



2022

Annual Report

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Abbreviations used in the Annual Report

AML/CFTP – anti money laundering and combating of financing of terrorism and proliferation

BSCEE – Group of Banking Supervisors from Central and Eastern Europe

CCU – cooperative credit union

CMU – Capital Markets Union

DGF – Deposit Guarantee Fund

EBA – European Banking Authority

EBRD – European Bank of Reconstruction and Development

EC – European Commission

ECB – European Central Bank

EEA – European Economic Area

EFDI – European Forum of Deposit Insurers

EIOPA – European Insurance and Occupational Pensions Authority

EMI – electronic money institution

ESAP – European single access point

ESMA – European Securities and Markets Authority

ESRB – European Systemic Risk Board

EU – European Union

FCMC – Financial and Capital Market Commission

FPI – Fund for the Protection of the Insured

IAIS – International Association of Insurance Supervisors

IFRS – International Financial Reporting Standards

IMF – International Monetary Fund

IOSCO – International Organization of Securities Commissions

ML/FTP – money laundering and financing of terrorism and proliferation

MTPLI – mandatory third-party liability insurance

NPL – non-performing loan

O-SII – other systemically important institution

OECD – Organisation for Economic Co-operation and Development

PI – payment institution

SRB – Single Resolution Board

SREP – supervisory review and evaluation process

SRF – Single Resolution Fund

SRM – Single Resolution Mechanism

SSM – Single Supervisory Mechanism

UCITS – undertaking for collective investment in transferable securities

Foreword by the Chair of the FCMC



Santa Purgaile

Chair of the FCMC until
31 December 2022, Deputy
Governor of Latvijas Banka as
of 1 January 2023

24 February 2022 draw a new demarcation line in the world's history. The initial shock of Russia's invasion of Ukraine quickly transformed into a committed fight against the war, weakening the economic capacity of Russia and its access to resources. Unfortunately, more than a year later the war started by Russia still continues.

The war affected many global processes, including developments in the economy and the financial sector. In 2022, extensive new international sanctions against Russia were imposed. Latvia's financial sector demonstrated its ability to apply them in a timely manner by identifying the persons subject to sanctions and the companies controlled by such persons and by freezing 83 million euro. Under given circumstances, transformation of the Latvian financial sector over more than last five years was a significant advantage of Latvia. Even though the economic ties between Latvia and Russia have historically been and remain relatively close, the financial sector has made important preparations to prevent the transaction business from becoming a bridge between Russia and Western countries and to ensure proper risk management.

The war has not had a significant impact on the resilience of the Latvian financial sector, because Latvian credit institutions ensure good capital reserves and have put in place well-developed systems for internal control and sanctions risk management. At the same time, the large volume of sanctions – currently 10 EU sanction packages – requires significant work in applying the sanctions.

The second important direction in 2022 was the integration of the FCMC into Latvijas Banka by implementing the decision adopted by the Saeima of the Republic of Latvia on 23 September 2021 which stipulated that Latvijas Banka takes over all functions related to the prudential supervision and the promotion of the development of the financial and capital market as well as the functions of the resolution authority as of 2023.

Together with Latvijas Banka and other stakeholders we have done extensive work to merge both institutions. 1 January 2023 has marked the beginning of a new stage in the prudential supervision of Latvia's financial sector, as integration will provide opportunities to ensure the prudential supervision and development of the financial market by combining knowledge and competence, infrastructure options and capacity as well as jointly establishing and implementing the strategic priorities of Latvijas Banka.

We will continue acting as a supervisor that, by engaging in an open dialogue with the financial sector, is able to find new solutions to ensure the sector's improvement and further development. The key aspect in the integration process was to ensure the continuity of functions as well as transfer of knowledge, best practices and historical memory.



At the same time, in 2022, the transformation of the credit institution sector continued, and it is a major step towards promoting competition and more balanced development. Credit institutions which had previously focused on servicing foreign customers started to change their business model in 2018, and the FCMC projected that consolidation will be one of development lines of activities performed by credit institutions representing this segment, and the FCMC presumed that some credit institutions will discontinue their operation. We are proud of the credit institutions that have managed to come to agreement and consolidate business by providing a more competitive business model in future and thus strengthening the credit institution sector of Latvia. It also gives us great satisfaction to see that 2022 was the first year the FCMC did not have to take decisions on imposing sanctions on credit institutions due to non-compliant internal control systems. At the same time, it is also important to highlight that risk assessment-based approach remains to be embedded and risk management strengthened in activities of credit institutions.

Regardless of the volume of the above work to be carried out, the FCMC ensured targeted action to further develop the financial sector during the reporting year. The second Latvian capital market forum “Ambitions. Growth. Sustainability” took place in February 2022, by marking out the avenues where work needs to be continued both by the supervisor and the institutions involved in capital market development. Meanwhile, in April we started to offer to the potential issuers a new support mechanism – “Securities Sandbox” – a unique opportunity to receive experts’ assessment and recommendations for a successful entry into the capital market of Latvia.

In September 2022, the first FinTech forum brought together more than 100 industry professionals to discuss development of Latvia’s financial technologies, i.e. the FinTech segment, and in parallel we engaged in drawing up the strategy of the Latvian FinTech sector development. It was reviewed by the Cabinet of Ministers in January 2023, and it contains several steps for development of the currently untapped potential in the field of financial technologies.

The financial sector undergoes rapid development by taking advantage of the opportunities provided by technologies and changing habits of financial services recipients. The Crowdfunding Services Law took effect on 5 May 2022. It establishes the procedure for the issuing and registration of authorisations for the operation of crowdfunding service providers, their operation and liability pursuant to Regulation (EU) 2020/1503 on European crowdfunding service providers for business, as well as the rights, obligations and powers of the FCMC in its capacity as the competent supervisory authority to

issue authorisations for the operation of crowdfunding service providers.

On 6 August 2022, the FCMC issued the first authorisation in Latvia for the provision of crowdfunding services pursuant to EU Regulation on European crowdfunding service providers for business, and was one of the first supervisory authorities to issue such an authorisation for the provision of crowdfunding services.

Looking ahead, it is clear that the year 2023 will continue to face challenges related to the ability to manage the risk of sanctions being circumvented, while maintaining a risk assessment-based approach. To ensure that financial market participants do not take radical risk mitigation decisions refusing to service particular geographical regions or particular customers, understanding of matters on the part of customers, who work in the regions or segments subject to high sanctions risk, and the efficiency of internal control systems in the area of sanctions play a key role.

In 2023, Latvijas Banka will pay particular attention to the management of various risks, the operational and financial resilience of financial market participants as well as the availability of financial services and the protection of the interests of recipients of financial services.



The work of financial sector supervisors becomes more extensive from year to year. Therefore, the recent integration of the FCMC into Latvijas Banka presents an additional opportunity to concentrate resources and knowledge for efficient supervision and development of Latvia’s financial sector.

One important phase in Latvian financial market supervision has concluded. We look forward to the future with determination to act, believing in the potential of the Latvian financial sector to develop, achieve good results and provide a major contribution both in the transformation of the economy and growth of the next business cycle!

Vision, mission, values

1.

Mission of the FCMC is to take care of society's interests:

- ▶ 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, and 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.

Values of the FCMC



Liability

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



Professionalism

We are experts of our sector, constantly enhancing our professional knowledge and skills, demonstrating initiative, decisiveness and results-orientated conduct.



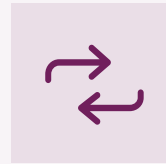
Development

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.

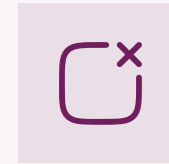
Consistent and professional supervision of the financial sector

2.

2.1. Licensing developments in 2022



There were minor changes in the composition of financial and capital market participants in 2022.



In accordance with the FCMC decision on the reorganisation licences of two credit institutions became null and void.

In 2022, the following segments of the market participants experienced changes.

Credit institutions

On 19 July 2022, a decision was adopted to allow Signet Bank AS 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 Signet Bank AS for the activities of a credit institution became null and void concurrently with the adopted decision on the reorganisation permit. Taking account of the fact that all assets and liabilities of Signet Bank AS were transferred to AS Expobank. the name of AS Expobank was changed to Signet Bank AS as of 12 July 2022.

Meanwhile, on 25 November 2022, a decision was adopted to allow AS PrivatBank 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 PrivatBank for the activities of a credit institution became null and void concurrently with the adopted decision on the reorganisation permit.

Branches of credit institutions of EU Member States

In 2022, the Latvian branch of PayEx Sverige AB (Sweden) announced its final decision not to launch business.

Cooperative credit unions

Changes in 2022 also took place in the credit union sector. Licences of three credit unions were cancelled: Tirza Cooperative Credit Union, cooperative credit union Savstarpējā CKS, Latvijas veselības un sociālās aprūpes darbinieku kooperatīvā krājzaiždevu sabiedrība.

Investment firms

In 2022, a licence for providing investment services and investment ancillary services was issued to Indemo SIA and SIA Capitalia Investment Services.

Meanwhile, a licence of AS IBS Renesource Capital was cancelled in 2022 based on its application.

Insurance brokerage companies

Two new insurance brokerage companies – ALPHA INSURANCE limited liability company and SIA OCTA24 – were registered in 2022.

Payment institutions (registered)

The entry of Unifiedpost AS was deleted from the payment institution register in 2022. These changes were associated with company's intent to transform its activity.

Electronic money institutions (registered)

Registration of one electronic money institution – SIA Paybanco – was cancelled in 2022, since it ceased its activities as an electronic money institution in 2016, and it had no liabilities towards customers.

Registered alternative investment fund managers

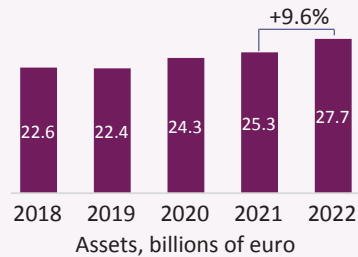
In the financial and capital market, interest remains with regard to the possibility to begin operation as a registered alternative investment fund manager. Three new alternative investment fund managers – SIA Merito Management AIFP, INDEXO AIFP SIA and Fat Alpha Capital AIFP SIA – were registered in 2022.

2.2. Prudential and operational compliance supervision

2.2.1. Prudential supervision of the credit institution sector

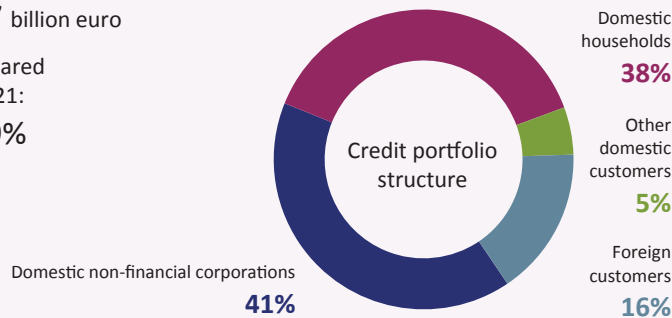
NUMBER OF CREDIT INSTITUTIONS AND TOTAL ASSETS

10* credit institutions
4 branches of EU credit institutions
Total assets
27.7 billion euro

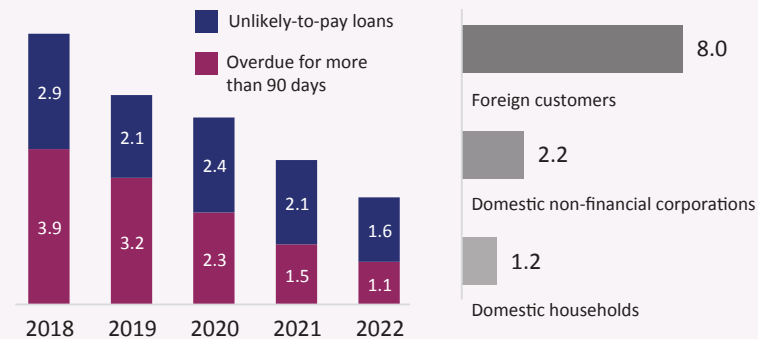


LOAN PORTFOLIO

Total loan portfolio
15.7 billion euro
Compared to 2021:
+6.9%

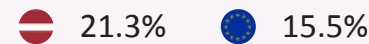


Share of NPLs in the portfolio of non-bank customers*, %

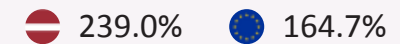


COMPLIANCE WITH REGULATORY REQUIREMENTS

CET1 capital ratio

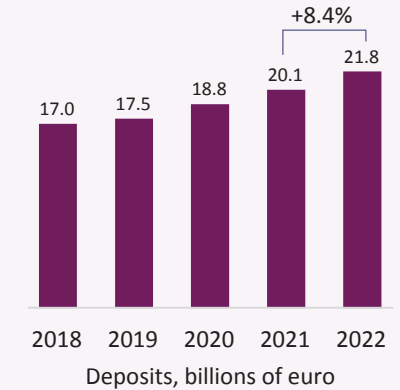
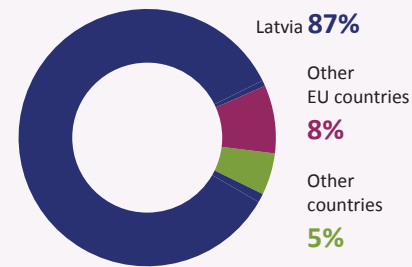


Liquidity coverage ratio



DEPOSITS

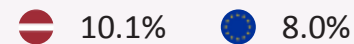
Total amount of deposits
21.8 billion euro



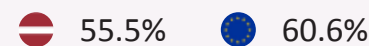
PROFIT AND PROFITABILITY

Profit of the credit institution sector
325 million euro

Return on equity (ROE)



Cost-to-income ratio (CIR)



* The FCMC Board made a decision on 12 December 2022 to suspend the provision of financial services of Baltic International Bank SE.

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 early as possible, 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 2022, 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 for 2022

In 2022, the FCMC ensured comprehensive and consistent supervision of credit institutions. The individual market participants supervisory programmes, as well as the horizontal activity plan were developed to ensure an action that is consistent with the FCMC's supervisory priorities, at the same time implementing a risk-based approach. Much emphasis was put on the enforcement and application of the principle of proportionality and improvement of its use in supervisory processes.

The war in Ukraine launched by Russia in 2022 made supervisors review the previously defined priorities and the planned activities. Although the supervisory priorities were not changed due to the war, the geopolitical situation and its impact were integrated into the key lines of supervisory priorities and in certain supervisory activities.

Based on the previous risk assessment of credit institutions and taking into account the priorities set by the ECB and EBA, the FCMC identified the supervisory priorities of credit institutions for 2022, as shown in Chart 1.

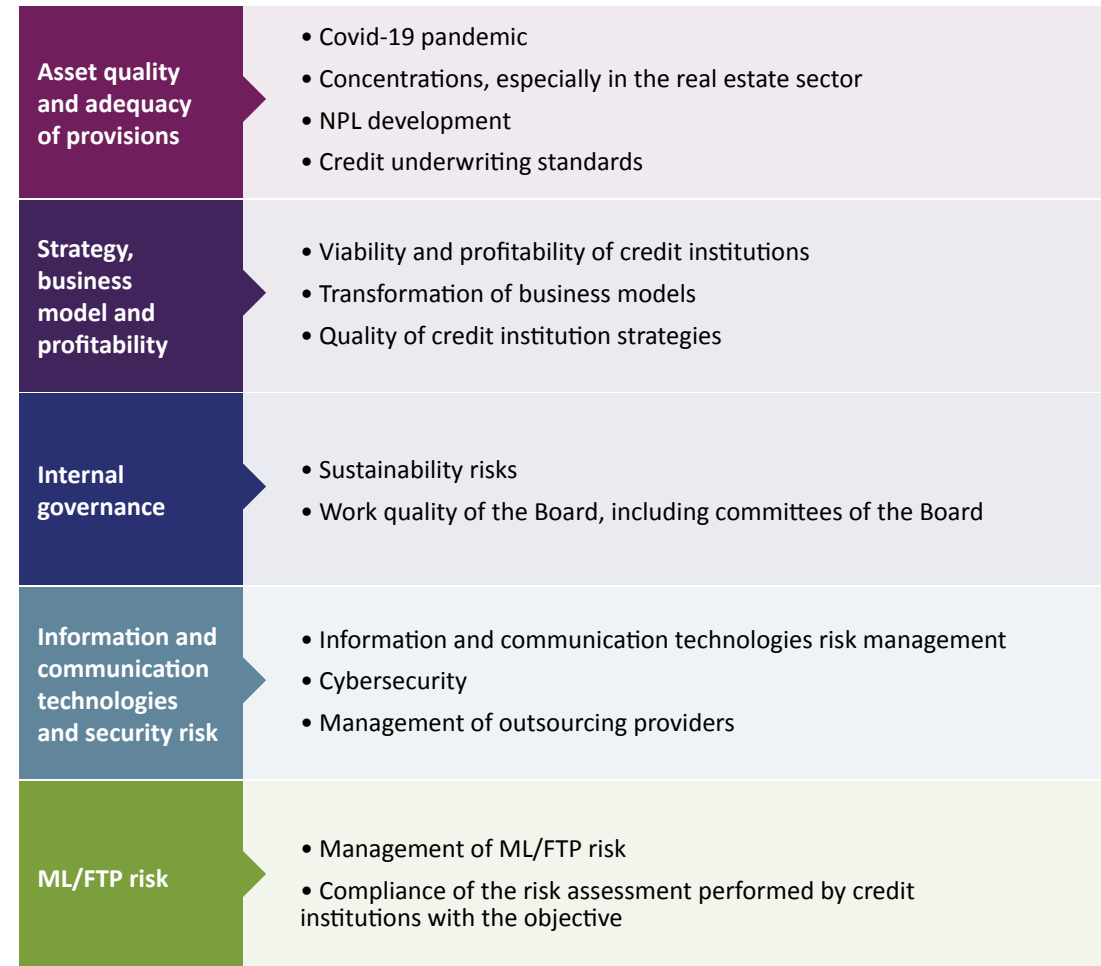


Chart 1. Credit institutions' supervisory priorities for 2022

The supervisory measures plan developed according to the selected supervisory priorities in the prudential field included a range of on-site and off-site activities at the level of both individual credit institutions and the sector at large, including the activities shown in Chart 2.

In the field of asset quality and adequacy of provisions, the impact of various external factors on the loan portfolio and asset quality as a whole was assessed more closely. In parallel with the initial plans to continue monitoring the impact of the Covid-19 pandemic, more attention was paid to the assessment of the effects of the geopolitical situation caused by the Russian-Ukrainian war. Dialogues addressing specific issues were organised with credit institutions and additional requests for information were initiated.

Inspections of NPL portfolios and their development continued in credit institution with a high NPL ratio, analysing the fulfilment of NPL strategies as well as assessing aspects of NPL management during the horizontal inspection.

In 2022, the supervisor focused on the concentrations in credit institutions' loan portfolios (with particular attention to the real estate segment), as well as on credit underwriting standards or the approach and principles of credit institutions applied when examining new loan applications and assessing the creditworthiness of the potential borrowers and laying down lending terms.

Assessment of sustainability risks and their integration into credit institution activities continued in the field of internal governance. Taking account of the fact that the FCMC published the supervisor's expectations in the field of sustainability at the beginning of the reporting year, it was not only the progress made in the field of sustainability but also the compliance with the supervisor's expectations that was analysed within the framework of the annual self-assessment activity of credit institutions in terms of sustainability.

In 2022, increased focus was put on credit institutions' councils and committees as well as their work quality. Both compliance issues and practical experience were addressed during discussions on certain topics with council members. In addition, a methodology for observing council meetings was developed allowing the supervisor to assess in practice the work of council members, ascertain the practical implementation of internal regulatory acts as well as identify certain shortcomings.

During an individual horizontal inspection, practice of credit institutions in the implementation of external regulations was assessed in more depth, identifying the areas to be improved and the best practice in the segment of less significant credit institutions.

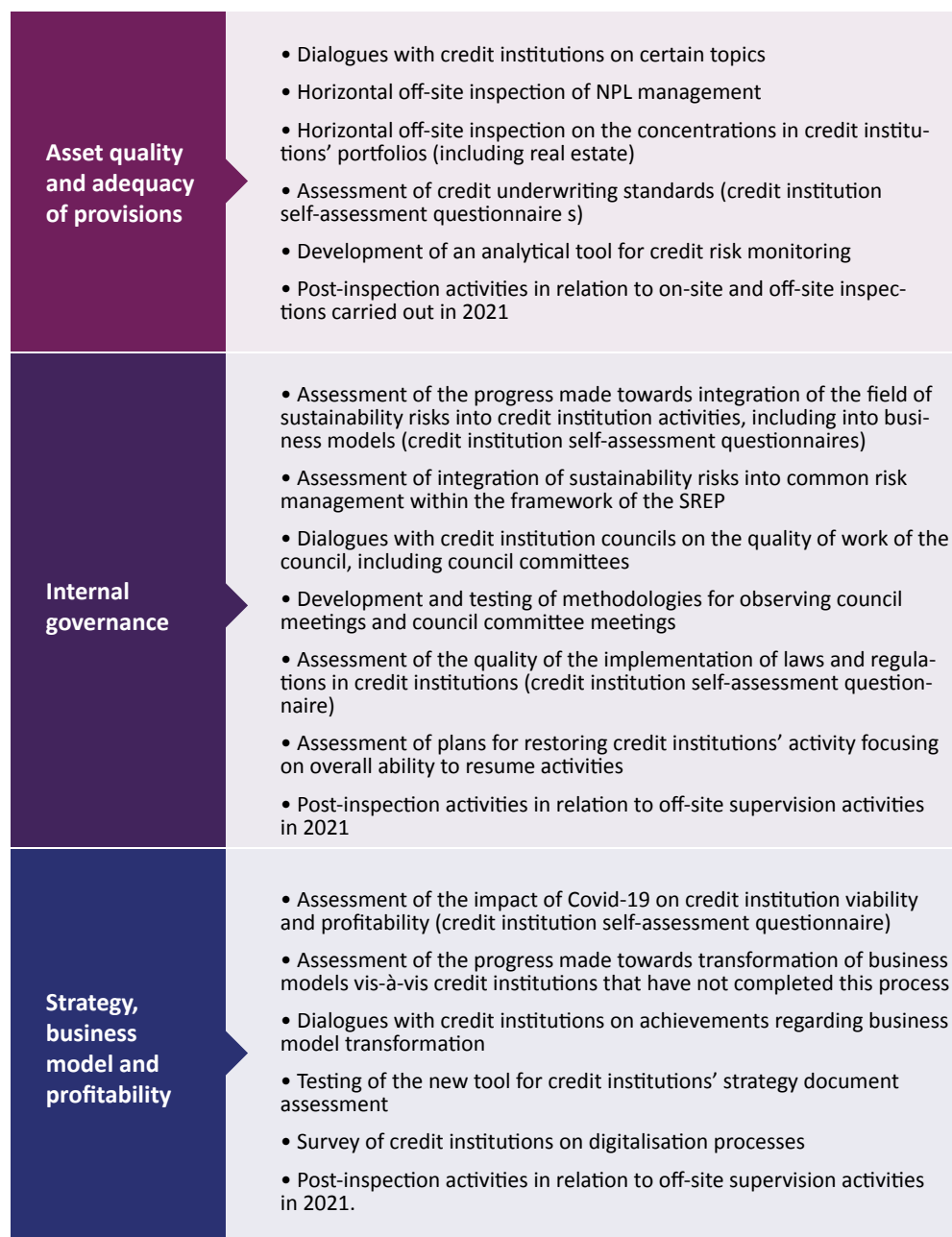


Chart 2. FCMC's plan of credit institution supervisory measures in 2022

In the areas of strategy, business model and profitability, the FCMC continued an in-depth assessment of credit institutions business models as well as the progress made in changing them within the framework of the SREP. In the first quarter of 2022, individual dialogues with less significant credit institutions took place to discuss the work done so far in the field of changing business models and to provide information about the steps to be taken.

In 2022, the supervisor also continued analysing credit institutions' profitability – its main drivers, the key hindering factors, as well as the compliance with the strategic goals.

Additional attention was paid to the assessment of credit institutions' development strategies not only by analysing the quality of certain strategy documents submitted by credit institutions but also improving the supervision methodology.

The impact of the Covid-19 pandemic and geopolitical situation

The credit institution sector has operated in an environment of high uncertainty over the last three years. Resilience of credit institution business models was tested by two major shocks – the Covid-19 pandemic followed by the war launched by Russia in Ukraine in 2022. The FCMC monitored the evolution of the situation and the possible developments, adjusting the supervisory measures accordingly. Moreover, the FCMC experts participated in an extended contact group established and chaired by the ECB SSM concerning Russia. This group became an important forum of supervisors discussing the impact of the Russian-Ukrainian war on credit institutions within the SSM and response of supervisors.

Taking into account the accrued capital buffers and the work done by credit institutions in transformation of business models during previous years, their resilience was sufficient for absorbing both aforementioned shocks. Exposure of the credit institution sector to Russia and Ukraine has fallen sharply over the past years and currently is low. Overall, the exacerbation of the geopolitical situation had no significant effect on the asset quality (NPL ratio is, on average, declining in the sector), credit institutions ensure profitability, capital and liquidity buffers remain high. At the same time, it can be projected that the macroeconomic environment factors like high inflation, increasing costs and rising interest rates may pose additional challenges to business of credit institutions in 2023. In this regard, both channels with direct and indirect geopolitical impact on credit institutions' profitability, asset quality, the ability to deliver strategic goals and maintain capital and liquidity buffers play a key role. Credit institutions are already adjusting their strategies and capital plans by integrating into them geopolitical impact. Credit institutions' stress test programmes and the supervisor's stress tests focusing on assessment of credit institutions' ability to absorb losses serve as an additional mechanism.

Latvijas Banka, as the successor of the rights and liabilities of the FCMC, has identified credit institutions' resilience to macroeconomic shocks as a supervisory priority in 2023.

Supervisory review and evaluation process

Risk assessment-based supervision remains one of the key supervisory principles. Following this principle, the supervisor, using the information reflected in the reports submitted by credit institutions and other information available thereto, constantly assesses the performance, the level of risks and the quality of management of credit institutions within the SREP, 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 setting capital requirements for covering the risks inherent to the banking activity or potential risks, and ensuring special liquidity requirements.

In 2022, the FCMC continued to implement the SREP according to the SREP guidelines developed by the EBA, as well as the ECB SSM guidelines regarding the SREP of credit institutions, with the process taking place within the scope of supervisory dialogues on the SREP results. Risk assessment, within the scope of the SREP, is carried out based on the analysis of quantitative indices characterising the risk level and their thresholds in accordance with the ECB methodology, as well as the analysis of its risk management information arising from the on-site inspections, thematic and horizontal inspections and information at the disposal of the FCMC on the compliance with the regulatory requirements in credit institutions, detected internal control system flaws, the quality of the capital and liquidity adequacy assessment processes, and the assessment of the recovery plan.

In 2022, the credit institution sector experienced consolidation due to merger or reorganisation of credit institutions, leading to cessation of operation of certain credit institutions. These events also affected the SREP cycle therefore a full assessment of SREP was performed in eight credit institutions.

Risk assessment within the SREP is carried out on a rating scale from 1 to 4, and in 2022 the following risk ratings were assigned to Latvian credit institutions (including credit institutions under direct ECB supervision).

Low risk Number of credit institutions – 0	Risk assessment 1.0–1.7
Moderately low risk Number of credit institutions – 3	Risku score 1.8–2.5
Moderately high risk Number of credit institutions – 5	Risk assessment 2.6–3.3
High risk Number of credit institutions – 0	Risk assessment 3.4–4.0

Chart 3. Risk assessment of credit institutions within SREP 2022

Assessment of the Covid-19 pandemic and geopolitical effects was the focus of the FCMC in 2022. The FCMC monitored the progress of implementation of the qualitative recommendations set within the SREP process of 2021. In 2022, the FCMC also developed a number of qualitative requirements and recommendations to support the improvement of credit institutions' internal control systems and the strengthening of resilience to shocks, mainly focusing on the internal management, ensuring sustainability, credit risk management, capital adequacy planning and management of operational risk, including the ML/FTP risk.

The capital guidance requirement or P2G has been binding on credit institutions since 2023. It was established at the end of 2022, and the FCMC took into consideration the requirements of the Credit Institution Law, the EBA SREP guidelines and the ECB methodology. When determining the capital guidance requirement and the potential reduction in Tier 1 capital ratio, the FCMC used the top-down stress test results of Latvijas Banka which include credit risk and market risk losses in case an adverse scenario materialises. The capital guidance requirement binding on credit institutions currently varies between 0.25% and 2.50%.

Single supervisory mechanism

On 4 November 2022, eight years had passed since the establishment of the ECB SSM – the European system of banking supervision. Within the framework of the SSM, national competent authorities from euro area countries operate together with the ECB (Eurosystem central banks and national supervisory authorities). The FCMC is also part of the SSM, which has three main objectives.

To ensure the safety and sustainability of the European banking system

To promote financial integration and stability

To ensure consistent supervision

Chart 4. ECB SSM objectives

In late 2022, there were 113 significant credit institutions under the direct supervision of the ECB, whereas 2078 less significant credit institutions were under the direct supervision of national competent authorities.

In 2022, three Latvian credit institutions were under the direct supervision of the ECB: AS Swedbank, AS SEB banka and AS Citadele banka. These credit institutions are supervised via participation of ECB and FCMC representatives in joint supervisory teams, which constitute the basis for day-to-day supervision of the significant credit institutions.

In 2022, the FCMC continued supervising the less significant credit institutions both in close cooperation with the ECB and in cooperation with the EBA to ensure consistent supervision across the entire European banking sector and promote the safety and sustainability of credit institutions, as well as stability of the financial system.

In 2021, FCMC experts also participated continuously in the committees and working groups set up by the ECB, contributing to the improvement of the ECB's single supervision methodology, as well as to coordination of various regulatory frameworks within the European Banking Union.

The ECB SSM, together with other supervisors in Europe, continued providing individual supervisory processes and activities, gaining confidence in the ability of credit institutions to overcome the adverse impact of the Covid-19 pandemic. Meanwhile, along with the war in Ukraine launched by Russia, more attention was paid to the assessment of the impact of geopolitical situation.

Participation in the ECB SSM decision-making

Through the member of the Board nominated by the FCMC Board taking part in the ECB Supervisory Board, the FCMC also participated in the SSM decision-making process, taking decisions both on the significant credit institutions under the direct supervision of the SSM and also regarding methodological issues determining the procedure for the implementation of the process of supervision of credit institutions in the euro area as a whole.

In 2022, the ECB SSM adopted 2582 supervision-related 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 assessment of credit institutions' officials, national powers decisions, the SREP, internal models, issues of own funds and reports.

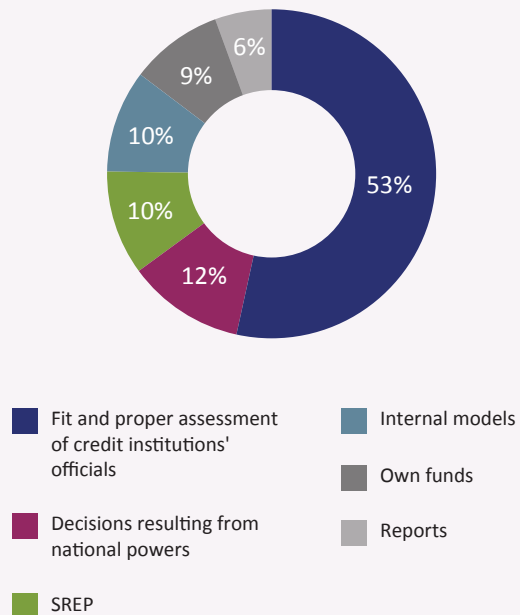


Chart 5. Structure of decisions taken by the ECB SSM in 2022

A total of 23 meetings of the ECB's Supervisory Board were held in 2022. Following the lifting of the Covid-19 pandemic restrictions, two of them were organised in person. The FCMC experts assessed and provided their view on the issues to be reviewed both at the Supervisory Board meetings and within written procedures.

Suspending operation of Baltic International Bank SE

To ensure the stability of Latvia's financial sector and protect the interests of the credit institution's customers, the FCMC Board, at its extraordinary meeting of 12 December 2022, decided to suspend the provision of financial services by Baltic International Bank SE. The FCMC recognised Baltic International Bank SE as failing or likely to fail and decided not to take resolution action of Baltic International Bank SE, i.e. to implement no measures to stabilise the credit institution.

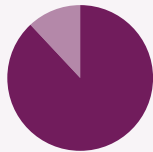
Meanwhile, the FCMC Board on 13 December 2022, took a decision on the unavailability of deposits at Baltic International Bank SE to protect the interests and deposits of its customers, preventing outflows of the credit institution's funds.

The FCMC has based its decision to recognise Baltic International Bank SE as failing or likely to fail on the grounds that the credit institution was not able to ensure the implementation of a viable business strategy over a sustained period, the strategy did not conform to the credit institution's capacity and was not feasible therefore the credit institution continuously failed to provide a profitable business model. The credit institution also had serious internal governance deficiencies, including the area of AML/CFTP. Despite the efforts of the FCMC to make improvements in these areas, the credit institution had not ensured compliance of its activities with the regulatory requirements governing the activities of credit institutions, as well as continued the existing trend: the credit institution operated at a loss, was unable to restore profitability, failed to ensure an adequate internal control system and a stable future vision.

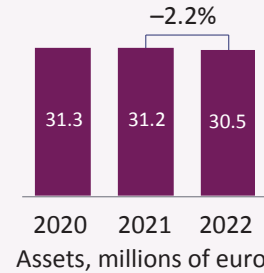
Supervisory measures applied to cooperative credit unions

NUMBER OF CCUS AND TOTAL ASSETS

30 CCUs
 -3 during the year
 15 070
 Total number CCU members
 (-712 during the year)



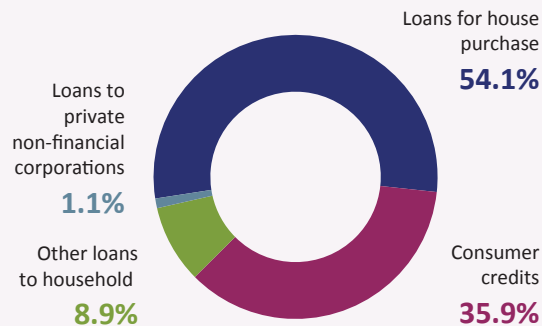
88.0%
 market share of five major CCUs



LOAN PORTFOLIO

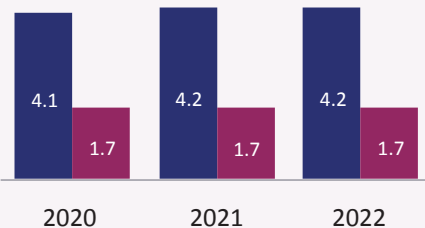
Total amount of the loan portfolio
 23.7 million euro

Compared to 2021:
 -0.6% (total)
 3.7%
 -3.8%
 -10.0%
 -9.8%



KREDĪTU KVALITĀTE

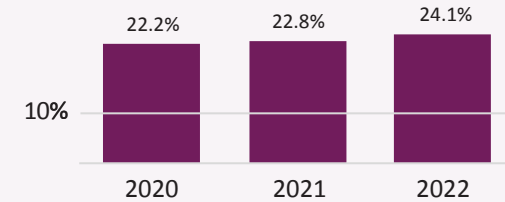
Loans and provisions, millions of euro



17.6%
 share of substandard, unlikely-to-pay and lost loans
 7.4%
 ratio of loan loss provisions to total credit portfolio

COMPLIANCE WITH REGULATORY REQUIREMENTS

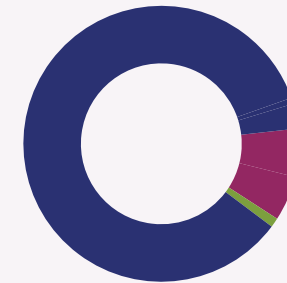
Capital adequacy (Minimum requirement - 10%)



DEPOSITS

Total amount of deposits
 20.9 million euro

Compared to 2021:
 -4.6% (total)
 -5.2%
 8.6%
 -49.0%



PROFIT AND PROFITABILITY

Total profit
 231.9 thousand euro

Return on assets (ROA)
 0.8%

Return on equity (ROE)
 3.2%

Cost-to-income ratio (CIR)
 76.7%



In 2022, supervision of cooperative credit unions was conducted 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 CCUs for covering such losses, as well as by carrying out on-site inspections. During the reporting year, FCMC experts carried out three on-site inspections aimed at assessing the financial standing of 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 2022, the FCMC organised an information meeting of CCUs to discuss the shortcomings identified during the on-site inspections conducted in 2021 and 2022 and to communicate the FCMC vision for improvement of the internal control system of cooperative credit unions. Representatives from 19 CCUs participated in the meeting.

When implementing the supervision of CCU operation, the licences of two CCUs were cancelled in 2022 based on the decision of the unions themselves, while the license of one union was cancelled on the basis of violations of laws and regulations.

2.2.2. Supervision of the insurance sector

NUMBER OF INSURERS

6 insurance companies

Branches of insurers of 11 Member States*

Life insurance: ●●

Life insurance: ●●●●

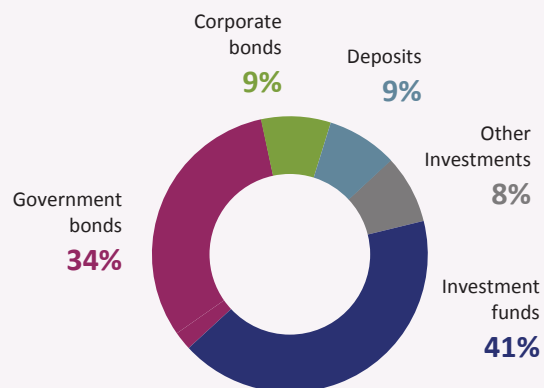
Non-life insurance: ●●●●●

Non-life insurance: ●●●●●●●

INVESTMENT PORTFOLIO (COMPANIES)

Amount of investments
1.3 billion euro

Compared to 2021:
-8.09%
changes in investments

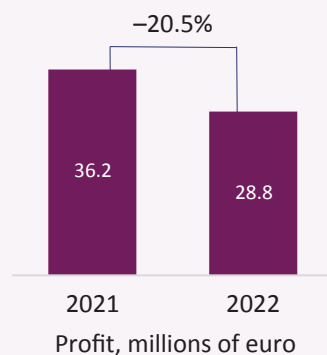


PROFIT OR LOSSES AND SOLVENCY (COMPANIES)

Profit 29 million euro

Solvency ratio** 172%

Return on assets (ROA) 2.0%



* Including branches of foreign insurance companies which terminated their activity in June 2022.

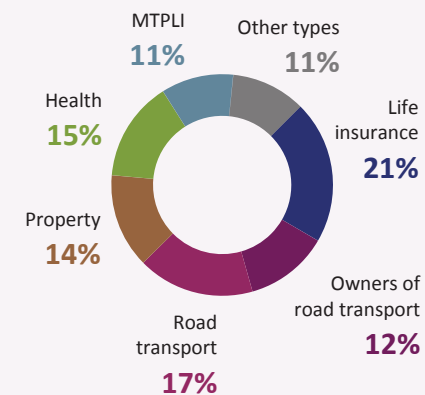
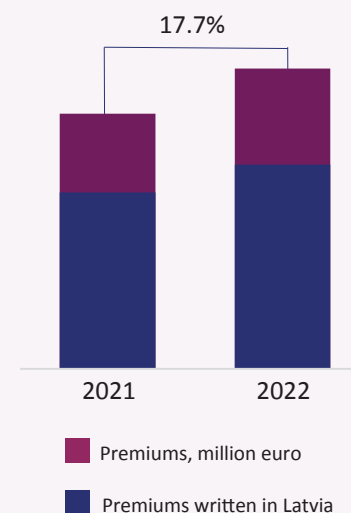
** Minimum requirement – 100%.

PREMIUMS WRITTEN (COMPANIES AND BRANCHES)

Total gross premiums written
1 billion euro

Gross premiums written in Latvia
680 million euro

Compared to 2021:
+15.9%

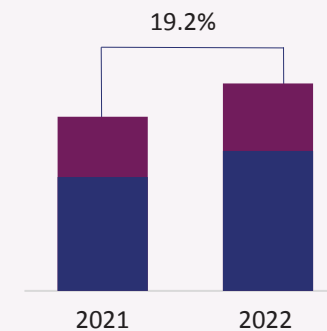


DISBURSED INDEMNITIES (COMPANIES AND BRANCHES)

Total disbursed indemnities
645 million euro

Indemnities disbursed in Latvia
435 million euro

Compared to 2021:
+23.0%



■ Indemnities, millions of euro ■ Indemnities disbursed in Latvia

Development of the insurance market

17 insurers operated in Latvia in late 2022 – two life insurance companies and four non-life insurance companies, as well as 11 branches of 11 Member States. There were 76 insurance and reinsurance brokers included in the Latvian Register of Insurance Intermediaries – three less than at the end of 2021.

In 2022, the insurance industry of Latvia saw an increase in the premiums written and indemnities disbursed (by 15.9% and 23% respectively compared to 2021). This was due to the recovery of the frequency of insurance events to the level observed before the Covid-19 pandemic, as well as due to the soaring inflation. The growth of the insurance sector in the global context is demonstrated by the dynamics of premiums written by insurers registered in Latvia, including those written abroad, with total premiums and indemnities climbing by 17.7% and 19.2% respectively in 2022 compared to 2021.

The financial results of insurance companies were positive in 2022, as all six insurance companies taken together closed the year with a profit of 29.3 million euro. The solvency capital requirement compliance ratio of insurance companies registered in Latvia also remained stable above the minimum requirements and reached 172% at the end of 2022 (the lowest permissible limit of the ratio is 100%).

Challenges of the industry – risks and impact

The insurance industry faced new challenges after overcoming the hardships brought about by the Covid-19 pandemic in 2022. The main underlying factor was the geopolitical situation in the region – the war launched by Russia in Ukraine and its negative consequences in the macroeconomic context. The soaring inflation put a pressure on the insurance indemnities and consequently on the premiums (product price), while the steep increase in interest rates driven by inflation encouraged insurers to reevaluate the structure of investment portfolios.

Under these geopolitical and macroeconomic circumstances, including the significantly increasing cyber risk and the related potential risks of disruptions of the information technology infrastructure due to the war, substantial focus was given to the operational and financial resilience of insurers when planning and ensuring their business continuity. Information furnished by insurance companies shows that their business continuity plans provide for various risk scenarios directly and indirectly related to the escalation of the current geopolitical situation and the potential risks of ensuring operation arising thereof. Moreover, as risks increase, updating and revaluation of plans is ensured on a timely basis.

The cyber risk is growing in the industry but at the same time, as insurers implement more monitoring activities and measures to strengthen the systems' protection capacity, no major business continuity incidents have been identified.

The high inflation, an uptrend in loan interest rates and slowdown in economic growth in 2022 also had an overall negative impact on consumers' purchasing power, posing risks to the growth of the insurance industry.

Supervisory measures

The context of the current geopolitical and macroeconomic shocks and the impact of the Covid-19 pandemic on financial services have led to focusing on the aspects of protection of financial services recipients in all financial sectors. Therefore, it is important to ensure an efficient product development, management and supervision process and strengthen customers' trust by offering clear and understandable information about financial products and service providers.

Adequacy of insurance protection in Latvia. Latvia ranks among the EU countries with a lower insurance premium ratio to both gross domestic product and the population. It raises concerns about the adequacy of population protection and puts a greater potential burden on the state and municipalities to cover damages induced by extreme climate conditions, the likelihood of which grows year by year. At the same time, it points to the development potential of the Latvian insurance market. This potential is currently being partially realised owing to annual growth in the insurance volume, and it could be further enhanced by welfare gains and increased financial literacy of Latvia's population. In 2022, the FCMC performed analysis of the adequacy of insurance protection in Latvia with regard to home and life insurance of individuals. The results of the analysis suggested that only one third of home owners are protected against unexpected financial losses owing to home insurance. Moreover, the insurance amount for a large part of insurance contracts is insufficient to fully rebuild the property in case of its destruction, given the rise in housing construction and repair costs. The increase in the above costs was considerable due to inflation over the last year.

Although climate risk insurance against losses caused by storms, floods or rainfalls is included in home insurance contracts to a sufficient extent, it is alarming to see the high share of flood-induced insurance events in which insurers refuse to disburse insurance indemnity. This means that attention needs to be paid to informing customers about the exceptions included in the contract.

Inadequate insurance protection is observed also in the life insurance sector as only about one out of ten inhabitants of Latvia has life insurance. Meanwhile, only one in five borrowers, who have concluded a mortgage loan contract with a credit institution, has insured life for the benefit of a credit institution. This means that uninsured persons in case of their death may leave liabilities to their heirs in the amount of the unpaid portion of their mortgage loan liabilities, which amounted on average to around 40 thousand euro per borrower in 2021.

The conclusions made as a result of the analysis conducted by the FCMC were examined during a dialogue with insurance market participants, and it was suggested to reduce the inflation risk impact on consumer protection by ensuring that the insurance amounts match the actual construction and repair costs against the backdrop of inflation. Monitoring of the adequacy of insurance amounts continues.

Within the framework of product management, taking into account different influencing environmental factors and changes in risks, as well as trends of development of customers' habits and needs, providers of financial services have to establish a process for developing and approving customer-oriented products where, within the framework of product development and review, their fitness for the target market and needs and requirements of certain recipient of the particular financial service is evaluated regularly and systematically.

In order to ensure the protection of interests of insured persons and better conformity of insurance products available in Latvia with the needs, features and objectives of the insured persons, the FCMC in 2023 performed a comprehensive inspection of 16 insurers and 10 insurance brokers operating in Latvia. On the basis of inspection conclusions, recommendations on supervision, management and distribution processes of insurance products were made to insurers as product developers and insurance brokers as distributors. The recommendations were based on the results of the inspection verifying compliance with the requirements of Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors.

Completeness, transparency and comprehensibility of the information provided to customers on insurance services is the main factor shaping customers' awareness. The provision of essential information about the insurance service and its distributor allows a customer to ease the understanding of the service to be purchased, assess its risks, coverage, exceptions provided for in the contract and the overall value of the service.

The horizontal inspection "Information provided to the customer when distributing life insurance investment products" implemented by the FCMC in 2022 by means of the mystery shopping technique included an assessment of the scope and quality of the information provided to the customer during the consultation phase regarding the life insurance investment product. The inspection embraced insurers and insurance brokers; the mystery customers met with distributors of insurance investment products in both off-site and on-site consultations before signing a life insurance contract. The conclusions drawn during the inspection on the need to improve certain aspects regarding the information provided to customers were explained to each market participant involved, and they were also discussed within the framework of the annual dialogue.

As customers tend to purchase insurance policies remotely more frequently, it is important to ensure timeliness and usability of the information provided by distributors on websites, mobile apps and other digital media. In order to check how insurance distributors comply with Sections 34, 36 and 39 of the Insurance and Reinsurance Distribution Law regarding information disclosure, the FCMC performed the thematic inspection of insurance brokers in 2022. Overall, it can be concluded that the requirements laid down in the above law are met incompletely and often formally – it is difficult for a customer to perceive the information provided, and the information available on websites is not updated on a regular basis. The shortcomings identified during the inspection are remedied, and it is expected that the recommendations made will allow improving customers' awareness of the insurance services received.

In 2022, the FCMC consistently implemented day-to-day inspection measures by examining compliance of reports and other documents submitted by insurers and insurance brokers with the requirements laid down in laws and regulations.

In 2022, two on-site inspections were carried out: one general inspection of an insurance company to assess the organisational processes, internal information exchange, the management system, 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 "Motor Insurers' Bureau of Latvia".

As part of a dialogue with the insurance sector, the FCMC continued the tradition of annual meetings by organising strategic meetings with the management of insurance companies to discuss the FCMC's strategic priorities, planned supervisory measures and sustainability issues, as well as to communicate the results of risk (inherent to each market participant) assessment carried out by the FCMC to insurance companies.

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

Undertakings for collective investment in transferable securities or UCITS funds

At the end of 2022, 21 UCITS funds operated in Latvia with assets worth 193.4 million euro. They were managed by four licensed investment management corporations.

Total amount of UCITS assets decreased by 29% or 79 million euro during 2022 notably driven by the decline in the book value of securities by 37.4% or 87.4 million euro due to increasing macroeconomic risks stemming from geopolitical shocks.

After Russia's invasion of Ukraine on 24 February 2022 and the introduction of sanctions on Russia and Belarus, the largest exposures in financial instruments of Russian, Belarusian and Ukrainian issuers were identified in UCITS managed by two investment management corporations. With regard to the imposed sanctions, suspension of financial instrument transactions and uncertainty prevailing in financial markets both market participants revalued investments in financial instruments of Russian, Belarusian and Ukrainian issuers considerably depreciating their value by applying a conservative approach and observing the precautionary principle. Taking into account the uncertainty prevailing at the end of the first quarter of 2022 regarding the fair value of the above financial instruments and liquidity problems, one of the companies suspended the unit redemption of one UCITS from investors at the end of February 2022. The above redemption of UCITS units was restored in November 2022.

All investment management corporations have assessed the scenarios regarding business continuity in the context of the geopolitical situation. Business continuity plans specify the potential crisis responses as well as the measures, implementation of which reduces the time needed to restore the operation, thus minimising the likelihood of potential crisis situations and losses. A number of investment management corporations have reviewed their business continuity plans. The situation development and geopolitical risk resolution are constantly monitored by performing regular liquidity stress tests in order to take decisions on new restrictions or resolution of operation of other managed investment funds and plans.

Alternative investment funds and their managers

Three new alternative investment fund managers were registered in 2022, and at the end of the year the total number of registered and licensed funds managed by alterna-

tive investment fund managers reached 31. When choosing the direction of activity of the alternative investment fund, investments in real estate and private capital strategies prevailed. Individual managers of alternative investment funds offer a possibility to invest in portfolio undertakings to promote generation of alternative energy, thus focusing on introducing and developing sustainability aspects in fund management.

The year 2022 saw an increase in asset value of alternative investment funds driven by new investments. In 2022, the focus of external risks shifted from the impact of the Covid-19 pandemic to the geopolitical risks in relation to Russia's war in Ukraine. Activities of alternative investment fund managers were affected by the change in raw material supply chains in portfolio undertakings as well as by the rise in inflation and loan interest rates, generating uncertainty in relation to future projections on indicators of alternative investment funds operation in subsequent phases of development.

Supervisory measures of investment fund managers

In turbulent conditions of the financial market, a proper valuation process of assets of the managed funds has a special weight. In 2022, the FCMC performed an off-site topical inspection "Compliance of asset valuation processes" in six investment management corporations and five alternative investment fund management corporations to check whether the corporations actually comply with the provisions and standards laid down in laws and regulations regarding asset valuation, as well as to assess risks stemming from the asset valuation procedures, incorrect valuation, incomplete valuation models and valuation methods for less liquid assets.

During the inspection, shortcomings were identified in the following areas:

- review of internal regulatory documents governing the asset valuation process;
- adherence to the principle of division of duties when drawing up internal regulatory documents and valuing assets of companies;
- regulation of roles, duties and responsibility limits of employees in charge of asset valuation, validation and control;
- valuation procedures, including the procedure for choosing information sources of financial instrument prices and their quotation and the procedure for asset valuation amid low market liquidity;
- inspections of compliance of asset valuation process;
- early warning mechanisms to identify valuation errors;
- information that can be disclosed to investors of alternative investment funds.

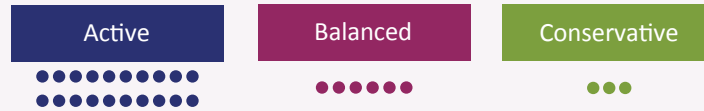
On the basis of the deficiencies found during the inspection, plans for their rectification were coordinated with the relevant market participants, and they were implemented within certain time limits.

STATE-FUNDED PENSION SCHEME MANAGERS (NUMBER AND PARTICIPANTS)

7 managers of state-funded pension scheme

1.3 million participants

29 investment plans

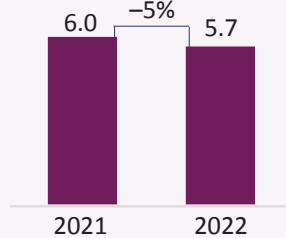


ASSETS OF PLANS

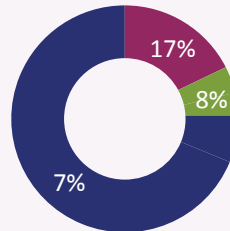
Assets

5.7 billion euro

4.4 thousand euro per 1 participant



Assets, billions of euro

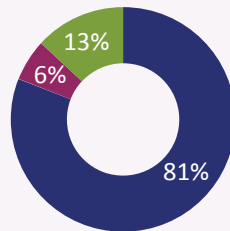


Assets

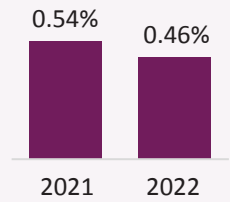
CONTRIBUTIONS TO PLANS AND MANAGEMENT EXPENSES

Contributions
1.2 billion euro

Compared to 2021:
-14% contributions



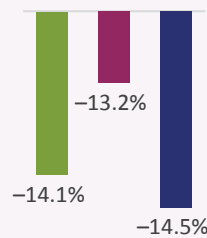
Contributions



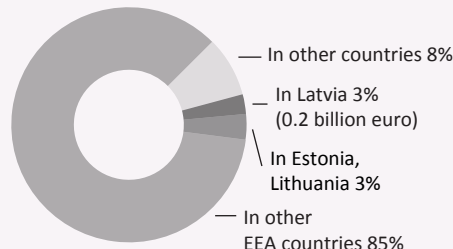
Management expenses, % of net assets

GEOGRAPHICAL* DISTRIBUTION OF AND RETURN** ON INVESTMENTS

-14.1% return



Return



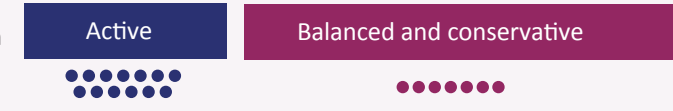
Investments

PRIVATE PENSION FUNDS (NUMBER AND PARTICIPANTS)

7 private pension funds:
6 open-end, 1 closed-end

0.4 million participants

20 pension plans

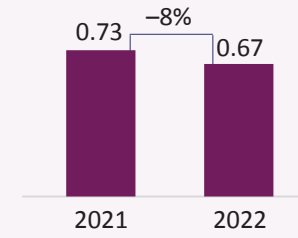


ASSETS OF PLANS

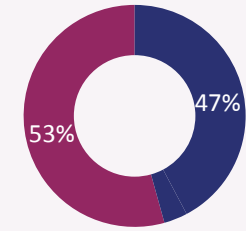
Assets

0.7 billion euro

1.7 thousand euro per 1 participant



Assets, billions of euro

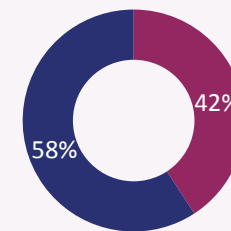


Assets

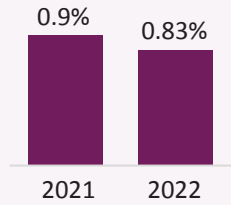
CONTRIBUTIONS TO PLANS AND MANAGEMENT EXPENSES

Contributions
0.10 billion euro

Compared to 2021:
-10% contributions



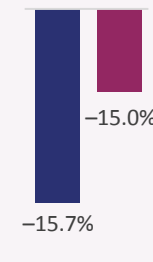
Contributions



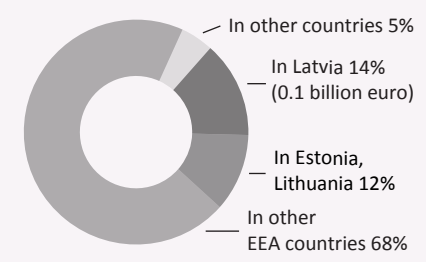
Management expenses, % of net assets

GEOGRAPHICAL* DISTRIBUTION OF AND RETURN** ON INVESTMENTS

-15.3% return



Return



Investments

* By issuer's home country

** Since the beginning of the year

State-funded pension scheme managers

At the end of 2022, there were seven state-funded pension scheme managers in Latvia. The total number of investment plans stood at 29, and in 20 of them the proportion of shares and securities equivalent to shares equalled to or exceeded 50%, in six plans the proportion of shares and securities equivalent to shares equalled to or was less than 20%, while three of them were balanced investment plans with the proportion of shares and securities equivalent to shares standing at 21%–50%.

The adverse impact of geopolitical situation caused dynamic response of financial markets, especially regarding investments in countries involved in the conflict or located in geographical proximity to the region. This led to a drop in asset value and return on investments – total net assets were 5672.8 million euro in 2022, and they decreased by 5.0% or 326.6 million euro compared to 2021 (5999.4 million euro). The lowest point of fluctuations of return indicators reached –23.1% in some cases.

Investments and their results were also affected by an increased inflation risk and growing loan interest rates, particularly for short-term investments. In response to elevated stress circumstances, managers reviewed investment portfolio structure, thus sometimes choosing between preserving the portfolio value in the long term and losses incurred by plan investors in the short term.

Over the year, the management and business continuity processes related to investment of funds became subject to stress testing and identification of situation impact to make timely decisions on the needed changes. The political situation also contributed to the increase in information and communication technology risk and cyber risk, resulting in the need of fund managers' initiatives for the purpose of checking the security of information technologies and ensuring additional security aspects to adapt technologies for better risk management.

Pension funds

At the end of 2022, there were six open-end pension funds and one closed-end pension fund in Latvia which jointly administered 20 pension plans. One pension plan was merged with another similar pension plan of the same fund in 2022.

The year 2022 was a year of geopolitical risk having an indirect impact on the decrease in total assets and contributions. The drop in assets (–8% compared to 2021) was driven by both the decline in the value of financial investments that affected investments in the active, balanced and conservative plans. Meanwhile the reduction of contributions (–10% compared to 2021) can be explained by the steep rise in inflation and costs of living as a whole. By contrast, the number of active participants in pension plans, com-

pared to 2021, increased by 8%. Increasingly more participants made savings, however, they spent less money for this purpose.

In accordance with the assessment of the risk profile of each financial market participant, several on-site and off-site supervision measures were taken. Two general on-site inspections of pension funds with more emphasis on strengthening continuity of funds' functioning and cyber risk were carried out. The horizontal inspection "Quality of information provided to the potential pension plan participants prior to entering into a contract" aimed at finding out how timely, clear and comprehensible the furnished information is and whether it allows making a decision on signing a contract. The inspection embraced all open-end pension funds, and mystery customers met with pension plan distributors in both off-site and on-site consultations before signing a contract. Information about the conclusions drawn during the inspection in relation to the need to improve certain aspects of information provided to customers was made available to each market participant involved, and these issues were also discussed during the annual dialogue.

Sustainability risks

Based on the requirements of European level and Latvian legislation in the field of sustainability and the need to include sustainability aspects and considerations in the risk management systems of financial market risk management, the measures launched to comply with these requirements and raise awareness thereof implemented in all investment management corporations, private pension funds, alternative investment fund management companies and life and non-life insurance companies, in the area of supervision were based on Latvian Financial Sector Sustainability Roadmap developed by the FCMC and sustainability risk management topics that were included in the current Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

It can now be concluded that financial market participants of the sectors of pensions, investments and insurance actively learn and raise awareness of aspects pertaining to the initiatives regarding sustainability assurance, and they have started to reorganise the internal processes to work intensively on compliance with the requirements of the laws and regulations and to ensure building of expertise and knowledge in the field of sustainability. Currently, the range of stakeholders that most need disclosure of information and transparency of operation in the field of sustainability have been defined comprehensively. Public information related to sustainability and its effects is becoming increasingly clearer, and the progress made in reconciling the impact of sustainability risks and operation aspects is evident. In general, it can be concluded that financial market participants already try to integrate these assessments in their work and decisions when developing assessment systems, seeking and studying the information and best practices available at this point in time.

2.2.4. Supervision of payment institutions and electronic money institutions

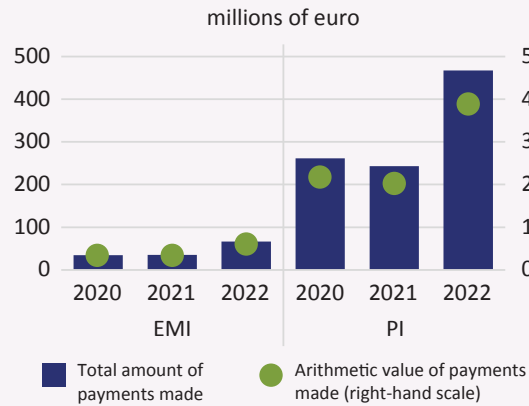
NUMBER OF EMIS AND PIS

6 EMIs -1 during one year

5 PIs -1 during one year

PAYMENTS TO EMIS AND PIS

Compared to 2021:
 +86% (EMI)
 +92% (PI)



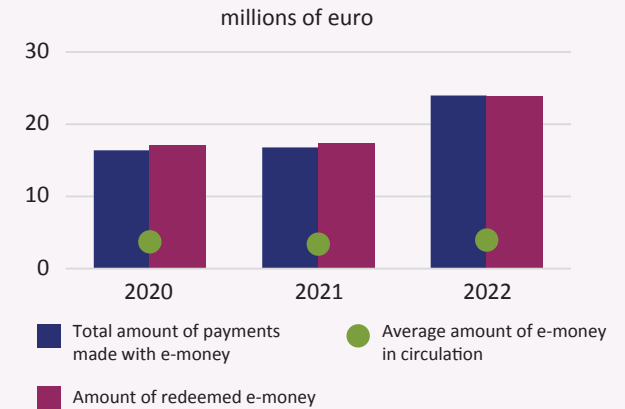
LICENSES OF EMIS AND PIS

3 – number of licensed EMIs 3 – number of registered EMIs

5 – number of licensed PIs 0 – number of registered PIs

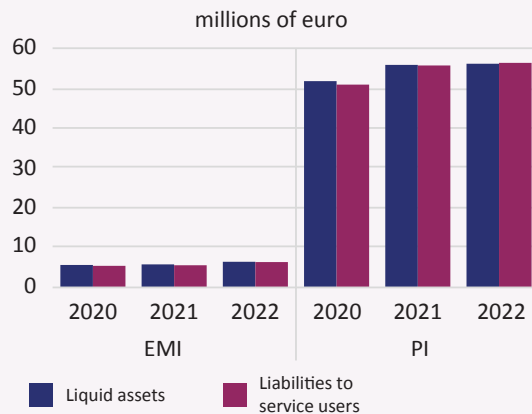
E-MONEY CIRCULATION (EMI)

Compared to 2021:
 +43%
 +38%



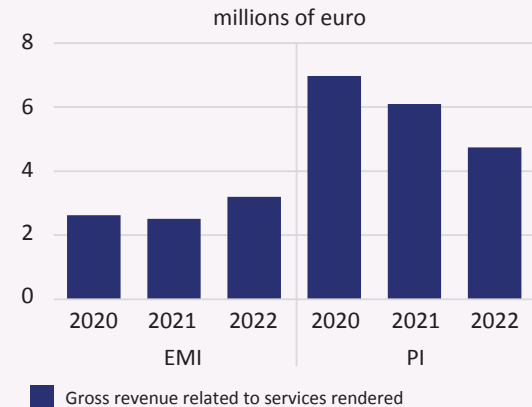
EMI AND PI LIQUID ASSETS AND CURRENT LIABILITIES

Liquid assets > current liabilities



EMI AND PI REVENUE FROM RENDERING SERVICES

Compared to 2021:
 +27% (EMI)
 -22% (PI)



The Crowdfunding Services Law came in force on 4 May 2022. Crowdfunding is a new segment of the regulated financial services market, and the single framework of crowdfunding services is included in Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937. One new license was issued to a crowdfunding service provider in Latvia in 2022.

The payment field saw an increase in the number of payment services provided by payment institutions (+56.8% compared to 2021) and electronic money institutions (+67.1% compared to 2021), as well as the average payment amount edged up (+30% vis-à-vis payment institutions and +40% vis-à-vis electronic money institutions compared to 2021). Liabilities of payment institutions to customers (including balances in customer accounts) did not change significantly (−0.6% compared to 2021), while those of electronic money institutions increased (+9.1% compared to 2021).

Revenue of payment institutions and electronic money service providers shows the following picture: electronic money institutions posted a slight revenue growth (+9.8% compared to 2021), while payment institutions' income from the provision of services decreased (−23.6% compared to 2021). This can also be explained by specification of the method used for accounting of payment services. Two licenses were cancelled during the reporting year – one licence of a payment institution and one – of an electronic money institution.

Supervision focused on receiving safe payments and electronic money services therefore the reporting year saw three on-site inspections of market participants and constant off-site supervision activities aimed at all market participants. Strategic dialogues with market participants were organised throughout the year to assess adaptation and via-

bility of business models, taking into account the global events – the impact of the Covid-19 pandemic, Russia's invasion of Ukraine, challenges faced in the cybersecurity area. During the reporting year, the supervised institutions both came under cyberattacks and invested resources in strengthening their cybersecurity.

In 2022, significant attention was paid to the protection of customers' funds which was examined in detail both during on-site inspections of market participants and off-site supervision throughout the year. Within the framework of the implemented supervisory measures, several weaknesses were identified in the accounting processes but, in reality, institutions ensured coverage of customers' funds as required.

The impact of the Covid-19 pandemic was still present in companies providing face-to-face services, as they had to adapt customer service to the requirements of epidemiological safety: society's habits changed, for instance, remote access to various services or work from home affected people's commuting habits and thus reduced the need to use various payment services.

Russia's invasion of Ukraine led to a general increase in prices and costs, which explains both the drop in service revenues and the increase in the average amount of payments of payment institutions and electronic money institutions, as some service providers offer different bill payment options, such as utility payments. Institutions of this financial sector also opened accounts and provided financial services to Ukrainian inhabitants.

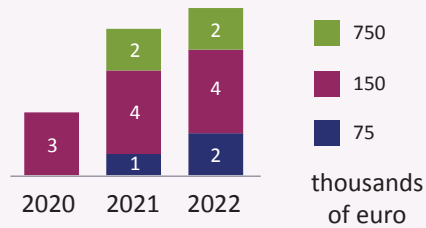
The supervised institutions continue to develop their services both by evolving new customer service channels and improving user experience, but there are also institutions which have not launched activity yet.

2.2.5. Supervision of investment service providers

NUMBER OF INVESTMENT FIRMS

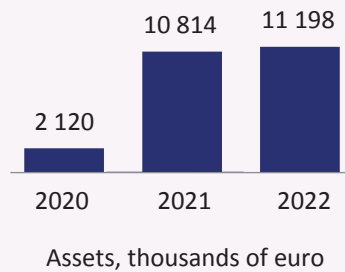
According to the initial capital requirement

8 firms



ASSETS

Total amount of balance sheet assets
11 198 thousand euro



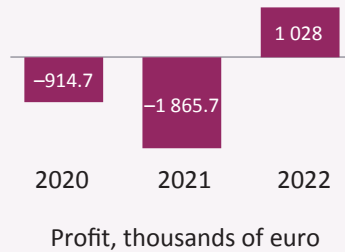
PROFITABILITY

Sector's profit

1 078 thousand euro

63% of firms earned profit

14.5% return on equity (ROE)



OWN FUNDS AND LIQUIDITY

147.4% own funds ratio
(162.5% in 2021)

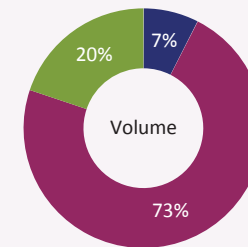
Minimum requirement 100%

352.1% Liquidity ratio
(307.7% in 2021)

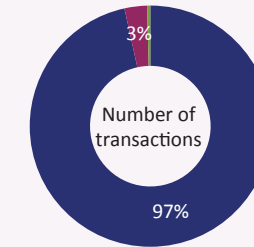
Minimum requirement 100%

VOLUME OF PRODUCT SALES AND THE NUMBER OF TRANSACTIONS*

Volume of total sales
5 719 millions of euro



Total number of transactions
16.8 thousand



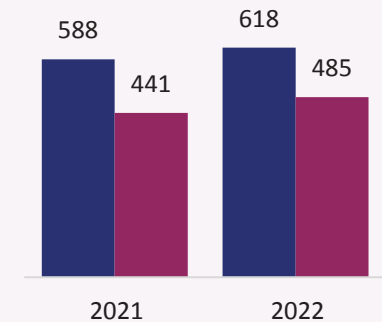
98.7% private customers (non-professional)

■ Debt securities ■ Financial contracts for difference ■ Other investment products

CUSTOMER FUNDS HELD AND MANAGED BY FIRMS

Average amount of customers' funds**

■ Asset holdings ■ Trust assets



Customer funds, millions of euro

* The number of transactions and volume of sales in 2022 as a whole. Volume of product sales is the amount of financial instruments purchased by customers at face value.

** According to the calculation set out in Regulation (EU) 2019/2033

At the end of 2022, investment services in Latvia were provided by:

8

investment firms
licensed in Latvia

8

credit institutions
registered in Latvia

8

investment management
corporations registered
in Latvia

2

branches of credit
institutions of
EU Member States

>600

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

In 2022, the total number of investment firms working in Latvia grew. Two new investment firm licences were issued, however, some market participants discontinued the provision of investment services, i.e. the licence of one investment firm for the provision of investment services and non-core investment services was cancelled in December 2022 on the basis of the firm's application.

In 2022, the FCMC continued to work actively with investment platforms which had received an investment firm licence in 2021 and which were subject to a transitional period during which the platforms had to replace the offer to invest in loans granted by lenders in the form of assignment contracts with the offer of financial instruments, and controlled the implementation of the measures planned for the transitional period.

The focus of supervision of the provision of investment services in 2022 was on:

- five meetings of supervisors with the management of market participants and with employees in charge.
- four in-depth inspections of individual market participants (in three investment firms and one credit institution);
- two horizontal inspections of market participants. One inspection focused on the readiness of market participants to ensure compliance with the requirements of the Financial Instrument Market Law regarding shareholder identification and ensuring the rights of shareholders, while the second inspection dealt with compliance of market participants' reporting of suspicious orders and transactions with financial instruments with 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;

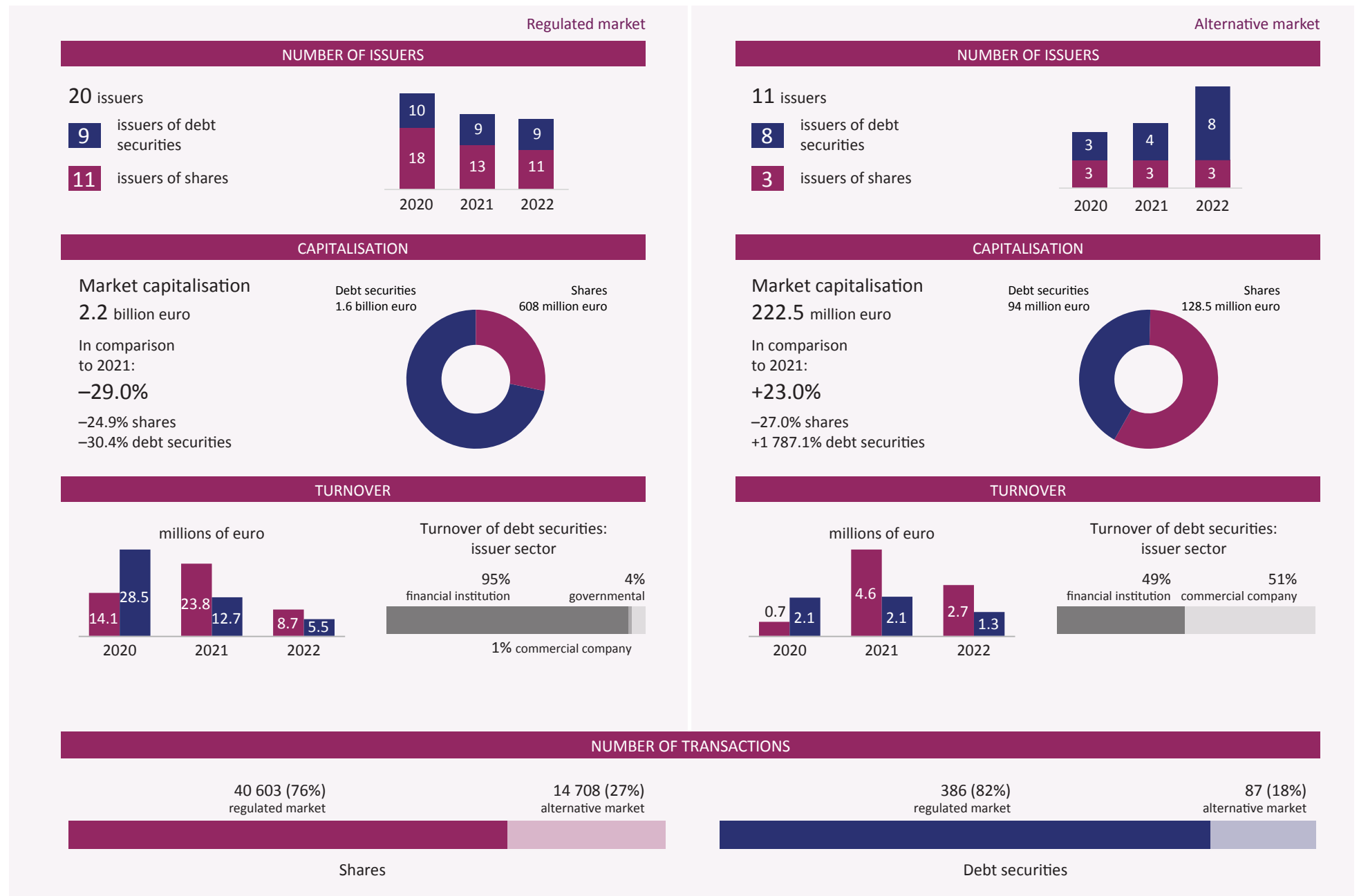
- participation in the single supervision exercise of the ESMA regarding disclosure of costs and expenses to customers;
- participation in the ESMA single inspection with regard to disclosure of information (including costs and expenses) to customers carried out by applying the mystery shopping technique;
- information exchange on sustainability topics with investment service providers;
- assessment of reports submitted by market participants and data quality control;
- review of complaints about investment service providers;
- conformity assessment of market participants' officials and shareholders.

Sanctions and corrective measures

In 2022, the FCMC entered into an administrative contract with one investment firm on the identified violations in the fields of AML/CTF and investment service provision. The firm was imposed a sanction – a warning – for the violations in the area of investment service provision.

In 2022, other sanctions and corrective measures in the area of investment service provision were not applied. At the same time, the FCMC controlled the elimination of shortcomings identified during the inspections of market participants.

2.2.6. Supervision of the financial instruments market



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

The focus of supervision over the regulated market operator AS Nasdaq Riga and the multilateral trading system or alternative market First North Latvia in 2022 was on:

- disclosure of pre-trade and post-trade information;
- ensuring adequate trading in financial instruments;
- supervision of trading in financial instruments;
- operational adequacy of information technology systems, prevention of incidents;
- review and harmonisation of regulations of AS Nasdaq Riga;
- cooperation in the supervision of issuers.

The supervision of the Central Securities Depository Nasdaq CSD SE in 2022 focused on:

- annual operational conformity assessment in accordance with Article 22 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (operational risk, business continuity risk, legal risk, evaluation of the operation of the securities settlement system, incident management, financial stability, business risk, capital requirements, recovery plan, internal control system, management, availability of depository services, depository connections, outsourcing, information disclosure). The Depository received eight recommendations based on the assessment;
- regular off-site supervisory measures (evaluation of submitted statements, reports and other information, meeting with the responsible employees from Nasdaq CSD SE);
- cooperation within the Nasdaq CSD SE supervisory college with the supervisory authorities from Lithuania, Estonia and Iceland, central banks and Latvijas Banka (two meetings of the supervisory college took place in 2022).

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 2022.

Supervision of issuers

The focus of the supervision of issuers in 2022:

- inspection of disclosure of information on transactions with related parties;
- horizontal inspection of compliance of preparation of internal information holder lists;
- timely disclosure of regulated information;
- in-depth examination of annual reports and interim reports;
- disclosure of notice on corporate governance and non-financial notice;
- disclosure of alternative performance indicators;
- evaluation of the compliance of prospectus;
- webinars and explanatory letters on application of laws and regulations.

Sanctions and corrective measures

Three administrative processes were initiated against issuers within the framework of the supervision process in 2022. One of them was related to identifying an issuer's transaction with a related party, the second – to a failure to provide information to the FCMC, failure to timely disclose interim report and information about resolutions passed in the shareholder meeting, and the third was related to a failure to timely disclose the annual report. In the administrative case on the failure to timely disclose the annual report, the FCMC gave a warning to the issuer, and in remaining administrative cases of 2022, decisions were pending.

In relation to in-depth examinations of annual reports and interim reports of the issuers, no violations or significant faults were identified.

In four cases, the FCMC sent letters of reprimand to the issuers – three concerning a minor delay in publishing the audited annual report and one concerning the publishing of the annual report in a non-compliant format.

Supervision of trading in financial instruments and investor activities

The supervision of trading in financial instruments and investor activities in 2022 focused on:

- supervision of trading in financial instruments
- review of reports on suspicious transactions and orders submitted by market participants;
- in-depth inspections of suspicious transactions (market manipulations, use of internal information);
- cooperation and information exchange with the supervisory authorities of other countries;
- timely and correct submission of investor notices.

Sanctions and corrective measures

When supervising the financial instruments market in 2022, no administrative sanctions were imposed. In some cases, the FCMC performed in-depth inspections and sent letters to the investors pointing at a prohibition of market manipulations according to the provisions of laws and regulations so that the investors would discontinue or abstain from activities that could mislead other investors on stock price, demand and supply.

In six cases, the FCMC sent letters of reprimand to persons due to a failure to comply with the deadline for the submission of the manager's notice in accordance with 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. NILLTPF un sankciju riska uzraudzība

1200
applications

2022 brought significant changes in sanctions landscape – the FCMC received and reviewed 1200 applications regarding imposing sanctions.



Results of inspections in the area of ML/FTP risk management in 2022 show that in general financial institutions have considerably improved the systems of determining and managing ML/FTP risk.

In 2022 numerous significant developments took place with regard to sanctions measures, as the EU and other countries imposed sanctions on Russia after its invasion in Ukraine. These sanctions were adopted on an unprecedented scale and rapidly, hand in hand with the dynamic escalation of the situation in Ukraine. They have had a significant impact in Latvia, taking into account that our country borders Russia, and historically Latvia has always had and still has relatively close economic ties with this country. At the same time, the significant work completed over the last years by Latvia’s financial sector in reducing the risk exposure of non-resident customers should be emphasised. The effect of sanctions on the financial sector has therefore been much more manageable.

The task of the FCMC in the application of new sanctions requirements during the reporting year was to make sure that the financial sector has developed the necessary control measures for an effective implementation of sanctions. The FCMC also issued permits to financial institutions for financial transactions with persons subject to sanctions as far as justified with the exceptions laid down in laws and regulations (for example, providing for the basic needs of persons, tax payments, etc.) and pertaining to the services of Latvia’s financial institutions.

As a result of the work in the last years on improving the application of a risk-based approach, considerable experience had been accumulated in the financial sector providing advantages in complying to the new sanctions regimes. The scope of sanctions and their significant impact are evidenced by the statistical data on the applications received by the FCMC. 1200 applications regarding sanctions were received between 1 March 2022

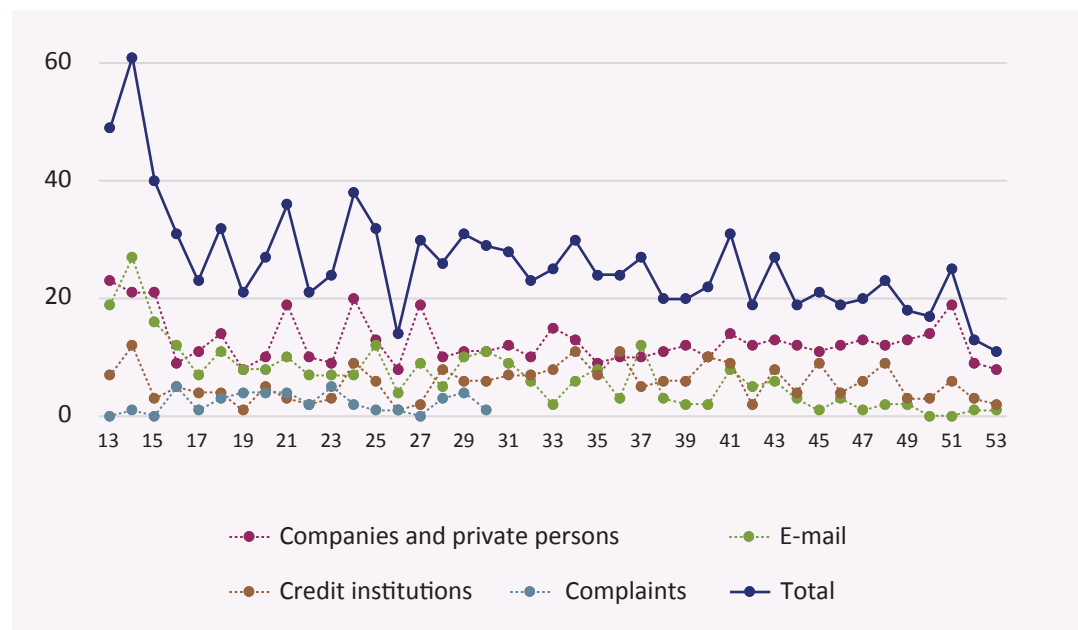


Chart 6. Applications received by the FCMC in the area of sanctions, weekly dynamics (March–December 2022)

and end of 2022, and most questions came from the private sector. Even though the number of applications and questions declined by the end of 2022, it was still relatively high – 30–40 applications per month on average.

At the end of 2022, the total amount of frozen funds of persons subject to sanctions or companies under their control was 83 million euro. The funds of 6 natural persons and 35 legal persons, owned or controlled by sanctioned persons, were frozen.

The major challenges regarding application of new sanctions regimes entailed sanctions circumvention risks related to using complex ownership structures to hide control by persons subject to sanctions and taking advantage of Russia's neighbouring countries to export or import goods subject to sanctions.

Inspections and their results

Inspection results in the field of ML/FTP risk management in 2022 suggest that financial institutions have overall substantially improved their systems for determining and managing ML/TPF risk inherent to its customers and the products offered. These systems need to be further developed to strengthen a risk-based approach so that resources are primarily devoted to the management of higher risks and the reduction of the administrative burden in the fields where the risks are lower.

The most common shortcomings identified during the inspections in the field of ML/TPF risk management were related to the efficiency of transaction monitoring systems and the ability to comprehensively assess the conclusions drawn during the customer due diligence.

The FCMC instructed financial institutions to implement particular measures towards eliminating the identified shortcomings within a specified timeframe and, following the integration, Latvijas Banka continues to supervise the implementation of these measures.

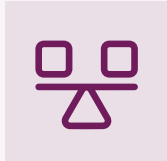
In 2022, the FCMC performed 13 inspections in the field of AML/CFTP (four full on-site inspections and nine off-site target inspections) in credit institutions and six full on-site inspections in financial institutions. Out of all inspections performed in the credit institutions, six off-site target inspections were carried out focusing on the management of sanctions risk. As a result of the full on-site inspections, the FCMC asked the credit institutions to draft the plans for eliminating the shortcomings established during the inspections and supervised the implementation thereof.

In 2022, the FCMC made a decision to suspend the provision of financial services in one credit institution, including due to violations in the field of ML/FTP risk management, and to appoint trustees in this credit institution.

In 2022, the FCMC imposed a monetary fine on one financial institution for violations in the field of ML/FTP risk management amounting the 21.3 thousand euro, and imposed an obligation to draw up a plan of measures to remediate the identified shortcomings.

Credit institutions and other financial institutions regularly submit their procedures before the development of a new product or service to the FCMC. Following the evaluation of these procedures, the FCMC provides its recommendations for the elimination of shortcomings to proactively ensure the effective development and implementation of necessary controls.

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



Local government risk is equated with the country risk

5

O-SIIs identified in Latvia

0 %

The size of countercyclical capital buffer remains unchanged

In 2022, the work continued on improving the legal framework of the operation of financial and capital market participants by introducing the requirements from EU directives and guidelines issued by the EU institutions, ensuring the application of the framework directly applicable to the EU as well as improving the macroprudential framework and using the instruments established therein.

New remuneration requirements for investment firms

On 13 September 2022, the FCMC “Regulation on the Remuneration Policies and Practices for Investment Firms” came into force. This Regulation implements the requirements for the remuneration policies and practices for investment firms established in Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU, as well as refers to the directly applicable EU legal acts on identifying positions affecting the risk profile

of investment firms and publishing of information. The Regulation provides for drafting, implementing and constantly maintaining a remuneration policy that applies to all employees and corresponds to the organisational chart of the investment firm, its scope, type, complexity and specifics of work, and at the same time is gender-neutral and provides for equal treatment of the employees regardless of their gender in all areas related to employment. The Regulation includes requirements for setting the variable part of remuneration for functions having an impact on the risk profile, delaying and granting in a non-monetary form thereof and holding of instruments. The new rules provide for a three-to-five-year long minimum period for the deferral of the variable part of remuneration and granting at least 50% of the variable part of remuneration in a non-monetary form – as shares in the investment firm or instruments related to shares, or instruments which properly reflect the portfolio instruments managed by it – at the same time determining a proportional threshold when these requirements should not be applied. Investment firms have to publish information about the remuneration policies and practices according to the directly applicable EU legal acts, as well as provide information to the supervisory authority about remuneration and practices, high earners and gender pay gap by filling out the report templates drawn up by the EBA.

Revised requirements for drafting the reports of investment firms

The FCMC “Regulation on the Preparation of Quarterly Reports of Investment Firms” came into force on 30 September 2022. It was drafted to obtain information for supervision, analysis of financial stability as well as preparing the balance of payments, international investment positions, financial accounts and other statistical data on financial intermediaries. The Regulation replaces the FCMC “Regulation on the Preparation of the Monthly Report of Investment Firms” of 1 December 2020 and introduces significant and extensive changes in the framework. At the same time, the burden of report drafting is significantly reduced for investment firms, because the number of reports, frequency of submission and volume of information to be submitted and its level of detail are reduced.

Updated requirements for drafting the reports of insurers

In view of the fact that the EC has confirmed IFRS 17 “Insurance Contracts” for application in the EU as of 1 January 2023, in December 2022, the FCMC introduced amendments to the “Regulation on the Preparation of the Annual Report and Consolidated Annual Report of Insurance and Reinsurance Corporations and Branches of Foreign Insurers”, “Regulation on the Preparation of the Public Quarterly Reports of Insurers” and “Regulation on the Preparation of the Reports of Insurers and Reinsurers” which came into force on 1 January 2023. Amendments to the “Regulation on the Preparation of the Annual Report and Consolidated Annual Report of Insurance and Reinsurance Corporations and Branches of Foreign Insurers” are related to the accounting of insurance contracts and the preparation of financial statements, and they will promote a common approach of market participants to preparing the annual report and consolidated annual report and the financial statements included therein. Meanwhile, amendments to the “Regulation on the Preparation of the Public Quarterly Reports of Insurers” were introduced because the adoption of IFRS 17 considerably changed the form of the profit and loss statement and balance sheet. Amendments to “Regulation on the Preparation of the Reports of Insurers and Reinsurers” were introduced due to the application of IFRS 17 in the EU as well as the need to strengthen the supervision of product management requirements and ensure data for statistical purposes in a broader scope.

Supplemented and improved requirements for providing information to be included in the recovery plans

On 9 November 2022, the FCMC “Regulation on the Content of Information to be Addi-

tionally Included in the Recovery Plan and the Procedure for Submitting the Plan” came into force. It aims at promoting a timely identification of crisis situations and carrying out efficient recovery measures. Planning of recovery helps to timely identify crisis situations and implement efficient measures to restore the financial position of the institution after significant deterioration thereof. The Regulation will promote market discipline and ensure that market participants develop stress scenarios, determine thresholds for recovery plan indicators and manage crisis situations within a group according to uniform principles and following the best practice. The Regulation includes requirements specified in the EBA “Guidelines on recovery plan indicators” which led to an improved minimal list of indicators to be incorporated in the recovery plan, supplementing the requirements for calibrating the threshold of indicators to be included in the recovery plan, including a requirement for an institution to calibrate indicators related to minimum requirements for equity and eligible liabilities and their thresholds, as well as setting requirements pertaining to the additional information to be included in the plan regarding the institution’s conduct in case of meeting the thresholds indicated in the recovery plan. Additionally, the frequency of evaluating the compliance of institutions with the simplified requirements for drafting the recovery plan was updated, stating that the evaluation should henceforth be performed at least biannually. The Regulation is binding on the investment firms with the initial capital of at least 750 000 euro, and credit institutions, except for significant credit institutions supervised by ECB.

Improved internal management requirements for the private pension funds

On 16 February 2022, “Regulation on Setting up a Private Pension Fund Management System” of the FCMC came into force. It was drafted on the basis of a delegation referred to in the Private Pension Fund Law and implemented Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast). The Regulation aims to improve the internal management processes in the private pension funds, simultaneously ensuring a uniform approach to and market participant understanding of the application of regulatory framework in the field of management. With this Regulation coming into force, amendments were also made to the FCMC “Regulation on the Establishment of the Internal Control System” of 1 December 2020, deleting a provision recommending to also apply this Regulation to the private pension funds in so far as it is applicable to the operation of the private pension funds.

Latvian local government risk is equated to country risk

On 23 August 2022, the decision of the FCMC Board on equating the risk of Latvia's local governments to the country risk of Latvia in accordance with Article 115(2) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 or the CRR to calculate the credit risk own fund requirements came into force. Accordingly, henceforth, when calculating the risk-weighted exposure amounts for credit risk, exposures to the local governments of Latvian State cities and municipalities can be equated to exposures to the Latvian government. The risk equation has been performed pursuant to Article 115(2) of the CRR. A decision on equating the Latvian local government risk to the country risk will allow the credit institutions to apply a lower risk degree to such exposures, thus reducing the credit risk own funds requirement, and they will also be able to optimise the credit risk management of these transactions by managing them as exposures to the central government in the future. Meanwhile, this decision will have a positive impact on the local governments of Latvia's State cities and municipalities as it will affect the price of loans available to them.

Determining the risk degree for exposures secured with a commercial real estate mortgage

The FCMC Board, acting as the designated authority pursuant to Paragraph five of Section 50 of the Credit Institution Law, evaluated the application of the conditions laid down in Articles 124 and 164 of the CRR regarding the compliance of the risk degree and default loss levels, which are applied to exposures secured with a commercial real estate mortgage, with the specifics of Latvia's financial sector and real estate segments. Given the existing uncertainty, the negative projections on the future economic development as well as the incentive to act prudently, which follows from the warning¹ published by the ESRB on 22 September 2022 on vulnerabilities in the Union financial system, also emphasizing a need to prepare for a potential realization of tail-risk scenarios, thus preserving or even strengthening the existing resilience of the financial sector, including by using an adequate macroprudential capital buffer, the FCMC Board decided on 15 November 2022 to keep the elevated risk degree determined according to Article 124 of the CRR at 100% for exposures secured with a commercial real estate mortgage registered in Latvia, at the same time not changing the remaining provisions of Articles 124 and 164 of the CRR.

Integration of sustainability factors and risks into the regulatory framework

Amendments to seven legislative acts adopted by the EC came into force on 2 August 2022. They will ensure that financial companies include sustainability factors in their procedures and investment consultations with customers. Requirements to integrate sustainability factors, risks and wishes into the supervision and management requirements for products, as well as into the management systems in the insurance sector were set for investment firms and alternative investment fund managers through amendments to the directly applicable EU legal acts. Meanwhile, requirements for those developing and distributing the financial instruments to take into account sustainability factors in the product management measures and determining the target market are included in the amendments to the Financial Instrument Market Law which came into force in 2022. Requirements for the investment management companies to take into account the sustainability factors and risk in their management system were set through amendments of 2022 to the Law on Investment Management Companies and the "Regulation on Setting up the Internal Control System of Investment Management Companies" of the FCMC.

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

Latvijas Banka as the successor of the rights and liabilities of the FCMC continues to actively follow the changes in the first level legal framework of the EU financial sector. The most important current amendment proposals are the planned changes in 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, i.e. the CRD and the CRR to complete the introduction of the international supervision standards Basel III final, the implementation of the CMU action plan, by intending to develop a regulation for the creation of ESAP as well as the review of Solvency II and regulatory requirements for insurers and the planned directive on corporate sustainability due diligence.

Basel III final is a proposal of the Basel Committee on Banking Supervision published in 2017 to promote the resilience of credit institutions and their ability to finance the economy and eliminate shortcomings in the credit institution regulatory framework fol-

¹ Warning ESRB/2022/7 of the European Systemic Risk Board of 22 September 2022 on vulnerabilities in the Union financial system, see https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning220929_on_vulnerabilities_union_financial_system~6ae5572939.en.pdf.

lowing the global financial crisis (2008–2010). In 2021, the EC published an amendment proposal for the CRD and the CRR that are expected to come into force in 2025. The goal of this proposal is to introduce the requirements of Basel III final as completely as possible, simultaneously ensuring that the total capital requirements of the EU credit institution sector do not increase significantly, as well as promoting the development of a harmonised internal market in relation to the services provided by credit institutions with lower compliance and reporting costs, especially for small credit institutions and those having a simple mode of operation. The proposal introduces a new requirement – the output floor of internal models, which determines a limit at which the credit institution capital requirement set via internal models can significantly differ from the capital requirement established according to the standardised approach. 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 implementing the Basel III final reform, the EC proposal also contains new requirements for credit institutions in the environmental, social and governance field, as well as changes within the framework of the assessment of officials and of the supervision, crisis management and deposit guarantees of the branches of third-country credit institutions. In November 2022, a political agreement was reached on the position of the Council of the European Union regarding these amendment proposals; meanwhile, in spring 2023, dialogues with the European Parliament and the EC will be launched to finalise the negotiation process and agree on the new requirements.

In order to promote the implementation of the first CMU action plan² adopted on 24 September 2020 and ensure a centralised access to the 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 Regulation as well as amendments to the European Long-Term Investment Funds (ELTIF) Regulation, Markets in Financial Instruments Directive (MiFIR), Alternative Investment Fund Managers (AIFM) Directive and Directive on the coordination of laws, regulations and administrative provisions relating to UCITS. The proposal for the ESAP Regulation provides for supplementing the existing framework of information disclosure requirements, ensuring public access to information which the companies and entities are required to provide in accordance with the EU laws and regulations, including the Regulation on prospectus, Regulation on short selling, Regulation on market abuse, Regulation on taxonomy, Directive on transparency, Directive on takeover bids, Directive on audit, etc. As of 1 January 2029, a possibility is provided for any entity (including small and medium

enterprises and entities not listed on stock exchanges) 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 (nevertheless, providing for the rights of the ESMA to apply the fee to the users requesting an excessive scope of information, or a fee for the provision of information subject to frequent updates). It is not planned to apply any cumbersome conditions for the use or repeated use of the data available at the ESAP. Opening the ESAP is scheduled for the end of 2025, gradually supplementing the available functionality during the transitional period until 2029. After further development and discussion of the proposal in 2022, it is planned to start dialogues according to the general legislative procedure in 2023. The purpose of amendments to the ELTIF Regulation is to promote investments in long-term assets via alternative investment fund managers and to balance the interests of various investors, focussing on the protection of non-professional investors, at the same time making the product more attractive. The discussion of the proposed amendments to the ELTIF Regulation started in 2022, and its finalisation is expected in 2023. Amendments to the MiFIR are intended for simplifying the transparency conditions for EU securities, which are not equity securities, in order to introduce consolidated tape conditions for bonds and equity securities, as well as to strengthen the role of the ESMA in determining the market information exchange standards. Proposed amendments to the MiFIR are intended to be discussed in dialogues in 2023. Meanwhile, the AIFMD is reviewed to achieve additional funding possibilities for commercial companies, by developing the involvement of alternative investment funds in lending activities so that these funds are subject to uniform requirements. The purpose of amendments to the AIFMD and the UCITS Directive is to promote the application of liquidity management instruments by introducing common requirements for more efficient liquidity risk management also under complicated market conditions, and improve the framework function in cases of delegation and in the field of the protection of interests of investors. The review of the proposed amendments to the AIFMD and the UCITS Directive is expected in dialogues in 2023.

On 22 September 2021, in the field of insurance, the EC published a proposal for comprehensive amendments to the Solvency II Directive as well as for the new Directive establishing a framework for the recovery and resolution of insurance and reinsurance undertakings. The purpose of amendments to the Solvency II Framework 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 economy, to strengthen the operation of the CMU

² 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”, see <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0590>.

and to facilitate the allocation of funds for the implementation of the European Green Deal. It is planned to strengthen the incentives for the insurers to be involved in the provision of longer-term sustainable funding, to improve the sensitivity of risk related to capital requirements, 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 the established requirements. Furthermore, it is planned to improve the quality, consistency and coordination of supervision of the insurance sector within the scope of the EU, strengthen the protection of insurance policy holders and beneficiaries (including in cases when the insurer becomes insolvent) and improve the ability to respond to potential accumulation of the systemic risk in the insurance sector. In turn, the Directive establishing a framework for the recovery and resolution of insurance and re-insurance undertakings is planned to be implemented for the purposes of ensuring that the insurers and supervisory authorities, within the scope of the EU, are better prepared for significant financial complications. It is also planned that the Directive will include requirements 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. Both above Directives are intended to be discussed in dialogues as from 2023.

On 22 February 2022, in the field of sustainability, the EC published a proposal for a directive on corporate sustainability due diligence. It aims to promote a sustainable and responsible conduct of companies across all global value chains. Since the companies play an important role in shaping sustainable economy and society, the proposal intends that they will have to understand and prevent, discontinue or reduce, if necessary, the adverse effects of its operation on human rights, for example, child labour and exploitation of employees, and on the environment, for example, pollution and loss of biological diversity. The new conditions are expected to provide legal certainty and level playing field for companies, better transparency for consumers and investors, as well as promote green transition and protect human rights in Europe and beyond. The proposal applies to companies established in the EU, corresponding to certain thresholds (more than 500 employees and more than 150 million euro net turnover worldwide), as well as other companies operating in certain sectors with a substantial impact on the sustainability factors and not complying with both thresholds of the group above, yet with more than 250 employees and at least 40 million euro net turnover worldwide (provisions will be applied to these companies two years later), as well as to companies in third countries engaged in commercial activity in the EU and with a threshold of turnover in the EU cor-

responding to the turnover of one of the above groups. The new framework will apply to the operation of these companies and their subsidiaries and the operation of value chains (direct and indirect business relations). Small and medium enterprises are not included in the scope of the proposal. The proposal will be submitted for approval in the European Parliament and the Council of the European Union, and, following its adoption, the EU Member States will be given two years to implement the directive in their national legislation.

Application of macroprudential instruments

Given that the adverse effect of the war in Ukraine and the Covid-19 pandemic can still be felt on the economic development, overall, no new, tighter macroprudential requirements were imposed on the financial sector in 2022, similar to 2021. As the cyclical systemic risk remained low, the countercyclical capital buffer³ was kept at 0%. In 2022, just like in 2021, five O-SIIs⁴ were identified – Swedbank AS (also at the level of the holding company Swedbank Baltics AS), AS SEB banka, AS Citadele banka, AS Rietumu Banka and BluOr Bank AS – and their O-SII capital buffer requirements were set at 2%, 1.75%, 1.75%, 1% and 0.25% accordingly from the total exposure value calculated pursuant to the CRR. This requirement entered into force on 1 January 2023. In comparison to the previously stated requirements, the volume of the O-SII capital buffer of AS SEB banka was increased by 0.25 percentage points.

On 16 August 2022, the FCMC Board made a decision to voluntarily recognise the systemic risk buffer of Lithuania at 2% for the credit institutions whose exposures (secured with a housing property) to natural persons who are residents of the Republic of Lithuania exceed the materiality threshold of 50 million euro on a consolidated group or sub-consolidated basis. On 27 September 2022, the FCMC also reviewed the existing general position regarding a voluntary reciprocity for macroprudential policy measures, mainly to ensure the cancellation of the materiality threshold of 1 million euro, which does not reflect the systemic significance of credit institution exposures in practice, instead hereinafter mainly focusing on the materiality thresholds specified in Recommendation 2015/2 of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures, as well as providing that henceforth an individual decision will only be made in cases when the measures of other countries are recognised.

³ See <https://www.bank.lv/darbibas-jomas/finansu-stabilitate/makrouzraudziba/pretcikliska-kapitala-rezerve>.

⁴ See <https://www.bank.lv/darbibas-jomas/finansu-stabilitate/makrouzraudziba/citu-sistemiski-nozimigo-iestazu-kapitala-rezerve>.

Business environment favourable to innovative and secure financial services



In 2022, the experts of the Innovation Hub provided 72 consultations to the financial technology companies.



34 market participants have set up a team for the development and implementation of innovative solutions.



A website was created for the participants of the financial technology sector – www.fintechlatvia.eu.

3.

Development of innovations

In 2022, compared to 2021, the proportion of market participants using some innovative solution for the provision of financial services has increased by 68% (FCMC survey, see [Financial innovations used by Latvia's financial and capital market participants 2022 – Fintech Latvia](#)). There was a significant increase in the usage of financial technology (FinTech) in the following solutions: cloud computing services, Application Programming Interface (API), biometric solutions and big data. FinTech solutions were mostly used by members of the insurance sector and credit institutions.

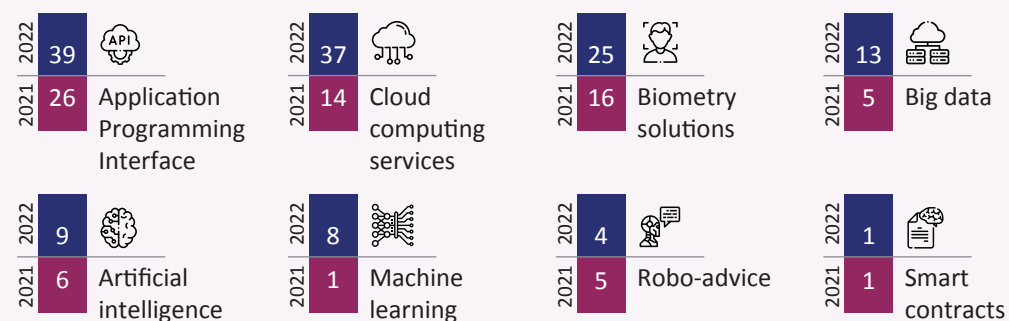


Chart 7. Innovative technologies applied in 2021 and 2022

During the reporting year, the proportion of market participants planning to develop and implement a new and innovative process in the next few years has increased by 143%, especially focusing on already used solutions – APIs, cloud computing services, artificial intelligence, machine learning, biometric data, robo-advice, digital onboarding and digital platforms as well as solutions unused so far, namely crypto-assets. The determination of financial market participants to develop innovations is also evidenced by the human resources dedicated to this purpose, namely 34 market participants had created special teams for the development and implementation of innovative solutions and their number had grown by 87% since 2021.

As impediments to the implementation or successful operation of FinTech solutions market participants acknowledged the following: the regulatory framework, its restrictions and complex regulatory requirements as well as the shortage of experienced IT specialists in the market and the financial aspects (limited financial resources, lack of investments).

Support instruments

In 2022, the FCMC's Innovation Hub continued its work. It is the main point of contact for the financial technology companies in matters concerning local legal framework and licensing. During the year, 72 consultations were provided to local and foreign representatives of the FinTech sector. More than two thirds of consultations were provided on the process and supervision of e-money and payment institution licensing, and on the licensing and supervision of crowdfunding service providers which is a new regulated FinTech sector. Meanwhile, 20% of consultations were provided in cryptocurrency-related services – both on the current regulatory framework and the future regulatory framework in connection with the Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937.

The FCMC continued developing and improving the scope of services in the Regulatory Sandbox aiming, together with the supervisory authority, to give an opportunity to test new, innovative business ideas. The FCMC joined the initiative of the EU Digital Finance Platform on the introduction of cross-border testing, which allowed the developers of FinTech innovative services in Latvia and abroad to start simultaneous testing in the regulatory sandboxes of several EU Member States and obtain an opinion of internationally coordinated supervisory authorities on the innovative product.

The FCMC has created a new website for the promotion of the financial innovation environment, dedicated to the participants of the financial technology sector – www.fintechlatvia.eu. Besides, in cooperation with the Investment and Development Agency of Latvia, the FCMC organised the first Latvia FinTech Forum on 13 September 2022 with more than 100 representatives of financial technology companies, industry experts and officials from Latvia and other European countries.

In 2022, the FCMC experts participated in more than 20 public events and shared knowledge and expert opinion on relevant FinTech issues – payment services, crowdfunding framework, dialogue between the supervisor and the consultants from FinTech companies, cybersecurity aspects in the financial sector – and also discussed the future regulatory framework with service providers operating in the field of cryptocurrency.

Management of the risk related to information and communication technologies and security

The operation of financial institutions becomes increasingly more digitised and increasingly more dependent on the security of information systems. In 2022, the FCMC performed several security checks of the information systems of market participants, especially regarding the use of the new technologies.

On-site inspections of information systems were performed in two credit institutions, in one investment firm and the Central Securities Depository. Increased attention was paid to the capacity of the institutions to ensure business continuity and cybersecurity or resilience against external attacks. Considerable effort was made for the review of the applications for the new services by market participants and the registration and licensing of new market participants, evaluating the compliance with the requirements of the regulatory framework of information systems and consulting on the application of certain requirements.

Several market participant surveys were also conducted in 2022, including a survey aimed at evaluating the outsourcing management and the introduction and use of innovative FinTech solutions in the financial sector. The analysis of individual market segments suggests that the largest share of market participants using FinTech solutions comes from the credit institution segment. Taking into account the geopolitical situation and growing cyber threats, the readiness of credit institutions to protect their infrastructure and make their services available in a crisis situation was assessed. Under the SREP, less significant credit institutions were surveyed and their information security and information technology leaders were interviewed. The risk related to information and communication technologies of these credit institutions was assessed.

In order to ensure constant availability of critical financial services for the Latvian public in case of a state-level threat, the providers of critical financial services prepared and submitted to the FCMC the plans of continuity of critical services that were prepared according to provisions of the FCMC regulations.

Currently, together with the EU supervisors, work is in progress on drafting standards and guidelines related to the Digital Operational Resilience Act or DORA.

Development of the FCMC internal innovations and supervisory technologies

2022 was the second year when the FCMC implemented a specialised supervisory technology, i.e. the SupTech strategy. Since the strategy was created as a dynamic instrument, it was reviewed, introducing new accents and still maintaining the defined vision. The environment of supervisory technologies remained dynamic also in 2022. It is shown by the increase in the number of projects and activities throughout the year. In early 2022, 28 supervisory technology projects were identified; their number grew to 50 over the course of the year. In order to implement them, dynamics and flexibility is crucial, and it is possible only in a professional, consolidated and motivated team.

In 2022, supervisory technologies focused on the following solutions: supervisory data processing tools for the supervision of market participants and the capital market, report introduction and automation projects, changes in the supervisory information system, development of the capital market supervisory system, drafting of penalty calculation tools, migration of all FCMC websites, development of the requirements for a single report portal and development procurement, introduction of a new supervisory project management environment.

One of the technologically significant milestones in 2022 was a broad movement towards using the cloud services – a logic continuation of the innovation laboratory or iLab project that was implemented in 2021. The movement towards a wider use of the cloud services is driven by several factors, including more opportunities to use data, rapid development of cloud service solutions offered by manufacturers, and security level in terms of data protection. The movement towards a wider use of the cloud services in supervision took place by assessing risks in more detail and depth as well as taking into account the increase in security capacity following the FCMC integration into Latvijas Banka. A wide range of different data are gathered and used in the supervision process, and it is very important that the use of these data become more detailed and automated because in practice it translates into greater efficiency of the supervision process. The use of cloud service solutions is a considerable improvement in the implementation of these principles, and in this regard, Latvia is one of leaders on a European scale.

In 2022, the FCMC continued a targeted and organised approach to the introduction of innovations. Like in 2021, the FCMC continued implementing innovation projects under iLab. iLab is a platform which allows a focused assessment, experimental testing and prototyping of new technological supervisory solutions in a short period of time. It is also a way to spot errors quicker and eliminate needless development of solutions that lack perspective. The FCMC innovation laboratory was granted the “Celmlauzis” (Pioneer) award by the public administration in 2022 for being a successful example of introducing changes by implementing innovative projects in the public sector.

AML/CFTP supervision, capital market supervision and synthetic data innovation projects were implemented under the innovation lab, and currently, they have materialised in a comprehensive project implementing the technological solution for capital market supervision so that the supervision of this market segment would be increasingly based on data and would be more efficient. To facilitate the development of new services, a practical set of instruments has been drafted in the Regulatory Sandbox to improve the FinTech development environment. A prototype for the synthetic data set has been developed under the experimental project and repeatedly validated over the course of the project with the potential users of synthetic data and their needs, as well as data experts from various industries. It is planned to start developing this prototyped solution in the innovation lab as a complete product in 2023.

The capacity of supervisory technologies applied in Latvia was assessed in 2022 in comparison to other European supervisory authorities (information was collected by the EBA). In terms of using various supervisory technology tools, Latvia meets the average European level, but, given the scope of the market, we are well above the average. The use of technologies will be a crucial element also in future to ensure not only qualitative but also cost-friendly supervisory services.

In parallel to the development of supervisory technologies, another important aspect of 2022 was the technological and procedural integration of the FCMC into Latvijas Banka. The necessary integration works were performed to ensure a seamless merger of the FCMC and Latvijas Banka in terms of processes and systems, as well as to make sure there was no additional administrative burden on the customers.

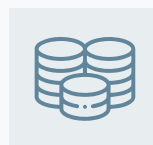
In 2023, an extensive work is expected in relation to technology integration in the infrastructure of Latvijas Banka. The activities related to the implementation of the SupTech projects and action plan will also continue. There are also new plans in relation to the implementation of iLab innovation projects and more efficient use of technologies after the integration of the FCMC into Latvijas Banka. The technological capacity available to supervision as a result of integration has increased, and in future, it will allow to fulfil ambitions associated with the use of technologies in supervision processes and defined in the services.

Integration into a single institution has enhanced the technological capacity and henceforth, additional benefits are also expected. Gradually, there will be new opportunities to develop specific supervisory technological solutions which will not only make the supervision process more efficient but also improve the user experience of financial and capital market participants and the quality of services provided to them. Currently, a new strategy of Latvijas Banka has been drawn up; therefore, the SupTech strategy subordinated to it will be reviewed and, if needed, adjusted to the common strategy of Latvijas Banka.

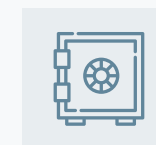
Efficient mechanism for crisis management in the financial sector and for the resolution of credit institutions



In 2022, 10 resolution plans were updated, including 7 resolution plans for the credit institutions and investment firms under the direct remit of the FCMC.



In 2022, Latvian credit institutions transferred 5.46 million euro to the SRF, and since 2015, Latvian credit institutions have contributed 48.7 million euro to the SRF.



At the end of the reporting year, 175.8 million euro were accumulated in the DGF account and 19.2 million euro – in the FPI account of Latvijas Banka.

4.1. Resolution mechanism and protection systems

The SRB carries out the functions of a resolution authority over credit institutions, as well as the cross-border credit institution 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 on determining the minimum requirement for own funds and eligible liabilities. In 2022, three Latvian credit institutions and one branch of the credit institution based in a Member State with an 84% share in the total assets of credit institutions were subject to direct SRB resolution.

In 2022, the priorities in the field of resolution were:

- to continue the operationalisation of the resolution mechanism;
- to ensure updating of resolution plans and approval of decisions on the minimum requirements for own funds and eligible liabilities;

- to ensure timely contributions to the SRF.

In 2022, 10 resolution plans were updated, including 7 resolution plans for the credit institutions and investment firms under the direct remit of the FCMC.

According to the SRB methodology, the minimum requirements for own funds and eligible liabilities were determined on a consolidation basis in 2022. The seven credit institutions under the direct remit of the FCMC were subject to the minimum requirements for own funds and eligible liabilities in the reporting year according to the strategy specified in their resolution plans.

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 according to the provisions of the SRB Regulation, and for managing and using the SRF funds. The objective of the SRF is to provide funds which the credit institutions can use to finance resolution in case of a crisis. The SRF are formed from the contributions of the credit institutions of the Member States, including

4.

Latvia, aimed at gradually achieving (by 2024) the amount comprising at least 1% of the covered deposits in all credit institutions in all Member States involved. According to the SRB calculations, in 2022, Latvian credit institutions transferred 5.46 million euro to the SRF, and since 2015, Latvian credit institutions have contributed 48.7 million euro to the SRF.

4.2. Guarantee scheme

Latvia's financial stability system is comprised of:

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

Deposit Guarantee Fund

Pursuant to the requirements established in Section 6 of the Deposit Guarantee Law, the FCMC performs the DGF stress tests on a regular basis. In 2022, the lists of the recipients of the guaranteed compensation of cooperative credit unions and credit institutions were inspected. The ability to prepare a list of depositors and submit the information requested by the FCMC in the set form and meeting the deadline was verified. According to the stress test results, the FCMC provided explanations on the preparation of the requested information, if needed, and sent letters to market participants after completing the test asking to make improvements in the internal control system.

The average applicable adjustment ratio for credit institutions in 2022 was 126% but for cooperative credit unions – 92.24%. Deposit takers contributed 21.7 million euro to the DGF for 2022.

In the reporting year, the FCMC ensured the disbursements of the guaranteed compensation to the depositors of AS Latvijas Krājbanka (LAS Latvijas Krājbanka) in liquidation, ABLV Bank, AS (LAS ABLV Bank) in liquidation, AS PNB Banka (LAS PNB Banka) in liquidation and Baltic international Bank SE in the amount stipulated in the Deposit Guarantee Law.

In 2022, the guaranteed compensation was disbursed in the following manner:

- 3 thousand euro to the depositors of LAS Latvijas Krājbanka;

- 1398 thousand euro to the depositors of LAS ABLV Bank;
- 2448 thousand euro to the depositors of LAS PNB Banka;
- 6505 thousand euro to the depositors of Baltic International Bank SE.

The day when five years have lapsed since the day when the FCMC has established that deposits have become unavailable (Paragraph four of Section 3 of the Deposit Guarantee Law) is 23 February 2023 in case of LAS ABLV Bank, 12 June 2024 in case of LAS Latvijas Krājbanka and 15 August 2024 in case of LAS PNB Banka. The disbursement of the guaranteed compensation to the depositors of Baltic International Bank SE will continue until 12 December 2027.

In 2022, the FCMC ensured the accumulation and management of the DGF funds, and at the end of year, the amount held in the NGF account with Latvijas Banka was 175.8 million euro.

Fund for the Protection of the Insured

The assets of the FPI consist of deductions of 0.1% by insurance companies from their total gross insurance premiums received from natural persons for the classes of insurance specified by law. Since the beginning of the operation of the FPI, its funds for the disbursement of the guaranteed compensation have been allocated in the amount of 12.3 thousand euro. Since at the end of 2015 the accumulated funds exceeded the amount stipulated in Section 288 of the Insurance and Reinsurance Law, the FCMC suspended contributions to the FPI in 2016. At the end of 2022, 19.2 million euro were accumulated in the FPI.

Protection of the customers of the financial instrument market (investors)

The Investor Protection Law forms the basis of the system of investor protection. Compensation per investor is calculated up to 20 000 euro. The 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 or legal entities, who, under the established procedure, have received the FCMC permit (licence) for the provision of investment services.

Dialogue with financial and capital market participants and communication with the general public

+13%

In 2022, the publicity volume in the media increased by 13%.

10

10 episodes of the podcast “Ability to earn” in the field of investments have been prepared.

5.

Objective, timely and clear communication in the form of a dialogue is one of the priorities of the FCMC strategy for 2019–2023. In 2022, the FCMC ensured a wide public access to the information on the website, and ensured operational information flows on relevant issues through the media, as well as implemented several activities related to promoting financial literacy. Much attention in communication was paid to the development of innovations in the capital market and in finance, the effect of Russia’s invasion and war in Ukraine on the financial sector, the application of sanctions imposed on Russia and strengthening the risk assessment-based approach.

External communication

In 2022, there were 4897 mentions of the FCMC in the Latvian media. The publicity volume increased by 13% year on year. It is explained by the

imposition of the EU sanctions on Russia where the financial sector and its supervising authority in Latvia played an important role. The FCMC also continued its active work on developing the FinTech and capital market, as well as informed about the transformation of credit institution sector and explained the reasons for suspending the operation of Baltic International Bank SE and the information relevant to customers underlying this decision.

In the reporting year, the Communications Division prepared and disseminated statements to Latvian and foreign media about the decisions adopted by the Board of the FCMC, the operation of financial market participants, relevant issues in the regulatory framework, changes implemented in the credit institution sector, sanctions imposed on the FCMC market participants, changes in the laws and regulations and other developments related to the FCMC. In 2022, infographics on the performance of the financial sector segments were prepared and published. The work on informing the Latvian population about investment fraudsters and the signs for identifying such fraudsters continued.

In 2022, extensive new international sanctions against Russia were imposed. Latvia's financial sector demonstrated its ability to apply them in a timely manner by identifying the persons subject to sanctions and the companies controlled by such persons and by freezing 83 million euro. The FCMC provided timely consultation support in imposing sanctions by setting up a dedicated website section, compiling a list of the imposed sanctions, providing methodological suggestions and publishing answers to frequently asked questions. Information was also prepared and provided on relevant topics related to the imposed sanctions, and the participation of experts in various informative events, discussions and media broadcasts was ensured. At the same time, information on the availability of financial services was provided to the Ukrainian refugees staying in Latvia.

Active communication on the development of the Latvian capital market continued in 2022. In February, the second Latvian capital market forum "Ambitions. Growth. Sustainability" took place, while in April, the FCMC presented the "Securities Sandbox", a new support mechanism which allows the potential market participants to receive an assessment by competent experts on a company's readiness to enter the Latvian capital market.

In October, the FCMC, in cooperation with Latvijas Banka, offered to all interested parties who had started investing or were planning to do so to expand their knowledge and acquire more valuable information by watching or listening to a new podcast "Ability to earn"⁵. In a cycle of ten episodes, industry experts provided valuable information which should be taken into account when making investments.

In 2022, the FCMC intensified and extended the communication on the supervision and development of FinTech and support provided by the FCMC to FinTech companies wishing to start or expand their operation in Latvia. The first website dedicated primarily to the participants of the FinTech ecosystem was created – finechatvia.eu. It provides handy guidelines on how to obtain a license in Latvia, and has also gathered information about backstops for innovative companies of the financial sector and Latvia's advantages in establishing FinTech companies, as well as explanations regularly provided by experts on the regulatory framework and development trends of the industry and stories where market participants share their experience.

Communication channels were diversified to reach the FinTech industry professionals, inter alia, a regular newsgroup of FinTech updates was created and communication on

the social network LinkedIn was expanded, as well as opportunities of digital marketing were used to reach the international audience.

The first FinTech Forum organised by the FCMC took place in September 2022 with more than 100 representatives of financial technology companies, industry experts and officials from Latvia and other European countries. Company managers shared stories of their journey in the financial innovation world and discussed with experts the directions of FinTech growth and incentives needed for the development of the industry in Latvia.

Communication on the integration of the FCMC into Latvijas Banka

In terms of external communication, in relation to the integration of the FCMC into Latvijas Banka, the main emphasis was placed on informing about the fulfilment of the task given by the Saeima, a successful course of the process and the practical aspects of integration. External communication activities were more focused on financial market participants, opinion leaders, cooperation partners and media.

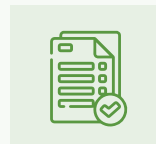
The media was the main communication channel for providing information about integration – both for responding to inquiries from media representatives and disseminating press releases. Information related to integration was also prepared and disseminated on websites and social media in a timely manner.

In addition to the above, information was also provided by organising bilateral meetings with the representatives of the Ministry of Finance and the Finance Latvia Association, as well as in the existing cooperation formats – the Consultative Financial Market Council, the parliamentary groups and committees of the Saeima.

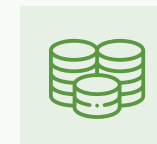
By merging the external communication functions of both institutions, the most important tasks of the Communication Working Group regarding the integration project were the integration of the website content, the update of the crisis communication plan in the financial sector, the development of the external communication strategy of the merged institution, the takeover of customer service functions and the setup of a uniform organisational process of the supervisory communication function in the central bank and financial sector.

⁵ See https://www.youtube.com/watch?v=j9EvbTkn9Ek&list=PLpPDokZafemGnYnt8uoDkill_tCPkonw9.

Professional and responsible organisation with efficient corporate governance and processes



In 2022, 57 meetings of the FCMC Board were held with 239 decisions made therein. Also, 18 meetings of the Consultative Financial Market Council took place.



The total actual budget execution expenditure were 12 267 376 euro – an increase by 9.6% year on year.



In the reporting year, 6 whistleblower submissions were received, which in the opinion of the submitters were about possible or actual violations in the financial and capital market sector, as well as 1 whistleblowing report was received in accordance with the requirements of the FCMC regulations.



On average, the FCMC employed 175.6 persons in 2022.

6.

6.1. International cooperation

International cooperation has always been an important direction of activity for the FCMC, by maintaining constant and close contact and actively cooperating with supervisory authorities of other countries (including in the field of AML/CFTP), resolution authorities and guarantee funds (protection schemes), as well as with European financial sector supervisory and resolution authorities.

Activities in 2022, in the area of international cooperation were largely affected by Russia's invasion of Ukraine, causing new challenges, including shifts in thinking of the relevant issues of international cooperation, as well as calling for reviewing current international relationship models and cooperation principles at the global scale.

In the reporting year, the main international partners of the FCMC were the supervisory and resolution authorities of other countries, the European financial sector supervisory authorities (EBA, EIOPA, ESMA, ESRB) with

whom regular cooperation and information exchange was ensured, along with ensuring participation in the ECB's SSM and SRM.

The FCMC also assisted public administration authorities by contributing to the representation of Latvia's interests and the preparation of opinions on initiatives relevant to the financial market – by participating in the working groups of the Council of the European Union, the EC and the OECD and preparing information on the issues of the financial sector regulation, supervision and resolution for various reports and reviews on Latvia, for example, with regard to cooperation with the EC, OECD, IMF, EBRD, rating agencies and other formats.

The FCMC also continued cooperation, information exchange and the representation of Latvia's interests in the Nordic and Baltic State cooperation formats, in the EFDI, the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) of the Council of Europe, as well as in the BSCEE, IOSCO and IAIS.

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

In 2022, in relation to the EU legislative initiatives in the financial sector, active work and discussions in international formats and meetings continued regarding the EU legislative proposals published over the previous years, and the FCMC actively took part and represented the interests of Latvia.

The following new EU legislative initiatives in the field of financial services were published in the reporting year: in March 2022, the EC presented a legislative proposal suggesting changes to the Central Securities Depositories Regulation⁶ to enhance the efficiency of the EU's settlement markets, while safeguarding financial stability; in October 2022, a EU legislative proposal on instant payments in euro was published⁷, and it was aimed at ensuring that instant payments in euro are affordable, secure and processed without hindrance across the EU; in December 2022, the EC published a proposal package for further development of the CMU⁸ which intends:

- to alleviate the administrative burden for companies of all sizes, in particular SMEs, so that they can better access public funding by listing on stock exchanges;
- to harmonise certain corporate insolvency rules across the EU, making them more efficient and helping promote cross-border investments;
- to make EU clearing services more attractive and resilient by preserving financial stability and supporting the EU's open strategic autonomy.

Throughout the reporting year, in international forum discussions, substantial attention was paid to the issues related to Russia's aggression in Ukraine and the geopolitical tensions it created, including EU sanctions and challenges in the energy sector. Moreover, issues relevant during the previous years in relation to support measures for remedying the effects of Covid-19, sustainability and green finance, as well as issues of digital finance continued to be relevant in the international agenda also in 2022.

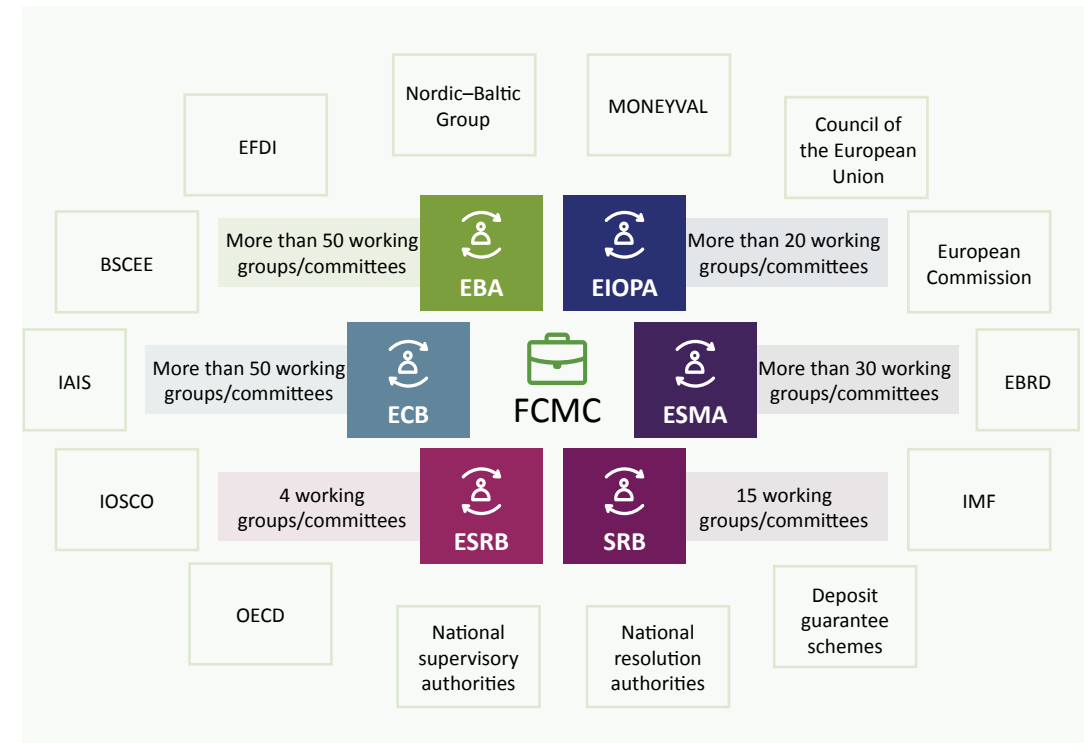


Chart 8. Representation of the FCMC in international working groups and committees of the financial sector supervisory and resolution authorities

⁶ See https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1729.

⁷ See https://finance.ec.europa.eu/publications/legislative-proposal-instant-payments_en.

⁸ See https://ec.europa.eu/commission/presscorner/detail/en/ip_22_7348.

6.2. Professional, responsible and development-oriented staff

Staff breakdown by number and changes thereof

In 2022, the FCMC continued to implement the key principles of staff policy, as highly qualified and professional staff plays a major part in the development of the FCMC. Similarly to the previous years, the FCMC continued to promote staff development and professional growth, and qualified and professional employees were recruited as a result of efficient recruitment processes. It was important for the FCMC to establish long-term employment relationships and create a motivating and supportive work environment for its staff.

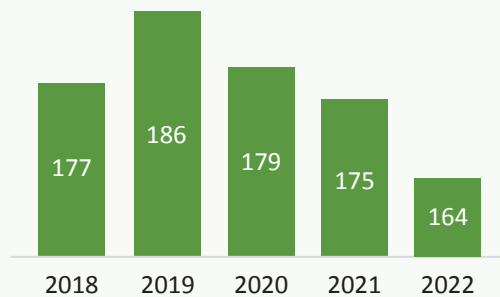


Chart 9. Changes in the number of the FCMC employees

In 2022, the staff turnover rate was 15.9%. Overall, 28 employees were released and 20 employees were recruited in 2022.

In 2022, the average number of employees, including those on long-term leave, was 175.58. As at 31 December 2022, the FCMC employed 164 employees, 122 of them were public officials (74%) and 42 were employees who were not public officials (26%). All FCMC employees were engaged in performing intellectual work.

In 2022, 10% of employees (17) had worked in the FCMC for up to one year (inclusive), while 60% of employees (99) had worked in the FCMC for up to 10 years (inclusive). 17% of employees (28) had been employed by the FCMC for 21 years, i.e. since the establishment of the FCMC in 2001.

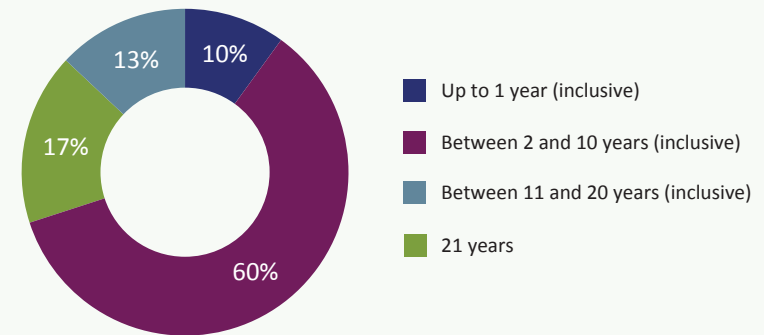


Chart 10. Staff breakdown by length of service at the FCMC

In 2022, 73% of all FCMC employees were women, whereas 27% were men. In the reporting year, the age structure of the staff was characterised by the following indicators: up to 30 years – 11 employees (7%), from 31 to 40 years – 55 employees (34%), from 41 to 50 years – 65 employees (40%), from 51 to 60 years – 31 employees (19%), over 61 years – 2 employees (1%). In 2022, the average age of the FCMC staff was 44 years.

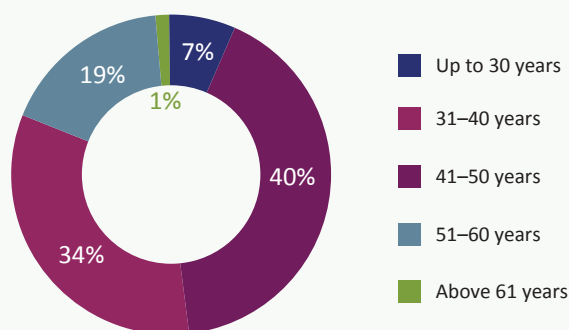


Chart 11. Age structure of the FCMC employees

6.3. Risk management

Operational risk management in the FCMC is focused on the accomplishment of its mission, sustainable development and achievement of the goals set in the strategy, by promoting improvements in the work organisation and maintaining high efficiency and quality of work performance. Operational risk management forms a part of the FCMC's corporate governance system and leadership. It is a systematic process encompassing operational risk identification, analysis, assessment, risk response, supervision and the regular reevaluation thereof, in order to timely aggregate, appropriately measure and

effectively manage the risks that can adversely affect the FCMC's ability to achieve the set goals and to fulfil the tasks prescribed by laws and regulations in due quality and effectively, inter alia, to take part in ensuring the fulfilment of the SSM functions.

In 2022, the FCMC managed operational risks according to the risk management policy approved by the FCMC Board and other legal acts in the area of operational risk management.

Risks related to the Covid-19 pandemic, remote working and work environment, the FCMC's integration into Latvijas Banka as well as the geopolitical situation and its impact on the business continuity of the FCMC were the main focus of 2022. Risks were managed accordingly and the implemented hedging measures kept the risks at a permissible level; therefore, in 2022, the FCMC was not exposed to threats with significant impact on its operation, bringing losses or having an adverse effect on its reputation.

6.4. Received whistleblower reports

A whistleblower may file a report on potential or actual violations in compliance with the requirements specified in the Whistleblowing Law or the FCMC's "Regulation on the Procedure for the Reporting of Actual and Potential Violations of Regulatory Provisions by a Person and Examining the Report by the Financial and Capital Market Commission".

The most important difference between these two laws and regulations of different hierarchies is that a person, who provides information in accordance with the Whistleblowing Law, should present a submission in such a way that it has legal force. Meanwhile, the FCMC Regulation is issued on the basis of various regulatory frameworks governing the financial and capital market sectors and provide for reporting violations of a particular type, thus meeting the requirements of the EU regulatory framework, and also permit reporting in the form of an e-mail message or even anonymously (i.e. it is not required to submit the application pursuant to the conditions for the preparation of documents).

In the financial and capital sector, persons may submit reports on various types of violations – 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 2022, the FCMC received six submissions corresponding to the features set by the Whistleblowing Law, which in the opinion of the submitters were about potential or actual violations in the financial and capital market sector. In one case, the report was forwarded to other competent institutions according to their competence, and in another case, the report was not forwarded to another institution because it was already stated in the report that it had also been sent to another institution.

In 2022, one report was received conforming to the features stated in the FCMC Regulation.

Compared to 2021, when 14 reports were submitted, a drop in the number of reports was observed in 2022 (7 reports). In some cases, the submitted reports did not correspond to the features stated in the Whistleblowing Law or the FCMC Regulation; however, if the submitter agreed, they were forwarded for examination according to the procedure stated in the Law on Submissions. Persons used various general ways of communication for the submission of reports – the central FCMC e-mail, postal address and e-address on the portal Latvija.lv.

6.5. Internal audit

Internal audit is an independent function of the FCMC aimed at evaluating and enhancing the effectiveness of the internal control, risk management and governance processes. The internal audit function is implemented in the FCMC by one employee – the internal auditor – who acts under direct functional subordination to the Board of the FCMC.

Internal audits are performed according to the “International Standards of the Professional Practice of Internal Auditing” and “Code of Ethics” of the Institute of Internal Auditors as well as the internal regulations “Internal Audit Policy” and “Internal Audit Procedure”.

The internal auditor prepares the internal audit plan observing a risk-based approach and taking into account the strategic goals and priorities of the FCMC, the strategic plan of the operation of the internal audit and the audit programme of the European System of Central Banks and the SSM.

Financing of the activity of the FCMC

In 2022, the activity of the FCMC was fully financed from the payments of financial and capital market participants, as well as from the FCMC resources. The FCMC performed all functions stated in Section 6 of the Law on the Financial and Capital Market Commission, inter alia, managed the DGF, the FPI and the National Resolution Fund, as well as administered the payment of the financial stability fee into the state budget and contributions to the SRF. The administration of the DGF and the FPI, as well as the financial stability fee and the SRF is funded from the FCMC budget, and the assets from these funds are not deducted for the purposes of the administration thereof for the benefit of the FCMC.

Table. Financing of the activity of the FCMC, 2021–2022, euro

	Actual performance in 2021	Actual performance in 2022	Budget for 2022	Budget performance for 2022, %	Share of the actual performance in total in 2022, %
REVENUES (+)	11 363 821	12 267 376	11 789 488	104.1	100.0
PAYMENTS BY FINANCIAL AND CAPITAL MARKET PARTICIPANTS	11 334 869	11 110 507	10 701 721	103.8	90.6
REVENUES RELATED TO THE SUPERVISION OF MONETARY FINANCIAL INSTITUTIONS	8 469 266	8 245 123	8 048 620	102.4	67.2
Payments by credit institutions	8 218 281	7 977 918	7 767 440		
Payments by credit unions	40 505	40 228	41 180		
Payments by payment institutions	151 912	143 117	188 000		
Payments by electronic money institutions	58 568	83 860	52 000		
REVENUES RELATED TO THE SUPERVISION OF THE FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	1 117 282	1 061 887	1 166 121	91.1	8.7
Payments by financial instruments market participants	701 240	686 004	753 384		
Payments by private pension funds	416 042	375 883	412 737		
REVENUES RELATED TO THE SUPERVISION OF INSURANCE	1 748 321	1 803 497	1 486 980	121.3	14.7
Payments by life assurance companies	459 927	401 881	349 540		
Payments by other insurance companies	1 231 794	1 340 723	1 077 440		
Payments by insurance brokers	56 600	60 893	60 000		
OTHER REVENUES	28 952	15 619	15 000	104.1	0.1
FCMC RESOURCES	-171 600	1 141 250	1 072 767	106.4	9.3



Table. Financing of the activity of the FCMC, 2021–2022, euro (continued)

	Actual performance in 2021	Actual performance in 2022	Budget for 2022 ⁹	Budget performance for 2022, %	Share of the actual performance in total in 2022, %
EXPENSES (–)	11 192 221	12 267 376	11 789 488	104.1	100.0
Staff remuneration and other payments, compulsory state social insurance contributions	8 662 138	8 880 832	8 878 942	100.0	72.4
Employee insurance	37 476	36 563	38 400	95.2	0.3
Staff professional training	92 162	115 910	115 000	100.8	1.0
Telecommunication, communication and information	139 288	150 391	138 380	108.7	1.2
Public awareness campaigns and internal and external communication	52 524	92 392	93 900	98.4	0.8
Maintenance and general service expenses	950 191	1 201 131	1 149 666	104.5	9.8
Professional services	101 242	147 896	152 400	97.0	1.2
International cooperation	899 387	1 425 283	969 200	147.1	11.6
Depreciation/amortisation of capital investments	237 433	213 712	210 000	101.8	1.7
Other expenses	20 380	3 266	43 600	7.5	0.0

In 2022, the FCMC's revenues from payments by capital market participants amounted to 11 111 thousand euro – 3.8% more than planned in the FCMC's budget of 2022 (10 702 thousand euro). Total expenses of the FCMC in 2022 amounted to 12 267 thousand euro – 4.1% more than planned in the budget of 2022 (11 789 thousand euro⁹). The above deviations were mostly driven by higher international cooperation expenditure – the co-funding for IT projects of EU institutions for previous periods as well as business trip and training expenses in relation to the lifting of the Covid-19 containment restrictions.

The FCMC resources amounting to 1141 thousand euro were used to cover the expenses of 2022 from the budget. In addition, expenses amounting to 1936 thousand euro in relation to the termination of the FCMC's operation were recognised in the financial statements. At the end of 2022, the FCMC's own funds or net assets equalled 7213 thousand euro (10 290 thousand euro at the end of 2021).

The approved financial statements of the FCMC for 2022, the financial statements of the DGF and FPI for 2022, as well as independent certified auditor's reports on them are available on Latvijas Banka's website: <https://www.bank.lv/en/news-and-events/archives-of-publications/archive-of-fcmc-annual-reports>.

⁹ Not including the planned expenses for the integration into Latvijas Banka (338 thousand euro).

Integration of the FCMC into Latvijas Banka and the priorities of the financial sector supervision in 2023



8.

Integration

In 2022, work continued on the integration of the FCMC into Latvijas Banka according to the new Law on Latvijas Banka approved on 23 September 2021 by the Saeima of the Republic of Latvia and the amendments to the Law “On Latvijas Banka” as well as the integration plan approved by the Council of Latvijas Banka and the framework for the integration project on the merger of the FCMC and Latvijas Banka approved by the Commission. In accordance with the decision adopted by the Saeima of the Republic of Latvia on 23 September 2021, Latvijas Banka took over all functions related to the supervision and the promotion of the development of the financial and capital market as well as the functions of the resolution authority on 1 January 2023, and all employees of the FCMC implementing its core functions were transferred in the employment of Latvijas Banka.

On 1 January 2022, Latvijas Banka took over the public financial literacy function from the FCMC. Since then, it has been one of the core functions of Latvijas Banka.

As the core functions of Latvijas Banka are considerably expanding along with the integration of the FCMC into Latvijas Banka, in the first half of 2022, special attention was paid to defining the new strategy and values of the merged institution as well as planning the governance framework.

In the second half of 2022, the work on the integration process focused on creating the processes necessary for the performance of the new core functions of Latvijas Banka and developing the regulatory framework as well as integrating employees. In autumn 2022, regulations of the newly created committees – the Supervision Committee of Latvijas Banka and the Resolution Committee of Latvijas Banka – were finalised and the regulation of the Consultative Financial Market Council was amended; they were approved by the Council of Latvijas Banka on 14 November 2022. “Regulation on the Scope of Payments by Financial Market Participants and Procedure for Calculation and Settlement of These Payments” was developed and approved by the Council of Latvijas Banka on 19 December 2022. At the end of the year, special attention was paid to the practical aspects of integration – the solving of issues related to the work environment and a complete integration of record keeping processes.

Different stakeholders, among them financial market participants, the Saeima, the Chancery of the President of Latvia, the Prime Minister’s Office and the Ministry of Finance, were regularly informed about the course of the project. The employees of Latvijas Banka and the FCMC were also informed about the course of the project on a regular basis. The general public was informed about the key aspects of the integration of the FCMC into Latvijas Banka via the media.

According to a survey conducted by the public opinion research company LATVIJAS FAK-TI in November 2022, 20% of respondents had heard about the integration of the FCMC into Latvijas Banka. 59% of respondents who had heard about the merger of both institutions welcomed it as the right step, and only 9% of respondents were of an opposite view, while the remaining respondents abstained from evaluation.

Latvijas Banka and the FCMC managed and implemented the integration project using almost exclusively their own resources in 2022. Some external consultants were slightly involved only in the process of formulating the strategies and values of the merged institution.

The main benefit from the integration of the FCMC into Latvijas Banka is more efficient management and faster decision-making, improved systemic risk management in the financial sector, as well as reduced administrative burden and more efficient use of resources. It will enable more effective supervision and development of the financial sector, thus contributing to the public good.

Supervision priorities for 2023

Latvijas Banka has set the financial market supervision priorities, and, based on them, the financial market supervision plan for 2023 has been approved and published.

In 2023, Latvijas Banka will devote particular attention to the management of various risks, the operational and financial resilience of financial market participants as well as the protection of the interests of consumers of financial services.

Five financial market supervision priorities have been set for 2023: macroeconomic and geopolitical risks, operational and financial resilience, transition risks (sustainability risks, digital transformation, change of business models), risk related to ML/FTP and to sanctions as well as the protection of consumers of financial services.

The priorities focus on assessing the impact of Russia's war in Ukraine and on the impact the associated inflation and interest rate increase has on the changes in asset value. The resilience of the financial sector to crises will also be evaluated by analysing the management of credit risk and other risks. At the same time, transition risks, including business model transformation, will also be assessed.

