. According to the accounting data of “LABA”, at the end of 2021, 41 depositors were still eligible to receive the GC in the amount of 28.9 thousand euro.

Fund for the Protection of the Insured

The assets of the FPI are made up of deductions of 0.1% by insurance companies from their total gross insurance premiums received from natural persons for the types of insurance specified in the law. *Since the beginning of the operation of the FPI, the assets thereof have been allocated in an amount of 12.3 thousand euro for the disbursement of the 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 2021, 19.3 million euro were accumulated in the FPI.*

Protection of customers of the financial instruments market (investors)

The investor protection scheme is based on the Investor Protection Law. Compensation for each investor is calculated in the amount of up to 20,000 euro. Disbursement of compensation is ensured by the FCMC.

The Investor Protection Law does not provide for accumulating the assets of compensation disbursement, but, if necessary, it is provided that the assets are ensured by the system participants of legal entities, who, under the established procedure, have received the FCMC permit (licence) for the provision of investment services.

Professional and responsible organisation with effective corporate governance and processes

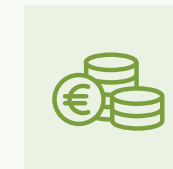
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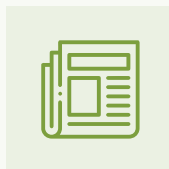
58 meetings of the FCMC Board were held, with 185 decisions made therein, as well as 9 meetings of the Consultative Council of the Financial and Capital Market were held.



Financial Literacy Strategy for the Latvian Population for 2021-2027 has been developed, the brand “Naudasprasme” (*Money Literacy*) was introduced.



Actual total budget execution expenditure was 11,363 thousand euro, which is 10.3% less than in 2020.



Publicity volume in media increased by 20%.



Average number of employees was 174.5.



5 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, 9 whistleblowing reports were received in accordance with the requirements of the FCMC regulations.

5.1. Implementing Sustainability Strategy

In 2021, the sustainability strategy of the FCMC was developed and approved, in order to purposefully facilitate the development of a sustainable, sound and safe financial sector of Latvia and a trustworthy and respectful relationship with the public, as well as to introduce the principles of the socially responsible organisation in the work of the FCMC. Sustainable development is one of the priorities of the FCMC in 2021 and 2022.

The role of the FCMC as the financial sector supervisor in promoting sus-

tainable development is to maintain a dialogue with the financial sector, in order to encourage the financial and capital market participants to introduce sustainability principles in their operational strategies and products.

The FCMC as the financial sector supervisor should make use of the supervisory tools at its disposal, in order to ensure the preparedness and resilience of the financial institutions to all types of risks, incl. those related to climate change. Attention should be paid to the establishment of appropriate risk management systems and observance of the principles of good corporate governance. Timely identified risks and taking purposeful steps for their mitigation ensures the adoption of well-considered

decisions and the ability to flexibly react in a situation of changes. The second significant aspect provided for by the FCMC's sustainability strategy is the integration of sustainability aspects into the FCMC's corporate governance, stipulating the development of an immersive, innovative and eco-efficient work environment and building the value of human capital, by increasing productivity, as well as paying sufficient attention to the aspects of well-being.

Along with the above mentioned, a significant role in the FCMC's sustainability strategy is given to promoting understanding about the meaning of sustainable finance, by stimulating the change of habits of the public and promoting personal financial literacy.

In order to implement productive cooperation and dialogue with the financial sector, cooperation partners and the public, in 2021, the FCMC was in close dialogue with the banking sector and insurance companies, established the "Green Finance Laboratory" on the LinkedIn platform, explained the essence and application of the existing and planned laws and regulations, organised and took part in events on sustainability topics, as well as signed the memorandum of cooperation on the facilitation of sustainability of the financial sector.

A significant area of the FCMC's sustainability strategy is the integration of sustainability aspects into the financial sector supervision implemented by the FCMC. To do this, in 2021, a self-assessment survey of the banks has been conducted in 2021.

The FCMC engaged in shaping a sustainable regulatory environment promoting competitiveness, by participating in the working groups on sustainability (Interinstitutional Management Working Group, EBA's *Subgroup on Sustainable Finance*, EBA's *SCARA Transparency Subgroup*, *Joint Committee Sub-Committee on Consumer Protection and Financial Innovation ESG Subgroup*, EIOPA's *Sustainable Finance Project Group*, and ESMA's *Coordination Network on Sustainability*). Also, the preparation of opinions about the drafts of the EU future regulation was ensured, the FCMC's "Regulations on Credit Risk Management" were updated, information about the laws and regulations in the field of sustainability was compiled and posted on the FCMC's website, as well as answers were provided within various supervisory surveys.

By developing an immersive, innovative and eco-efficient work environment, the FCMC shifted to using green electricity, introduced sustainability standards in procurements, as well as reduced CO₂ consumption (electric cars, improved the ventilation system, reduced water and office paper consumption).

5.2. 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 2021, the FCMC ensured public access to the wide array of information on the website and ensured operative information flows on topical issues through the mass media, as well as implemented several activities related to promoting financial literacy. A great deal of attention in the communication was paid to the development of all segments, but, more specifically, capital market, analysis of the impact of the Covid-19 pandemic on the Latvian financial sector and strengthening the risk assessment-based approach.

External communication

In 2021, there were 4,258 references to the FCMC in the Latvian mass media. As compared to the previous year, the publicity volume increased by 20%. This is attributed to the FCMC actively operating with respect to the development of the Latvian financial and capital market, as well as actively communicating regarding financial literacy issues.

Information reflected in mass media is indicative of a significant activation of the FCMC's operation, with a special focus on the subject of financial literacy, incl. identifying fraudulent financial service providers, issues of the development of the capital market and other segments and fields, as well as various issues regarding the supervision of financial and capital market participants.

In the reporting year, the Communications and Financial Literacy Division prepared and spread communications to Latvian and foreign mass media on the decisions taken by the Board of the FCMC, the activities of financial market participants, topicalities of regulatory requirements, changes implemented in the banking sector, the sanctions imposed by the FCMC on market participants, changes in the laws and regulations and other FCMC topicalities. In 2021, infographics were prepared and published regarding the performance results of the financial market sectors, accomplishments in the field of combatting financial crime and regarding the sustainability strategy, as well as the Financial Literacy Strategy for the Latvian Population and the results thereof.

In 2021, the FCMC expanded communication via digital channels by developing new content formats and strengthening communication in social networks. The number of followers of the FCMC's social network accounts continued to grow, and at the end of the year the FCMC's Twitter account had 3,040 followers, while LinkedIn – 3,620 followers.

In the reporting year, comments and explanations were provided to the Latvian and foreign mass media representatives, and regular interviews of FCMC management were also organised in the Latvian mass media, thus performing broad explanatory work that gradually contributed to the change of understanding in the mass media environment regarding the FCMC, its work in promoting changes in the financial sector, the introduction of a risk-based approach, establishment of the FinTech ecosystem and advancement of the balanced development of all segments. Much attention was paid to informing the Latvian population about investment fraudsters and the signs for identifying fraudsters.

Corporate communication

In 2021, 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 as well as to promote a dialogue with market participants and their associations and more productive and effective cooperation, to reduce the administrative burden and ensure discussions on the issues regarding the development of financial market segments.

In the reporting year, special attention was paid to the issues of capital market development. In January, Latvian Capital Market Forum 2021 “Today’s Decisions = Future Opportunities” was held, in which the FCMC presented a 10-step programme for the development of Latvia’s capital market, discussed the capital market challenges and the measures to be taken in the future together with Latvian and foreign experts, as well as presented the experience of other Baltic states. In addition to the above mentioned, the FCMC initiated and, jointly with other institutions, organised a cycle of six discussions for better corporate governance and a forum, where the newly introduced Latvian Corporate Governance Awards were granted.

Special attention in public communication was paid to explaining various issues related to the monitoring of the Covid-19 situation, explaining the shift in the work style of the FCMC, aimed at making the FCMC a more open and more dialogue-orientated institution, and providing information about the change of approach with respect to inspections, as well as integration with the Bank of Latvia.

At the end of 2021, the FCMC conducted a survey of the opinion leaders and representatives of the parties involved in the issues of the financial sector, where 37 people from public authorities, private enterprises and non-governmental organisations took part, providing their evaluation of the FCMC’s work, communication and tasks to be performed in the future.

The respondents of the survey, when characterising the topicalities of the Latvian financial sector, emphasised four important directions:

- situation after “capital repairs”, where **the need to introduce risk management-based governance model was brought up to date**. At the same time, **the steep FinTech sector-driven development** and **general digitisation of the financial sector** was accentuated;
- emphasis on the **local capital market development**, forming a priority for all audiences of respondents. It is exactly what is seen as the main driving force for the improvement and development of the competitiveness of Latvian national economy;
- **sustainability issues** – the theme of importance across the entire framework of operation of the financial sector.

Unanimity is observed among the respondents regarding significant transformations in the operation of the FCMC, the shift in decision-making and structure was emphasised, as well as the balance between the supervision and development of the financial sector, specifying that significant improvements have been introduced in the field of development.

The majority of participants of the survey highly appreciate the positive changes, characterising the style of management of the FCMC. Special emphasis is laid on involvement in dialogue, orientation towards development, progressivity, professionalism, transparency, effectiveness, as well as the ability to distinguish what is important and what is not.

The FCMC’s public communication was rated with 4 points on a scale of 5 points. The rating has grown since 2016.

As regards the prospects for the future, one key word dominates in the answers of the survey participants – risk-based development is commensurate and facilitating the sustainability of the financial sector. The need to view the supervisory issues of the sector from the competition perspective was also emphasised, namely, viewing the supervisors of other countries and the practice implemented by them from the perspective of competition. Educating the population and restoring the reputation of Latvia in the international financial sector were additionally emphasised as important work directions.

Financial Literacy

In 2021, larger attention in the field of financial literacy was paid to the implementation of the following tasks:

- to develop the Financial Literacy Strategy for the Latvian Population for 2021-2027;

- to coordinate the operation of the work group for implementing the Financial Literacy Strategy;
- to develop and introduce the financial literacy brand;
- to monitor the impact of the Covid-19 pandemic on the financial resilience of the population, as well as to facilitate the ability to identify financial fraudsters.

At the beginning of 2021, a working group for the development and implementation of the Latvian Financial Literacy Strategy established by the FCMC completed the development of the Financial Literacy Strategy for the Latvian Population for 2021-2027. It was presented to the public in March 2021, when opening the “Financial Literacy Week 2021”. During the period of this week, various informative and educational events were organised, as well as materials published, being a valuable instrument for raising the financial literacy of various groups of society. In light of the restrictions related to the spread of the Covid-19 pandemic, events were mainly held online, and it ensured that a broad audience was reached. For the purposes of successful implementation of the strategy, starting from 2021, the working group develops a plan of measures for a particular year, ensuring more accurate planning, more targeted implementation of activities and the achievement of results. In addition to the above mentioned, the FCMC ensured the coordination of work of the working group and organisation of regular meetings.

At the beginning of 2021, the financial literacy brand “Naudasprasme” (*Money Literacy*) has been introduced, helping the population of Latvia to identify high-quality and trustworthy content in the field of financial literacy.

In the reporting year, participation in the work of the OECD financial literacy expert body *International Network on Financial Education* (INFE) and the EC Financial Literacy Working Group was ensured. The work of these organisations was mainly focussed on revising the financial literacy standard for adults, monitoring the impact of the Covid-19 pandemic, sustainability issues and more efficient raising of financial literacy among various groups of society.

During the Covid-19 pandemic, the biggest challenges in terms of financial literacy stemmed from the activities of financial fraudsters with the aim of defrauding the population of finances and data. The FCMC informed the public on a regular basis regarding the actions of fraudsters and non-licensed service providers. In 2021, the website section was created, as well as two informative materials were prepared on how to identify fraudsters and to act correspondingly. The FCMC also continued to ensure up-to-date content in the section “Warnings” on its website, as well as on the social networks *Facebook* and *Twitter*.

The FCMC also paid attention to the financial sustainability of the population during the crisis, which was generally satisfactory. During the Covid-19 pandemic, the population reduced their spending and became more cautious about borrowing. In 2021, under the influence of high uncertainty and limited consumption possibilities, the domestic household deposits, compared to the previous year, grew by 15.2%. Growth was also observed in the State-funded pension schemes (36.0%) and private pension schemes (19.7%).

In accordance with the Transitional Provisions of the Law on the Bank of Latvia, starting from 1 January 2022, the Bank of Latvia shall take over the fulfilment of the task – promotion of the financial literacy and economic literacy of the general public from the FCMC.

5.3. International cooperation

International cooperation is an important and comprehensive direction of the FCMC's activities. Within the scope of this cooperation, the FCMC maintains regular close contact 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.

Similarly to 2020, also in 2021 international cooperation activities were largely affected by the Covid-19 pandemic, determining the need to mainly continue cooperation in the digital environment and to seek more and more new solutions and possibilities for the development of cooperation and adapting it to the new circumstances.

The main international partners of the FCMC, also in the reporting year, were the supervisory and resolution authorities of other countries and the European financial supervision authorities (EBA, EIOPA, ESMA, ESRB) with whom regular cooperation and information exchange was ensured, along with ensuring participation in the SSM and SRM. The FCMC also provided support to other public administration authorities, 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 EC and OECD, as well as preparing information on financial sector regulation, supervision and resolution issues for various reports and reviews on Latvia, such as cooperation with the EC, OECD, IMF, the European Bank for Reconstruction and Development, rating agencies and other formats.

The FCMC continued cooperation, exchange of information and the representation of Latvia's interests in the Nordic-Baltic Cooperation Forum, the European Forum of Deposit Insurers, Moneyval Committee of the European Council, as well as in the Group of Banking Supervisors from Central and Eastern Europe and the International Organization of Securities Commissions.

2021 was a productive year in the field of new financial sector EU-level legislative initiatives, which were also actively discussed at the meetings of the international working groups and committees, where the FCMC represented the interests of Latvia. In the first six months of 2021, the EC published its proposal for a Corporate Sustainability Reporting Directive¹³, in the middle of the year – the package of four proposals¹⁴ in the field of AML/CTPF, amendments to the Consumer Credit Directive¹⁵, as well as a proposal for EU green bonds¹⁶, in the second half of September – revised insurance regulation and a new proposal for regulation for the recovery and resolution of the insurance sector¹⁷, at the end of October – the so-called banking package¹⁸, stipulating to also introduce *Basel III* requirements, whereas at the end of November the package of legislative proposals in the field of the CMU development was published¹⁹, prescribing to ensure better access to data and revising the rules in the field of the investments and financial instruments market.

In 2021, a great deal of attention in the international forums was still paid to support measures with respect to solving problematic issues caused by the Covid-19 pandemic, sustainability and green finance issues, as well as digital finance issues, also being actively solved in the previous year.

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



Figure 10. Representation of the FCMC in working groups and committees of the European financial sector supervisory and resolution authorities.

¹³ https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

¹⁴ https://ec.europa.eu/info/publications/210720-anti-money-laundering-counteracting-financing-terrorism_en

¹⁵ https://ec.europa.eu/commission/presscorner/detail/en/ip_21_3242

¹⁶ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/european-green-bond-standard_en

¹⁷ https://ec.europa.eu/info/publications/210922-solvency-2-communication_en

¹⁸ https://ec.europa.eu/info/publications/211027-banking-package_en

¹⁹ https://ec.europa.eu/info/publications/211125-capital-markets-union-package_en

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 2021, the FCMC continued to implement the key principles of staff policy, as highly educated and professional staff plays a major part in the development of the institution. Similarly to previous years, the FCMC continued to promote staff development and professional growth, as well as to recruit qualified and professional employees as a result of effective recruitment processes. It is of importance to the FCMC to establish long-term employment relationships and ensure a motivating and supportive work environment for employees.

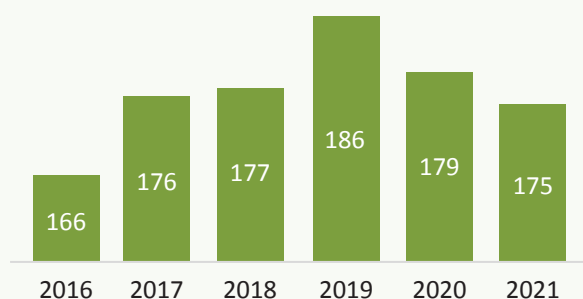


Figure 11. Changes in the number of FCMC employees

Staff turnover was 18% in 2021 (32 employees were released and, by 31 December, 27 new employees were recruited). In 2021, the average number of employees, including those on long-term leave, was 174.5. On 31 December 2021, the FCMC employed 175 employees, of which 124 (71%) were public officials and 51 (29%) – other employees. All FCMC employees were engaged in performing intellectual work.

In 2021, 36 (21%) employees of the FCMC had been employed by the FCMC for less than a year, 76 (43%) employees had been employed by the FCMC for less than 10 years, while 32 (18%) of employees had been employed by the FCMC for 20 years, i.e., as of the establishment of the FCMC in 2001.

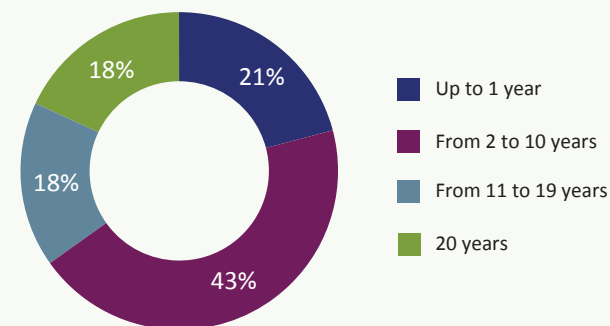


Figure 12. Breakdown of FCMC staff by length of service at the FCMC

In the reporting year, 72% of all FCMC employees were women (126), whereas 28% were men (49). The average age of employees was 35 years. The age structure of the staff was characterised by the following indicators: up to 30 years old – 11 employees (6%); from 31 to 40 years old – 62 employees (35%); from 41 to 50 years old – 67 employees (38%); from 51 to 60 years old – 29 employees (17%) and over 61 years old – six employees (3%).

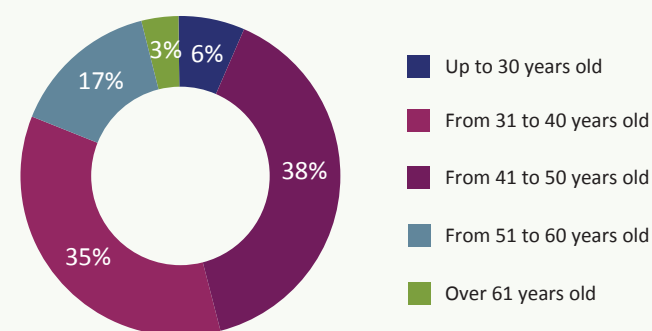


Figure 13. Age structure of FCMC employees

Improving staff qualifications

Similarly to 2020, also in 2021, due to the restrictions related to the Covid-19 pandemic, employees continued to actively use remote training possibilities, and a total of 68% of FCMC employees continued to enhance their professional knowledge in the field of financial and capital market supervision and regulation.

Much attention was paid to the development and increase of effectiveness of the internal processes of the FCMC; therefore, 39% of employees, inter alia, heads of structural units, mastered the key principles of project management, using the knowledge acquired during practical workshops in the management of FCMC projects. To raise the effectiveness of the process of licensing of market participants, a group of various FCMC experts, inter alia, heads of structural units, mastered the methods of design thinking, applying them in practice.

Several FCMC employees continued to improve their professional knowledge in the international professional certification programmes ICA.

In the reporting year, the FCMC continued to take care of the well-being of employees; therefore, training for executives was organised regarding maintenance of the well-being of the team under remote work circumstances. All employees had the possibility to take part in an online webinar about mutual boundaries, conflict situations and feedback in the work environment, as well as, on a weekly basis, to participate in practical well-being exercise – a yoga class.

The fulfilment of the staff training plan of the FCMC corresponded to 87% of the total planned staff professional improvement training budget.

5.5. Risk management

Risk management in the FCMC is focused on the implementation of its mission, sustainable development and achievement of the goals set in the strategy, by promoting improvements in work organisation and maintaining high efficiency and quality of work performance.

Risk management forms a part of the FCMC's corporate governance system and leadership. It is a systematic process encompassing risk identification, analysis, assessment,

risk response, supervision and regular revaluation thereof, in order to timely identify, appropriately measure, and effectively manage the risks that can adversely affect the ability of the FCMC to achieve the set goals and to fulfil the tasks prescribed by laws and regulations in due quality and effectively, inter alia, to take part in ensuring the fulfilment of the SSM functions.

The "Risk Management Policy" approved by the FCMC Board sets out the objectives and basic principles of risk management. In line with the stipulations of this Policy, a detailed risk management process description was developed according to which the risks of all FCMC functions and their relevant processes are being managed, as well as the risks associated with projects at all levels of the organisation, observing the risk management principles and acceptable risk level.

In 2021 the FCMC:

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

The state-declared emergency situation and restrictions imposed to limit the spread of the Covid-19 infection, as well as changes in the FCMC's work organisation by remotely organising work have not adversely affected its operations, and the FCMC has been able to ensure 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 "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 the report in such a way that it has legal force. In turn, the FCMC's regulations are issued on the basis of various norms of law governing the financial and capital market and provide for reporting

violations of a particular type, therewith fulfilling the requirements of the EU regulatory framework, and also permit reporting in the form of an e-mail message or even anonymously (namely, there is no mandatory requirement for the report to be prepared in accordance with the conditions for the preparation of documents).

In the financial and capital market sector, people can file reports on violations of various nature, for example, on the activities of both market participants licensed by the FCMC and non-licensed subjects, 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 pointing out the deficiencies in the internal control system of a licensed market participant.

In 2021, the FCMC received five whistleblower reports corresponding to the features set by the Whistleblowing Law, which in the opinion of the submitters were about possible or actual violations in the financial and capital market sector. In three cases, the reports were forwarded to another institution according to their competence. In addition, in 2021, nine reports were received, corresponding to the features set by the FCMC regulations. In two cases, examination of the reports also continued in 2022.

Compared to 2020, when 10 reports were submitted, there has been an increase in the number of reports observed in 2021 (14 reports). The FCMC observes an increasing interest to report violations. In separate cases the submitted reports do not correspond to the features set by the Whistleblowing Law and the FCMC regulations; however, if the submitter agrees thereto, they are passed for examination under the procedure laid down in the Law on Submissions. Persons are actively using various general ways of communication for the submission of reports – central FCMC e-mail, postal address and e-address in the portal Latvija.lv.

5.7. Internal audit

Internal audit is an independent function of the FCMC, whose task is to evaluate and enhance the effectiveness of the internal control, risk management and governance processes. The internal audit function in the FCMC is implemented by one employee – internal auditor, acting under direct functional subordination to the Board of the FCMC.

The internal audits 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 in accordance with the FCMC’s 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 latest evaluation was completed in 2019 and, as a result thereof, the evaluator provided the evaluation of “Generally compliant”.

The internal auditor prepares the internal audit plan, observing the risk-based approach, considering the strategic objectives and priorities of the FCMC, strategic plan of the operation of the internal audit and the systems of European central banks/SSM audit programme. In 2021, the internal auditor performed audits in the field of licensing, in the field of application of sanctions and supervisory measures and in the field of information technologies security.

The internal auditor has established and maintains a system for monitoring the implementation of audit recommendations.

In accordance with the requirements of Section 27 of the Law on the Financial and Capital Market Commission, the FCMC financial statements are audited by independent sworn auditors. The audit of the financial statements for 2021 was performed by SIA “Baltic Audit”.

5.8. Financing of the activity of the FCMC

In the reporting year, the activities of the FCMC were fully financed from payments by participants of the financial and capital market. During the reporting year, within the scope of the budget for ensuring FCMC activity, the FCMC also managed the DGF, the FPI and the NRF, as well as administered the contribution of the financial stability fee to the state budget and contributions to the SRF at the European level. The administration of the DGF and the FPI, as well as the financial stability fee and the SRF has been carried out within the scope of the approved budget of the FCMC, and no deductions from these funds for the purposes of the administration thereof for the benefit of the FCMC were made.

	Actual budget performance in 2020, euros	Actual budget performance in 2021, euros	Budget for 2021	Budget performance for 2021, %	Share of the actual budget performance in total in 2021, %
REVENUE (+)	12,668,470	11,363,821	11,430,334	99.4	100
PAYMENTS BY THE PARTICIPANTS OF THE FINANCIAL AND CAPITAL MARKET	12,655,862	11,334,869	10,491,024	108.0	99.7
REVENUE RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	9,631,053	8,469,266	7,960,624	106.4	74.5
Payments by credit institutions	9,372,332	8,218,281	7,658,064		
Payments by credit unions	42,098	40,505	42,820		
Payments by payment institutions	155,720	151,912	193,600		
Payments by electronic money institutions	60,903	58,568	66,140		
REVENUE RELATED TO THE SUPERVISION OF THE FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	976,054	1,117,282	908,460	123.0	9.8
Payments by participants of the financial instruments market	630,745	701,240	572,880		
Payments by private pension funds	345,309	416,042	335,580		
REVENUE RELATED TO THE SUPERVISION OF INSURANCE	2,048,755	1,748,321	1,621,940	107.8	15.4
Payments by life insurance companies	530,110	459,927	423,420		
Payments by other insurance companies	1,464,238	1,231,794	1,138,520		
Payments by insurance brokers	54,407	56,600	60,000		
OTHER REVENUE	12,608	28,952	15,000	193.0	0.3
FCMC RESOURCES			924,310		

Table 1. Financing of the activities of the FCMC in 2020-2021, in EUR (beginning).

	Actual budget performance in 2020, euros	Actual budget performance in 2021, euros	Budget for 2021	Budget performance for 2021, %	Share of the actual budget performance in total in 2021, %
EXPENSES (-)	10,783,332	11,192,221	11,430,334	97.9	100.0
Salaries, other payments to employees, and national social insurance mandatory contributions	8,231,194	8,662,138	8,846,464	97.9	77.4
Employee insurance	37,362	37,476	41,830	89.6	0.3
Improving professional qualifications of the staff	67,830	92,162	105,000	87.8	0.8
Telecommunications, communications, and information	160,641	139,288	150,500	92.6	1.2
Information to the general public, internal and external communication	113,719	52,524	52,300	100.4	0.5
Maintenance and operational expenses	945,564	950,191	867,224	109.6	8.5
Services for the provision of supervision	145,611	101,242	161,000	62.9	0.9
International cooperation	796,791	899,387	982,016	91.6	8.0
Amortisation/depreciation of capital investments	233,124	237,433	224,000	106.0	2.1
Changes to the provisions for holiday	36,444	4,776	-	-	-
Recovered expenses for previous periods	(22,791)	(28,423)	-	-	-
Negative interest on account balance	31,329	42,155	-	-	-
Account maintenance expenses		1,093	-	-	-
Fees		719	-	-	-
Losses	6,514	60	-	-	-
RESULT	1,885,138	171,600	0		

Table 1. Financing of the activities of the FCMC in 2020-2021, in EUR (continuing).

The actual financing of the FCMC for 2021 declined by 10.3%, as compared to 2020.

In the reporting year, the FCMC paid special attention to asset quality and credit risk management of the banks, development of financial technologies and risks associated with it, cybersecurity, sustainability issues, capital market development, as well as continued active dialogue with the representatives of the financial sector.

In 2021, 70% of the FCMC working resources were allocated to the function of financial market supervision, whereas for client interest protection and AML/CTPF control – 12%, and for the management and support function – 18%.

In the reporting year, FCMC financing was fully planned, considering the payments of market participants. It was planned that 75.9% of all payments by market participants would be sourced from monetary financial institutions, 8.7% from financial instruments market participants together with private pension funds, but 15.4% 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 106.4% of the planned one, thus ensuring contributions into the FCMC budget in the amount of 74.7% of the total financing by market participants in 2021.

Salaries and similar payments, incl.:	7,020,429
disbursed bonuses	4,295
accrued bonuses	254,730
supplements	39,702
including remuneration to the FCMC Board	294,985
State social insurance mandatory contributions, incl.:	1,641,709
including the state social insurance mandatory contributions on the remuneration of the FCMC Board	69,455

Table 2. Breakdown of FCMC staff remuneration in 2021, in EUR

In 2021, the total budget execution expenditure was 11,192 thousand euro (2.1% less than budgeted; budgeted – 11,430 thousand euro). The execution of budget expenditures was influenced by several factors, the most significant of which were the changes in the distribution of FCMC positions, as well as measures taken to strengthen the use of internal resources and the efficiency of processes, incl. investments in information technology solutions.

In 2021, the largest costs of operational provision of the FCMC were comprised of expenses for the remuneration of employees of the FCMC (77.4%).

In 2021, the FCMC represented Latvia in eight European and global level organisations supervising financial markets and supervision coordination organisations, the membership fee of which was 8.69% more than in 2020.

	2020	2021	Changes in 2021/2020
Payments to EU organisations	688,295	806,390	17%
Payments to international organisations	51,430	52,384	2%
Total	739,725	858,774	8.69%

Table 3. Membership fees paid by the FCMC to EU and global organisations in 2020 and 2021, in EUR

The spread of the Covid-19 infection and the imposing of restrictions reduced the total cost of business trips, training and the total operational expenses. The Covid-19 pandemic had no adverse impact on the continuity of operation of the FCMC.

The approved financial statements of the FCMC for 2021, the financial statements of the DGF and FPI for 2021, as well as independent certified auditor's reports on them are available on the FCMC website: <https://www.fktk.lv/par-mums/gada-parskati/>.

The main objectives for 2022



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The FCMC Board has identified the following priority areas for action for 2022:

1. Effective, risk-based and development-driven supervision of the financial sector

The FCMC will pay special attention to asset quality and credit risk management, risks related to the development of financial technologies, as well as cyber security, and will continue active dialogue with the representatives of the financial sector. The FCMC will focus on the issues of strategy, profitability of business models, internal governance and sustainability of the banks, as well as the operation of control systems, defined risk appetite of the market participants and ability to manage risks they have assumed.

Monitoring of the impact of the Covid-19 pandemic will still remain on the agenda.

The enhancement of the regulatory environment of the Latvian financial sector will continue, considering:

- the EU directives, regulations and guidelines, as well as good international practice;
- the challenges caused by the rapid entry of various innovative solutions to the market, in parallel to traditional financial services;
- dynamic development of innovative solutions and the risks pertaining thereto.

At the same time, the FCMC will ensure the balance of development, new ideas and regulatory framework, preserving commensurate compliance, national security and cyber security requirements.

An important role on the fulfilment of the tasks to be fulfilled by the FCMC in 2022 will be played by participation in the SSM, SRM and implementation of measures initiated by the ECB, as well as in information exchange prescribed by the participation of the FCMC as the representative of the Republic of Latvia in other international (EU) supervisory institutions of the financial sector – EBA, ESMA, EIOPA, etc.

2. Risk-based approach in the field of AML/CTPF

The FCMC will continue strengthening the risk-based approach both with respect to the supervisory measures taken by the FCMC and with respect to the approach of the market participants to the field of risk management. In the field of strengthening risk-based supervision, it is planned to continue developing data analysis, enhancing information technologies solutions, staff knowledge and skills and to take on good international supervision practice. In turn, in the field of strengthening the risk-based approach of market participants, it is planned to continue active dialogue with the market participants, both by organising training and discussions and by providing explanations.

3. Digitisation and innovation

Given the steep development of the technology-based financial innovations environment, the FCMC, in cooperation with other institutions, will take measures for creating a FinTech-friendly environment, which, in turn, would promote innovative financial services in Latvia and attract new enterprises for the provision of these services. At the same time, attention will also be paid to the development of innovative supervisory technologies.

4. Sustainability

A sustainable, socially responsible and well-governed financial sector is the driving force of the European Green Deal, and the FCMC as the supervisor of the financial sector expects the financial institutions to proactively integrate the sustainability direction into their operational strategies. The future customer will highly appreciate a sustainable, socially responsible and green thinking financial sector. The largest challenge of the FCMC is to foresee the expectation of next generations already now and to act correspondingly, by shaping a climate neutral national economy. The FCMC will continue working on the introduction of the sustainability strategy approved in 2021.

5. Capital market development and promotion of investment culture

To develop Latvia's capital market and make use of its potential, the FCMC will actively continue the launched work, in order to implement the 10-step programme for the development of Latvia's capital market.

6. FCMC integration in the Bank of Latvia

On 23 September 2021, the Saeima (Parliament) of the Republic of Latvia adopted the new Law on the Bank of Latvia, prescribing the integration of the Bank of Latvia and the FCMC into one institution, starting from 1 January 2023.

The Bank of Latvia and the FCMC have been implementing preliminary work for several months already in 2021 (with the Saeima expressing its conceptual support to the idea of integration), for the integration process to be carefully thought-out, successful, as well as corresponding to the interests of the public and financial sector. In 2022, this process, in close cooperation between the employees of the Bank of Latvia and the FCMC, will continue even more actively, in order to accomplish all preliminary work and so that the joint institution will start operating on 1 January 2023, ensuring the professional and effective implementation of the functions of the Bank of Latvia and the FCMC.

