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A Year of Reforms

In 2008, the approach to managing the Financial and Capital Market Commission (hereinafter, the Commission) was changed and, in order to deal with the global financial crisis, the supervisory reform of the financial sector was launched and continued also in 2009.

Year 2009 was exceptionally difficult for the Latvian banking sector: the costs of financial resources increased, overdue credits grew rapidly and bank losses for the year at the end of 2009 amounted to 773 million lats, the largest volume of banking losses in the history of the re-established Latvian State. It had to be concluded, though, that the situation had evolved due to both the borrowers' overly optimistic assessment of their loan repayment ability and the aggressive crediting policy of banks during the boom years.

In view of the above mentioned, in 2009 the Commission established an obligation for banks to increase their capital in aggregate for 998 million lats and, as a result, at the end of the year the average capital adequacy ratio of Latvian banks reached 14.5% (the minimum requirement was 8%) that could be considered a high level in the given situation. By the end of the year, it could be said that the test in respect of the consequences of the excessive risk-taking during the previous years had been passed because the funds earmarked within the international loan to Latvia for the stabilisation of the financial sector were not used in 2009 and the "safety cushion" was still available.

The year was significant also because of the new initiatives regarding the role and the responsibility of banking supervisors in the world of global challenges. In 2009, it was recognised at the international level that the approach to the supervision of financial institutions and banks in particular during the economic boom had been insufficient and the opinion that the free market would put everything in places had failed. As a result, a long-term work was started to reform the current supervisory system first at the European Union (EU) level and the Commission's experts were also involved. Without doubt, more stringent regulation would apply in the European economic area in future especially to banking; e. g., in 2009, the Commission developed and introduced the "Regulations on Core Principles of Remuneration Policies" according to which banks were required to implement a remuneration policy that would not foster only short-term profit and cause negative consequences in future. In view of the fact that budget funds of notable amounts had been used in many countries to surmount the crisis and therefore the viability of many economies had been impacted, changes in the regulatory provisions governing the financial and capital market were necessary both at this juncture and also in future.

After assessing the expected economic indicators of the sector after the rapid economic slowdown in the country in 2009, an overall conclusion was that the Latvian banking sector would not be able to return to profitability without a significant upturn in the Latvian economy. Year 2010 will most likely be a year of mere transformation because the structural changes in the Latvian economy have not been sufficiently profound to trigger sustainable growth. It is very likely that in 2010 the economic activity will shrink less than projected, unemployment will decrease slightly and a gradual growth will start in export-related branches, but an increase in lending will not be possible without a more rapid economic recovery and a larger number of new jobs. Therefore the volume of lending in Latvia may remain on a downward path at least until the end of 2010, though it may be less steep than before; at the same time, businesses may experience more difficulties while resuming and developing their activities without bank loans. It would be reasonable to believe that the increase in mortgage loans to households may re-start at a later stage and at a slower pace compared with loans to businesses. This process does not depend solely on the will and the possibilities of banks. People should be feeling sure about their jobs and confident about tomorrow.

In 2010, banks may still have to make provisions for doubtful debts and a part of banks may still suffer losses despite the fact that at the end of 2009 already a positive trend — a gradual reduction in the growth of loans that had been overdue for 90 days — started. This provides a reasonable basis to believe that in 2010 the number of debtors may start to diminish gradually, household income and expenses may return to balance and banks may not have to increase rapidly the volume of provisions. At the beginning of 2010, the seasonally adjusted data about Latvia provided hopeful evidence that GDP had increased by 0.3% for the first time since the end of 2007 and a gradual growth of retail trade had resumed. In the first quarter of 2010, especially in April, tax revenues in the country exceeded the projections. In 2009, the banking sector strengthened notably its capital and ensured sufficient liquidity, and by the end



Irēna Krūmane
Chairwoman, Financial and
Capital Market Commission

of the first quarter of 2010, it could announce that the volume of deposits with banks had reached the pre-crisis level, i. e., it had reached the level recorded in September 2008, and in April 2010, the annual growth rate of deposits was positive for the second consecutive month.

Overall, global economy also showed hopeful signs in 2009: the economy of the USA stabilised and major EU economies gradually recovered after the recession. These factors contributed to an increase in the Latvian export volumes and provided grounds to hope that in 2010–2011 the stabilisation of the Latvian economy would be driven by exports. Heads of several EU national central banks confirmed that growth had resumed and the process had been faster than projected, though in the annual meeting of the European Bank for Reconstruction and Development the mood was referred to as "cautiously optimistic". Latvia's achievements in stabilising the financial sector in 2009 were praised by Mr. Dominique Strauss-Kahn, Managing Director of the IMF: he noted that Latvian institutions had shown truly good progress in this area by strengthening their capacity to implement more stringent regulations and introduce a new supervisory framework in the financial sector.

At the time when the annual report and the activity report of the Commission for 2009 are being prepared, euro area member states (our neighbour Estonia will join them next year) have to deal with difficult issues and the decisions made will determine the fate of the monetary union in the years to come. Euro area countries have already reached an agreement about a support mechanism to the member states experiencing financial difficulties that will amount to EUR 440 billion and together with the additional financing of the European Commission and the International Monetary Fund the support will total EUR 750 billion. At the same time, the sovereign debt crisis of Greece and other euro area members has already threatened the stability of the euro and could hamper the initiated economic recovery of the Baltic States.

At the time when the people and the heads of government of some euro area countries are even considering leaving the euro area, this part of the world may still be facing complicated challenges and the Latvian financial system should be ready for them. It means that the reforms we have started to create a new supervisory framework will continue also in Latvia. It is likely that an agreement about a special bank levy will be reached to avoid the necessity in future to use tax-payers money to reduce the systemic consequences of bank problems. In 2011, the European Systemic Risk Board will be launched and its task will be to ensure early warning about possible systemic risks and make recommendations to prevent them. Latvian financial supervisors will join that supervisory system and ensure both an efficient international cooperation and an exchange of experience about the accomplishments in Latvia.

Irēna Krūmane



Chairwoman
Financial and Capital Market Commission

Report of the Board of the Financial and Capital Market Commission

The Commission had been operating as a full-fledged and autonomous public institution as of 1 July 2001. The activities of the Commission were fully funded from the payments by the participants of the financial and capital market. In accordance with the Law on the Financial and Capital Market Commission, the Commission supervised banks, credit unions, insurance undertakings and insurance intermediaries, investment management companies, participants of the financial instruments market as well as private pension funds by ensuring stability of the financial and capital market, promoting its development and guaranteeing the observance of interests of the customers of market participants.

The Commission's activities were managed by its Board. In the reporting year, the membership of the Board did not change and was as follows: Chairwoman of the Commission Irēna Krūmane, Deputy Chairman Jānis Brazovskis and Board Members Ludmila Vojevoda, Jānis Placis and Gvido Romeiko.



Board of the Financial and Capital Market Commission

In 2009, 50 Board meetings were held during which 217 decisions were made (186 in 2008); as well, seven meetings of the Consultative Council of the Financial and Capital Market Commission (hereinafter, the Consultative Council) were held during which 48 draft regulations that were binding on the financial and capital market were discussed (27 in 2008). The Consultative Council was notified, on a regular basis, on the funds accumulated in the Deposit Guarantee Fund (DGF) and in the Fund for the Protection of the Insured (FPI) as well as the management of these funds. At the end of 2009, the Consultative Council assessed and approved draft budget of the Commission for 2010 and the Commission's work programme for 2010.

In response to the risks and problems posed by the global financial crisis, in 2009 the Commission started introduction of a new supervisory framework that significantly improved the timeliness and efficiency of preventive measures and, as a result, the Commission could duly interfere with the activity of banks and take the necessary measures. In 2009, the Commission enforced liquidity control of banks by introducing additional **daily** reports about deposit dynamics. Over the year, all banks were required to develop contingency funding plan to withstand potential liquidity stress. Corrections were introduced in the capital adequacy calculation of 11 banks and it was uncovered that the capital of four banks was below the volume needed to cover the risks therefore the Commission required that these banks increase their capital. All banks carried out the required measures and, as a result, both sufficient capital base and liquidity of Latvian banks were ensured in 2009.

The following **additional measures** were introduced: audited interim financial statements for six months and additional operative reports about banking activities in the area of liquidity risk management, operational risk management, internal control system, capital adequacy and stress tests, monthly reports about the structure and quality of credit portfolios and quarterly reports about problem loans. Also, a requirement that during loan assessment information should be collected about the volume of all loan losses was introduced in 2009.

Overall in 2009, the Commission carried out 80 on-site inspections in all sectors of the financial and capital market (57 in 2008), of which 44 on-site inspections were carried out in banks (29 in 2008) and special attention was paid to assessing capital adequacy, lending process and risk management, and during 11 on-site inspections and 12 off-site inspections bank activities in relation to money laundering were assessed. Also, nine inspections were held in order to establish whether issuers disclose information in full amount and in a timely manner pursuant to the requirements of the Law on the Financial Instruments Market. In 2009, the Commission carried out seven on-site inspections in respect of information system security of market participants.

In 2009, the Commission increased the number of employees to perform off-site supervision by analysing reports and statements and therefore ensured due receipt of operative information and ability to respond swiftly to rapid changes or new risks in the financial market. During the reporting year, off-site inspections of private pension funds were carried out during which their financial standing, asset quality of pension plans and income and expenses structure were assessed. The supervision of credit unions was also carried out in 2009 by monitoring their performance indicators on the basis of the analysis of their financial statements.

In 2009, the following sanctions were applied to market participants: the activities of three banks were restricted, including partial suspension of the provision of financial services, a proxy to supervise the bank's activities was appointed by the Commission in one

bank, enhanced supervision was applied to three banks, special provisioning policy or the asset recognition policy deriving from own funds requirements was applied in 12 banks, all licences of one insurance undertaking were suspended due to its failure to comply with the solvency requirement, four administrative proceedings were instituted for violations of mandatory information disclosure whereby a fine of 1000 lats was applied to one issuer and a warning was issued to three issuers, in one case information about a possible market manipulation was sent to law enforcement bodies for assessment, in three cases warnings were issued for a failure to notify the Commission about the transactions that had been carried out, in three cases warnings were issued for a failure to notify the Commission about acquired or disposed qualifying holding, and a fine of 5000 and 6000 lats was applied for a failure to make a mandatory share buyout offer. Fines of 10 000 and 50 000 lats were applied to two credit institutions for the violations of the Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing.

In 2009, in cooperation with the Commission's experts, a new Payment Services Law was developed and approved. The Commission's experts also participated in drafting amendments to the Consumer Rights Protection Law and the Deposit Guarantee Law. Significant amendments were introduced into the Credit Institution Law to extend the Commission's authority and in relation to those the Law on the Financial and Capital Market Commission was also amended.

The Commission developed and approved six new regulations and amended one regulation. In order to implement the recommendations of the World Bank experts in the area of protecting consumer (bank customer) rights, in the reporting year the Commission developed the "Principles and guidelines for out of court consumer mortgage workouts". Also the "Guidelines for determining the value of separable assets" were approved.

In 2009, the Commission received and reviewed 404 applications about market participants (247 in 2008). Of them, 254 applications were in respect of banks, 117 were about insurance undertakings, four about issuers, one about private pension funds and six about providers of investment and ancillary services and investment management companies, whereas 22 applications were received about different issues relating to the financial market.

In the reporting year, the Commission continued to improve its quality management system to ensure its compliance with the requirements of EN ISO 9001:2008 standard and balance the necessity to satisfy customer needs and to perform the Commission's functions to ensure that the Commission's customers trust the unfailing quality of the services provided by the Commission. In the reporting year, adjusting the quality management system to the new standard EN ISO 9001:2008 **Quality management systems - Requirements** was accomplished and the certification audit carried out by the *Bureau Veritas Certification* recognised again that the Commission's quality management system complied with the standard.

In 2009, the Commission implemented fully the electronic document management system into which a secure electronic signature had been integrated. As a result, in 2009 the Commission was one of the few public institutions that started to use electronic documents in its communication with public and local government institutions, financial and capital market participants and certain foreign institutions; these documents bore an electronic signature to which a time seal had been attached. Letters on paper were used only in exceptional cases where it was impossible to send an electronic document. Overall, the introduction of electronic documents reduced the Commission's costs for postal expenses by 51% resulting in the saving of 2452 lats.

In order to ensure complete information to the general public and also educate people about the developments in the financial and capital market, in 2009 the Commission disseminated 60 statements to mass media (51 in 2008) and held four press conferences during which the management provided comments about the latest statistical data about the performance indicators of Latvian banks and explanations about topical trends in financial markets. To determine the confidence indicator of the Latvian people in the financial and capital market during the reporting year, the annual survey was carried out in respect of the previous period. At the same time, to ensure circulation of international information and availability of objective information about the situation in the Latvian financial sector in 2009, four meetings for the ambassadors accredited in Latvia were organised and information with Latvian embassies abroad was exchanged on a regular basis.

Personnel Policy

Personnel were the most important resource of the Commission that ensured achieving the goals of the Commission and further development of the institution. Pursuant to the Commission's activity strategy for 2009-2011, in 2009 the reform of personnel management processes was started: personnel management policy and its implementation procedure were revised, the requirements for qualification, job specifics and responsibility for the 55 positions in the Commission were defined and summarised within the position assessment procedure according to the current situation, and the procedure for salary calculation in respect of each position was developed. Special attention was paid to introduce new employees with their jobs: an adaptation plan was established for each new employee, staff training needs were determined and the procedure for approving the annual schedule of business trips was approved.

Changes in the Number of Employees and Personnel Changes

As at 30 December 2009, the Commission employed 111 persons, of which:

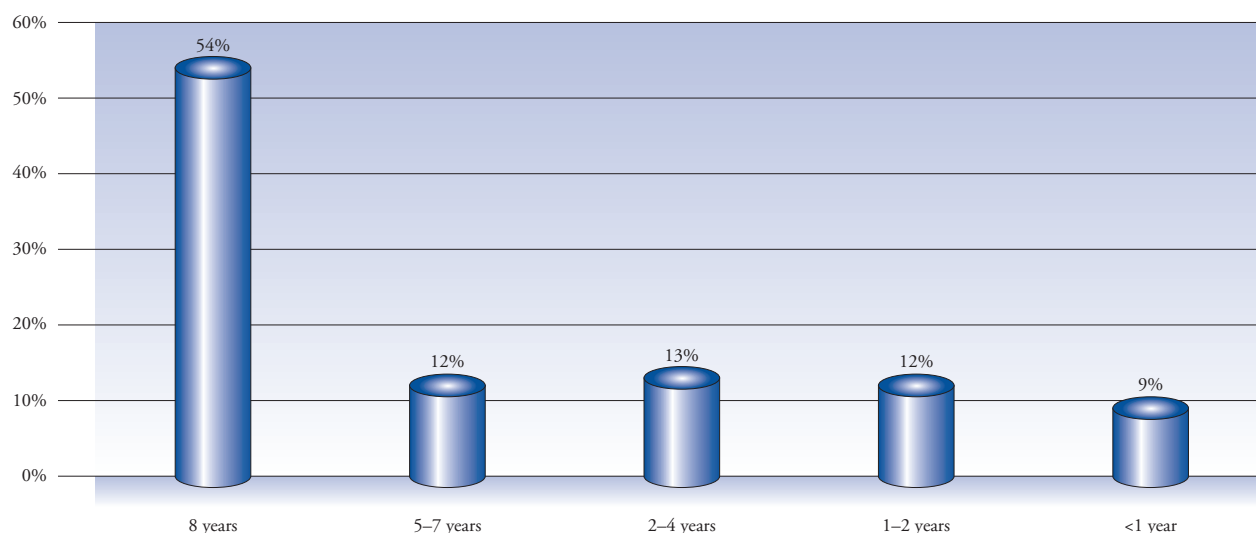
- 86 (77%) were performing core activities and 25 (23%) were performing support functions;
- 108 (97%) were performing intellectual work and 3 (3%) were performing physical work;
- 74 (67%) were public officials and 37 (33%) were employees.

49 (44%) employees participate, on a regular basis, in the work of the Council of the European Union and of working groups of various committees (Committee of European Banking Supervisors, Committee of European Securities Regulators, Committee of European Insurance and Occupational Pension Supervisors).

On average, 108 employees had job relationship with the Commission in the reporting year. As at 2009, 54% (60) employees had had job relations with the Commission for eight years, i. e., as of the establishment of the Commission in 2001, whereas 9% (10) employees had worked in the Commission for less than a year (see Chart 1).

Chart 1

Job duration profile of the Commission's personnel (%)

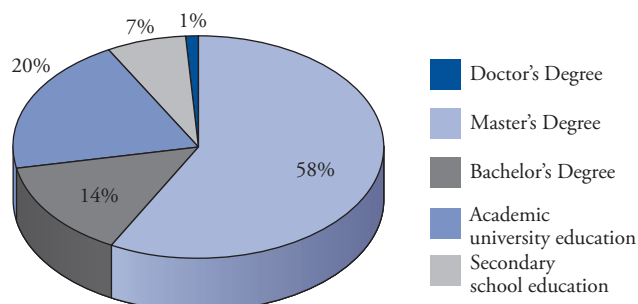


The staff turnover rate in 2009 was 3.6%. In the reporting year, 10 new employees started their work in the Commission. After the trial period, in accordance with the established adaptation plan all 10 employees received a positive evaluation that certified to the efficiency of the staff selection process. Four employees terminated their job relations with the Commission in 2009: one employee retired due to reaching the retirement age, whereas three started careers in the private sector.

Staff Qualifications

In the reporting year, 93% (103) employees of the Commission had a University education (of which 58% had a Master's Degree), and 7% (8) had a general secondary or professional secondary education (see Chart 2).

Chart 2
Education profile of the Commission's personnel (%)

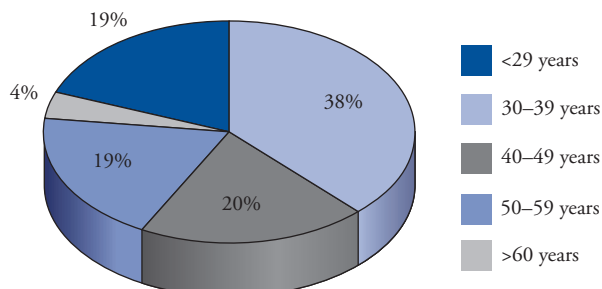


Demographic and Age Profile of the Commission's Staff

In 2009, of all Commission's employees 77% (85) were women and 23% (26) were men. The age profile of the staff in the reporting year was as follows: 19% of employees were below 29, 38% were between 30 and 39, 20% were between 40 and 49, and 23% were above 50 (see Chart 3).

The average age of the Commission's staff in the reporting year was 39.

Chart 3
Age profile of the Commission's staff (%)



Improving the Staff Qualification

In order to improve the activity processes of the Commission pursuant to its strategy and to ensure that banking supervision is carried out in line with the current economic situation in the country, on average 63% (70) employees of the Commission improved their qualification by attending job-related training both in Latvia and abroad. 26 employees improved their knowledge in the area of bank liquidity management, whereas 40 employees improved their knowledge of the methods and practical implementation of stress tests. Like in previous years, the Commission's staff attended seminars about the new bank capital requirements or Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework and about other issues related to financial supervision. One employee of the Commission participated in an expert capacity in the training of the employees of Slovenian financial institutions that was carried out within the Council of the European Union MONEYVAL expert group 4th round inspection.

Financing of the Activities of the Commission

In the reporting year, the activities of the Commission were fully financed from the payments by market participants. Within the budget for ensuring its activities, the Commission also managed the Deposit Guarantee Fund and the Fund for the Protection of the Insured in the reporting year.

Commission's Budget Result in 2009, in lats

	2009				Share of actual result, %
	Actual result in 2008 ¹	Actual result ¹	Approved budget ¹	Budget result, %	
INCOME (+)	3 561 654	5 103 260	5 035 180	101.4	100
PAYMENTS BY THE PARTICIPANTS OF THE FINANCIAL AND CAPITAL MARKET	3 503 694	5 088 232	5 005 180	101.7	99.7
INCOME RELATED TO THE SUPERVISION OF MONETARY INSTITUTIONS	2 392 261	3 779 598	3 463 700	109.1	74.1
Payments by credit institutions	2 382 348	3 766 848	3 453 480	109.1	73.8
Payments by credit unions	9 913	12 750	10 220	124.8	0.2
INCOME RELATED TO THE SUPERVISION OF INSURANCE UNDERTAKINGS	871 723	1 056 751	1 288 670	82.0	20.7
Payments by life insurance undertakings	90 597	120 881	132 740	91.1	2.4
Payments by other insurance undertakings	781 126	935 870	1 155 930	81.0	18.3
INCOME RELATED TO THE SUPERVISION OF THE FINANCIAL INSTRUMENTS MARKET AND PRIVATE PENSION FUNDS	210 037	251 404	252 810	99.4	4.9
Payments by the participants of the securities market	165 279	202 922	195 120	104.0	4.0
Payments by private pension funds	44 758	48 482	57 690	84.0	1.0
OTHER PAYMENTS ²	29 673	479	-	-	-
INCOME FROM TERM DEPOSITS	57 960	15 028	30 000	50.1	0.3
EXPENSES (-)	4 179 148	4 194 238	4 691 376	89.4	100
REMUNERATION	3 234 655	3 363 943	3 635 851	92.5	80.2
Salaries and payments equivalent to salaries ³	2 415 624	2 657 221	2 855 682	93.1	63.4
Mandatory contributions to the State Social Insurance	527 766	641 075	706 674	90.7	15.3
Social guarantees ⁴	291 265	65 647	73 495	89.3	1.6
IMPROVING PROFESSIONAL QUALIFICATION OF THE STAFF AND BUSINESS TRIPS	196 384	146 439	277 320	52.8	3.5
SERVICES AND COMMODITIES TO ENSURE ACTIVITIES	640 143	554 522	635 515	87.3	13.2
Telecommunication, liaison and information	115 730	106 738	133 000	80.3	2.5
Information to the general public, internal and external communication	17 272	23 382	43 630	53.6	0.6
Maintenance and maintenance-related expenses	375 974	322 960	340 075	95.0	7.7
Professional services	131 167	101 442	118 810	85.4	2.4
PARTICIPATION FEES IN INTERNATIONAL ORGANISATIONS	63 656	75 416	89 140	84.6	1.8
AMORTISATION/DEPRECIATION AND EXCLUSION OF CAPITAL INVESTMENT	44 310	53 918	53 550	100.7	1.3

¹ In accordance with the accrual principle.

² Payments by the participants of the financial and capital market for the previous reporting year.

³ Payments equivalent to salary include one-off benefits to employees for the birth of a child, the death of a family member, or a benefit when retiring and a compensation of up to 90 lats for correcting the eyesight with medical means (i. e., to buy glasses) as prescribed by a special doctor for vocational illnesses. In 2008, these payments included also a benefit for the annual holidays and a supplementary payment for replacing an employee who was absent for a long time.

⁴ Staff insurance against the risk of illness and accident, in 2008 also against the risk of death.

Over years, the proportion of market sector payments in the financing of the Commission had evolved to disclose the proportion of the costs relating to the supervision of each respective sector. In 2009, the proportion of financing by market participants changed because the situation and financial indicators in the market changed drastically. The Commission paid more attention to the supervision of monetary institutions and it was appropriately reflected in the share of their payments as income related to the supervision of monetary institutions grew by 6% in 2009 (see Charts 4 and 5).

Chart 4

Structure of the financing for the Commission in 2007-2009, share, %

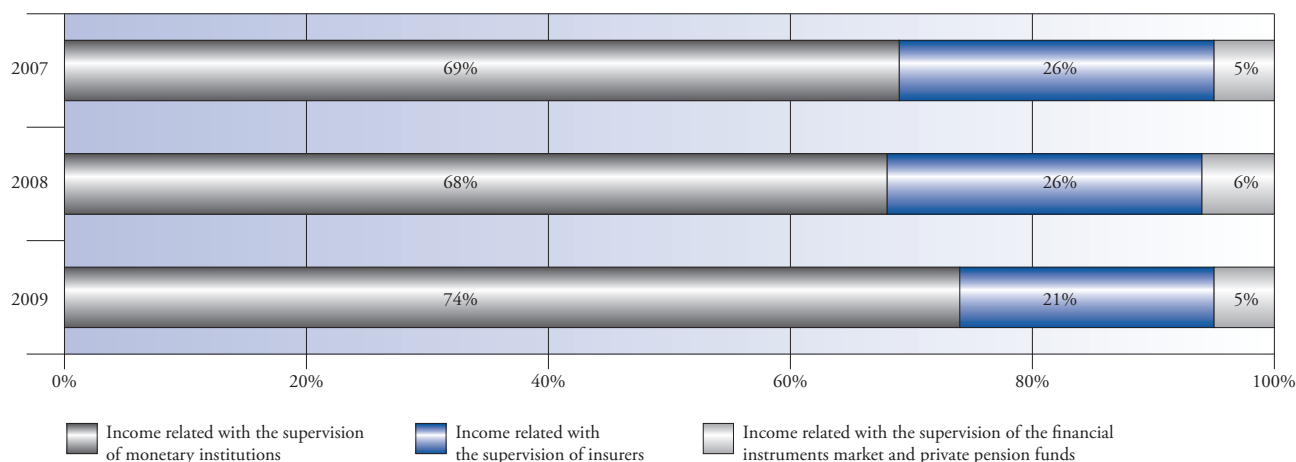
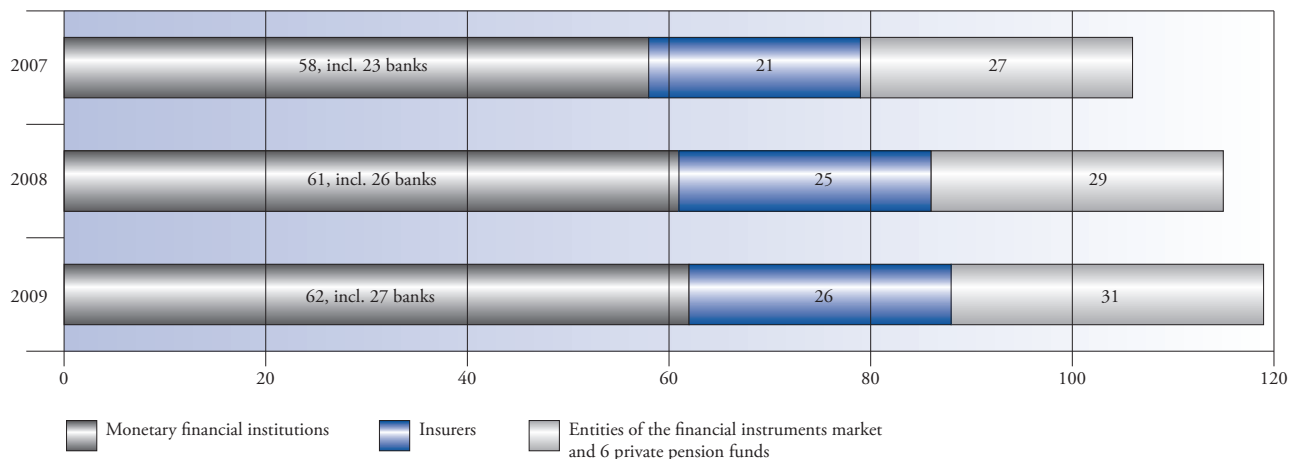


Chart 5

The number of providers of the financing to the Commission and of the entities of the financial and capital market subject to supervision, excluding the entities that do not provide financing to the Commission, 2007-2009



In 2009, the largest share (80%) in the expenses covered from the financing to the Commission was for the salaries of the Commission's employees, and their amount changed in line with the number of positions and salary changes in the financial sector that served as the benchmark for the Commission to determine the remuneration of its employees. Due to the necessity to comply with the Law on Remuneration of Officials and Employees of State and Local Government Authorities in 2009, i. e., with the requirement to cut the expenses for remuneration in view of the prohibition to pay annual holiday benefits and of the reduction of social guarantees, the Commission amended the budget for 2009 and as a result the remuneration to its employees, including salaries, were reduced using different personnel policy tools in both 2009 and 2010 (see Table 1).

Table 1

Changes in the average remuneration of employees, 2008-2010, %

	2009/2008	2010/2009	2010/200.
Changes in the average remuneration of employees	-14	-17	-29
of which salary and payments equivalent to salary	-5	-16	-21
of which social guarantees	-80	-44	-88

In order to ensure its functioning, the Commission selected providers of commodities and services in accordance with the requirements of the Public Procurement Law or by means of the electronic procurement system; as a result, in 2009 the Commission saved 13% of the projected expenses for purchasing services and commodities. A new agreement about the renting of the Commission's premises was signed whereby the costs per square metre were reduced by 52.5% in 2009 and the Commission saved 75 503 lats in absolute numbers.

As of its establishment, the Commission had invested notable funds in information technologies in order to optimise the supervision and organisational management processes of the Commission itself and ensure that the financial information submitted by the entities of the financial and capital market for supervisory needs is processed more efficiently. At the end of 2009, book value of information technologies comprised 71% of total long-term investments. Investments in information technologies included a regular changing of the stock of computers to ensure their optimum performance, also developing and improving information systems, as well as using licensed software. In order to ensure the flow of statistical, supervision and recorded documents, several information systems had been developed upon the Commission's order that had been aimed at diminishing the flow of paper documents and the number of manual processes and ensuring swift action, quality of data and comfortable cooperation environment for market participants (see Table 2).

Table 2
Dynamics of changes of the Commission's capital investment, 2007-2009

	Changes in 2009 ⁵ (in the amount of the historic cost)	Changes in 2008 ⁵ (in the amount of the historic cost)	Changes in 2007 ⁵ (in the amount of the historic cost)
Total capital investment, in lats	38 236	99 222	32 156
Total units	196	388	307
of which software and information systems, in lats	35 074	32 394	30 798
number of units	156	229	265
of which improvements of the existing units	11	7	9
of which information technology equipment	10 547	51 712	3 094
number of units	-7	67	7
of which improvement of the existing units	1	2	1

The financial statements of the Commission for 2009 and of the Deposit Guarantee Fund and the Fund for the Protection of the Insured managed by the Commission along with the opinion of independent auditors are available on the Commission's website at www.fktk.lv.

Important Changes in the Regulatory Framework during the Crisis

In 2009, changes in the regulatory requirements governing the activities of market participants were made in view of the global financial crisis and of the necessity to ensure implementation of directives, guidelines of EU institutions and the best international practice.

Drafting New Laws and Amending the Existing Laws

In 2009, several amendments to the **Credit Institution Law** were made. The amendments of 12 February 2009 introduced a bank restructuring mechanism, i.e., transfer of the banking undertaking or its part to a third person, and also a mechanism whereby a Commission's proxy was appointed with the right to take over the management of a bank. The amendments of 26 February 2009 detailed the regulation for acquiring a qualifying holding in a bank and established the rights to increase a bank's capital without convening a shareholders' meeting where the Cabinet of Ministers had passed a decision for acquiring or increasing a qualifying holding by the state in a bank; also, the range of the participants of the Credit Register was specified. The amendments of 30 June 2009 established the right of an insolvency administrator to request that a bank provide information about a debtor's accounts and banking operations performed by the debtor. The amendments of 22 October 2009 defined the subordinated liabilities and established a prohibition for a bank to make payments in respect of such liabilities during the time when support to commercial activities was provided and the Commission had established restrictions for meeting the bank's liabilities.

In order to extend the authority of the Commission in supervision, on 12 February 2009 the Latvian Parliament (Saeima) approved **amendments to the Law on the Financial and Capital Market Commission** whereby the Commission's Board is vested with the right to take decisions restricting the rights, fulfilment of liabilities and the activities of market participants.

⁵ Acquired during the year, excluding those closed out.

On 12 February 2009 and on 4 June 2009 the Saeima approved **amendments to the Deposit Guarantee Law** whereby the deadline for payment the guaranteed compensation in case of unavailability of deposits was reduced from three months to 20 business days and the mechanism for using the funds of the state budget for paying deposits, if necessary, was specified.

On 21 May 2009 the Saeima passed **amendments to the Consumer Rights Protection Law** that included a number of specific provisions regarding credits whose repayment is secured with a real estate mortgage. Amendments established the rights of a consumer to request that the provider of the credit change the maturity and the currency of the issued credit and the obligation of a credit provider to consider the request; as well, the amendments established that under certain conditions the rights of the provider of the credit to request that the borrower provide additional security for the credit, cover the costs for revaluating the security and for repayment of the credit before maturity were restricted.

Within their competence the Commission's staff took part in developing the **Payment Services Law**. According to the law, payment services might be provided not only by credit institutions and SJSC "Latvijas Pasts" (Latvian Post Office), but also by payment institutions as the new entities of business activity.

Drafting New Regulations and Amending the Existing Regulations

The Commission developed the **"Regulations on the Internal Capital Adequacy Assessment Process"** (in effect as of 25 March 2009). Banks were required to maintain a capital reserve so that their capital was sufficient to cover losses in case of possible adverse events and to ensure that the volume of capital at their disposal was sufficient throughout the economic cycle. The Commission considered that the capital adequacy indicator of a well capitalised bank had to be at least 10%. In 2009, an informal agreement was reached with banks to the effect that 10% was the threshold of bank capital adequacy.

The **"Regulations on Assets Quality Assessment and Provisioning"** (in effect as of 28 March 2009) defined the essential conditions for making provisions for doubtful loans and requirements for calculating the expected loss in respect of impaired assets.

Provisions governing remuneration ranked high in the reform of the financial sector regulation. In 2009, the Commission developed the **"Regulations on Core Principles of Remuneration Policies"** (in effect as of 24 December 2009) whereby all banks had to implement a remuneration policy that would not promote short-term profit that might affect negatively bank performance indicators in the long run. It also established the requirement for the making information about bank remuneration policy available to the public.

The **"Regulations on Credit Risk Management"** (in effect as of 6 January 2010) were improved in view of the changes in the practice of credit risk management. The regulations established the requirement to develop and apply methodology for determining the permitted level of credit risk and clarified the responsibilities and the liability of the bank's council and board members and of the staff engaged in managing credit risk, addressing in particular credit granting policy and procedures and managing concentration risk. The regulations detailed the requirements for stress tests of banks' credit risk and activity plans developed on the basis of these tests.

With adoption of the revised **"Regulations on Liquidity Requirements, Compliance Procedures and Liquidity Risk Management"** (in effect as of 1 April 2010) the following additional requirements were introduced: for managing the financing structure, for managing assets that could be used to secure a loan and a requirement to develop a set of internal indicators for assessing liquidity. A new reporting form was introduced for information about the projected cash flows and concentration of financing. On the basis of three types of stress tests a bank had to establish the necessary amount of the liquidity reserve and to maintain appropriate liquid assets to ensure the reserve, and also it had to develop a contingency plan.

Amendments to the **"Regulations on the Preparation of Public Quarterly Reports of Banks"** (in effect as of 24 December 2009) established a requirement that a bank that received support for commercial activity in accordance with regulatory provisions had to disclose information about its shareholders who had a qualifying holding in the bank's share capital at the time of granting the support, the amount of credits granted, of guarantees issued and of other gains, as well as the amount of subordinated loans or other loans and deposits received from these persons and the conditions of deposit agreements.

In order that the payment to DGF was based on the risks inherent to a particular deposit taker, the **"Regulations for preparing a report of guaranteed deposits and for determining the adjustment ratio to be applied to the payments in the deposit guarantee fund"** were approved (in effect as of 1 January 2010). The regulations established the procedure whereby the Commission determined the adjustment ratio to be applied and the procedure whereby a deposit taker prepares and submits quarterly reports about the guaranteed deposits and payments to DGF.

Guidelines

In order to improve the understanding of lenders and borrowers about the general principles of out-of-court workout of mortgage loan agreements, the Commission in accordance with the recommendations of World Bank experts developed "**Principles and guidelines for out of court consumer mortgage workouts**" (in effect as of 21 August 2009).

The "**Guidelines for determining the value of separable assets**" (in effect as of 12 November 2009) included general principles to be taken into account when assessing the set of the separable property of an undertaking of a credit institution that would be transferred to the ownership of the state or a person financed by the state.

Licensing

	As at the beginning of 2009	As at the end of 2009	New market participants in 2009
Banks	21	21	0
Branches of banks of EU MS	6	8	+2*
Cooperative credit unions	35	34	+1**
Providers of banking services from European Economic Area (EEA)	221	240	+19
Electronic money institution from EEA	10	11	+1
Insurance undertakings	15	14	-1***
Branches of insurance undertakings of EU MS	11	11	0
Providers of insurance services from EEA	368	395	+27
Investment management companies	15	16	+1
Providers of investment management services from EEA	14	17	+3
Investment brokerage firms	8	7	+1****
Providers of investment brokerage services from EEA	920	1 103	+183
Agents attracted by service providers	1	2	+1
Private pension funds	6	6	0
Insurance brokerage firms	98	114 (13 entries were cancelled)	+29
Insurance agents	740	736 (112 entries were cancelled)	+108
Providers of payment services from EEA	0	21	+21

*Permission to start operations was issued to Latvia branch of Pohjola Bank plc and a Latvia branch of joint-stock bank SNORAS.

**Licences of the cooperative credit union "VIDZEMES DUKĀTS" and of the *Latvijas Industriālo nozaru arodbiedrības biedru kooperatīvajai krājaizdevu sabiedrībai* (Cooperative Credit Union of members of trade unions Latvian industry branches) were withdrawn, and a licence was issued to the cooperative credit union "AlfaBeta".

***Upon request of Latvia branch of *If P&C Insurance AS* the licences of insurance joint-stock company "If Latvia" were withdrawn and during the reorganisation process all rights and liabilities of the insurance joint-stock company "If Latvia" were taken over by *If P&C Insurance AS*.

****The licences of a limited liability company investment brokerage firm "Axio Capital" and of the joint-stock company "Evli Securities IBS" were withdrawn, and a licence was issued to a limited liability company investment brokerage firm "Real Trade".

Supervisory Reform

In 2009, in response to the risks posed by the global financial crisis, the Commission **started to introduce a new enhanced supervisory framework** that notably improved the timeliness and efficiency of preventive measures and ensured an opportunity to the Commission to interfere without delay into a bank's activities and take the necessary measures.

After the global financial turmoil at the end of 2008, credit institutions started their work in 2009 in a financial environment with a risky perspective. The crisis had brought global financial markets to a halt and many financial institutions were facing liquidity problems. Latvian banks, too, had to pay particular attention to maintaining liquidity that completely depended on customer trust in banking. In the reporting year, problems in the real estate market caused significant losses for banks and they had to maintain their capital

at a level that would ensure covering those losses. Moreover, during economic downturn the solvency of borrowers deteriorated rapidly and banks had to take effective action to recover bad loans without unduly aggravating the financial standing of borrowers in order to protect their reputation.

Therefore, ensuring sufficient liquidity in Latvian banks and maintaining capital basis by promoting effective debt restructuring were the Commission's priorities in its supervisory functions. An essential aspect of supervision in 2009 was improving the protection of borrower rights by enhancing public confidence in the banking sector. In 2009, supervisory methods were based on the assessment of operational risk of market participants by using related methods, such as monitoring bank performance on the basis of the analysis of financial statements and on-site inspections.

The number of the Commission's employees that performed supervision by analysing statements was increased because the Commission actively used off-site inspections that ensured immediate receiving of operative information and ability to respond swiftly to the rapid changes in the financial market. The Commission and the Bank of Latvia continued carrying out regular stress tests to broader assess the risks inherent to each bank. In addition, each bank carried out bottom-up stress tests on the basis of a uniform macroeconomic scenario.

Monitoring Bank Performance Indicators

As at the end of the reporting year, 21 banks and six branches of EU MS were operating in Latvia, and the Commission enhanced control over all banks and introduced new reporting requirements.

Upon the Commission's instruction, banks had to ensure extended reports by sworn auditors in the area of bank liquidity, credit risk management and capital adequacy along with the audit of their financial statements for 2008. As well, the Commission required that banks prepare interim financial statements for six months, up to 30 June 2009, and perform their audit. These reports enabled the Commission to obtain an independent third party conclusion about the financial situation of banks.

In May 2009, an interview was held with the sworn auditors that had performed audits of the bank financial statements for 2008, and the Commission obtained evidence to the effect that reports gave a fair opinion about the banks' performance in 2008 and in accordance with the auditors' opinions banks had assessed their assets (in particular, loan portfolios and financial instruments) at their fair value and taken into account the situation of the financial instruments market and of the real estate market at the end of 2008.

New Instruments for Enhanced Supervision

In 2009, in order to improve bank supervision, **additional operative reports and statements** on bank activities were introduced in a number of areas.

Liquidity Risk Management

At the end of 2009, the market share of 10 subsidiaries of foreign banks in total assets of the sector was 55%. The liabilities of these banks to associated and affiliated financial institutions comprised 4.1 billion lats at the end of the year. In view of the notable amount of liabilities, a requirement **to report** twice a month **the liabilities to affiliated financial institutions** was introduced in 2009.

Those banks that before the crisis had been predominantly funded from the resources granted by non-associated financial institutions or from short-term deposits by customers were facing a serious problem of attracting resources, therefore in 2009 the Commission enhanced bank liquidity control by introducing also **daily reports about the dynamics of deposits**. The Commission also assessed concentration risk and management practice of bank funding and asked banks to develop business continuity plans for possible liquidity crisis.

Credit Risk Management

In 2009, in addition to the existing reports the Commission received from banks regular information for analysing loan portfolio: **monthly report about the structure and quality of bank loan portfolio, quarterly report about problem loans**, i. e., restructured loans, loans whose principal or interest repayment deadlines had been changed and loans being recovered, **decisions of bank credit committees and bank boards, and reports by bank internal auditors** about the audits they had performed.

In 2009, a requirement was introduced that during a loan assessment **information about all credit loss events** had to be accrued irrespective of the fact whether credit quality deterioration was recognised (i. e., whether provisions were made for the credit). This information would make it possible to carry out a comparative analysis of bank loan portfolios (and also of sub-portfolios) and would serve as a benchmark for banks in the credit risk management process. Banks were also required to submit **information about interest that had been accrued in respect of credits whose repayment had been overdue for more than 90 days**, restructured credits and credits

that had been capitalised during restructuring. That information would be taken into account when calculating own funds and would allow to implement a prudent approach to determining own funds on the basis of the concept of expected loss.

Operational Risk Management and Internal Control System

As of 2009, the Commission started to receive from banks regular information enhancing the analysis of the management quality and the decision-making process, in particular in relation to recovering problem assets, development plans and trends, and practical implementation of essential risk management. The Commission identified problems and could interfere without delay in a bank's activities and take the necessary preventive measures.

Capital Adequacy and Carrying out of Stress Tests

In view of the rapidly deteriorating quality of bank loan portfolios and in order that capital increase could be required in a timely manner, if necessary, the Commission performed **quarterly analysis (stress tests)** to make sure whether the existing capital of a bank could absorb potential losses in case the quality of the credit portfolio would decrease. The assessment was made using a uniform scenario that was based on the macroeconomic projections for the Latvian economy.

Where stress test results showed that a bank might need additional capital, in the dialogue with the Commission the bank submitted information about the measures planned by its shareholders and management to ensure compliance with capital adequacy indicator in 2009 and further on. **Overall in 2009, Latvian banks increased their capital by 998 million lats.**

On-site Inspections in Credit Institutions

In the reporting year, the Commission carried out **44 inspections** in **banks** and it paid special attention to assessing capital adequacy, crediting and risk management functions, i. e., management of credit risk, operational risk, interest rate risk, foreign exchange risk and liquidity risk, and compliance of the activity to the control function. The task of the supervision strategy was, within a time as short as possible, to accurately identify essential risks and to take immediate action to mitigate the effect of these risks and stabilise the market.

Capital Adequacy

The Commission assessed whether banks calculated capital adequacy indicator pursuant to the new requirements (in accordance with the "Regulations for Calculating the Minimum Capital Requirements", and specifically assessed the motivation for including exposures in the following categories of exposures: exposures secured with a housing mortgage (with assigned 35% degree of risk) and a portfolio of retail exposures (with assigned 75% degree of risk).

The Commission verified whether banks had developed the procedures for identifying and managing those credits and for their appropriate inclusion into capital requirements calculation. **In 2009, the Commission adjusted the risk weightings assigned to exposures by four banks** until banks either improved the procedures as requested or no longer used this option in calculating capital adequacy.

The Commission also enhanced the assessment of whether the provisions made by banks were sufficient for the projected losses. The positive difference between the amount of the projected losses and the provisions made in accordance with the requirements of accounting standards was taken into account when assessing bank's capital adequacy. **In 2009, the calculation of capital adequacy was adjusted for 11 banks.**

In addition to ensuring compliance with the minimum capital adequacy requirements banks also carried out internal assessment of capital adequacy to determine the actually needed capital in view of their risks. During 2009, during on-site inspections in four banks and off-site inspections of other banks on the basis of the information they had submitted, the internal process carried out by banks to assess their capital adequacy was evaluated and the compliance of the process with the requirements of the Credit Institution Law established. Inspection outcomes uncovered areas where banks needed improvements, which, *inter alia*, included capital planning process, covering of risks inherent to the current and the planned activity, the procedure for determining the necessary amount of capital, the methods used in stress tests and the analysis of results thereof.

In the reporting year, the Commission **estimated regularly the amount of the capital necessary to each bank to cover its losses** that, in addition to the minimum capital requirements, established the amount of capital needed to cover interest rate risk in non-trading portfolio, concentration risk in the loan portfolio, risk of money laundering and terrorist financing, other risks (including reputation, strategy, business and other risks). In its estimates the Commission included also the capital reserve (the established amount is at least 10% of the total minimum capital requirements) necessary to ensure that a bank has sufficient capital in case of possible adverse scenarios. In 2009, the Commission uncovered that **capital of four banks was below the amount necessary to cover their risks and these banks were required to increase their capital.** All banks carried out the necessary measures and ensured sufficient capital to cover their risks.

Credit Risk

In the reporting year, the Commission's employees assessed the quality of banks' credit portfolios and credit risk management systems to identify, in a timely manner, shortcomings and possible loan repayment problems. In 2009, the total balance of granted loans decreased and their quality deteriorated rapidly, therefore bank provisions for bad loans increased notably. At the end of the year, provisions for bad loans amounted to 1.3 billion lats. Therefore in 2009, compared with the end of 2008, bank provisions had increased four-fold or by 1 billion lats. At the end of the year, provisions for bad loans comprised 8.6% of the credit portfolio, and overall the share of overdue loans in the credit portfolio had increased from 15% at the end of 2008 to 25.5% at the end of 2009. These indicators notably differed bank-by-bank and sector-by-sector.

In the Commission's opinion, the notable deterioration of the quality of credit portfolios (an increase in overdue payments by borrowers), especially in respect of the loans secured with real estate (credits for operations with real estate, for building, acquiring a housing, other loans to private persons), was not followed by an appropriate increase in provisions. Even though it was explained by a sufficient value of the collateral of real estate, the Commission considered that banks had to take into account also liquidity of the real estate market because the Commission believed that both the slowdown of the real estate market and the decrease in the prices of the real estate had an adverse effect on the quality of banks' credit portfolios. Therefore the Commission paid more attention to the provisioning policy and real estate assessment procedures of banks. Banks were often notified of shortcomings in assessing creditworthiness of real estate construction companies and of private persons.

During the inspections it was uncovered that in 2009 banks had introduced changes in their crediting and credit risk management policy and procedures and had established more prudent crediting limits by enhancing requirements in respect of a borrower's solvency and requirements for the information to be submitted to the bank. In the area of crediting, banks predominantly were dealing with problem loans. Hardly any new credits were granted in 2009. In 2009, the Commission requested that banks assess their compliance with the "Principles and guidelines for out of court consumer mortgage workouts" and concluded that banks ensure compliance with the guidelines.

Liquidity Risk

Turmoil in the global financial market and the subsequent ebbing of deposits from the Latvian banking sector as of September 2008 were the reason for the Commission to pay particular attention to bank liquidity. To control the banks' cash flows, in 2009 the Commission requested that banks submit daily operative information about the dynamics of deposits and paid greater attention to managing liquidity of foreign bank subsidiary undertakings in a group because these banks were heavily relying on the resources provided by their parent banks. As a result, the Commission managed liquidity risk in the banking sector in general and, where necessary, it requested that banks take preventive measures to improve liquidity risk management.

Market Risk

The global financial crisis triggered a negative revaluation of the financial instruments held by banks and, as a result, the financial performance and capital of several banks were severely impacted in 2008. In the reporting year, the bank portfolio of financial instruments decreased significantly and reached 6% of total bank assets or 1.3 billion lats (in 2008, it was 8.9% or 2.0 billion lats). Stabilisation of the market in 2009 had a positive effect on the financial performance. Where at the end of 2008 bank losses from revaluation of financial instruments amounted to 100 million lats, at the end of 2009 revaluation result was positive already and amounted to 18 million lats.

Cooperative Credit Unions

As at the end of the reporting year, 34 cooperative credit unions were operating in Latvia, and they were supervised by using performance monitoring based on the analysis of their financial statements. Significant violations were not detected.

Insurance Undertakings

In 2009, 10 non-life insurance undertakings and four life insurance undertakings were operating in Latvia. The Commission's employees carried out five full-scope inspections and two thematic inspections of the activities of non-life insurance undertakings.

Breaches of regulatory requirements were uncovered and the following sanctions were applied: all licences issued to one insurance undertaking were suspended because it had failed to ensure sufficient solvency margin to comply with the established solvency requirement and had failed to ensure that its technical reserves were fully covered with the assets as established by law.

In accordance with the option provided for in the "Regulations on the Calculation of the Required Solvency Margin and the Available Solvency Margin for Non-life Insurers" three insurance undertakings received a permission to include in the calculation of solvency margin the revaluation reserve that had been made as a result of revaluing land and buildings acquired for their own needs and the

profit of previous years recognised as a result of revaluating investment property.

In 2009, the Commission performed an inspection of the guarantee fund administered by the society "Latvijas Transportlīdzekļu apdrošinātāju birojs" (*Motor Insurers' Bureau of Latvia*) regarding compliance with the procedure for establishing, making accruals and managing the fund; the Commission detected no significant violations and notified the Ministry of Finance and the society itself of the inspection results.

Investment Management Companies

As at the end of the reporting year, 16 investment management companies were operating in Latvia, and they were supervised predominantly using the performance monitoring based on the analysis of their financial statements. In 2009, one on-site inspection of an investment management company was performed during which the Commission assessed its financial standing, management performance and asset quality of the investment fund. No significant violations were detected.

Managers of Assets of State Funded Pension Schemes

In the reporting year, two on-site inspections were carried out aimed at assessing the financial standing, management performance, asset quality, income and expenditure structure of investment companies and their compliance with the regulatory requirements. No significant violations were detected. Moreover, the stabilisation of global financial markets in 2009 had a positive effect on the performance of the investment plans of state funded pension schemes. The average return of investment plans of state funded pension schemes in 2009 was plus 12.3% (at the end of 2008, it was minus 11.5%), and for certain investment plans returns ranged between plus 4.8% and plus 20.8% (on 31 December 2008, the range was between minus 24.5% and plus 7.4%).

Private Pension Funds

As at the end of the reporting year, six private pension funds were operating in Latvia. The Commission performed their off-site monitoring and, in order to obtain assurance about the performance and development prospects of pension plans, it requested that they submit comparison of the performance with the projected result in the previously submitted activity plan in respect of each pension plan. In 2009, private pension funds operated with a profit of 89.7 thousand lats (two of six private pension funds finished the year with a loss). As the investment value of pension plans stabilised, the average return of pension plans in the four quarters of 2009 reached plus 10.5% and exceeded the projections (it was minus 10.1% in the four quarters of 2008).

Investment Service Providers

As at the end of the reporting year, seven investment brokerage firms registered in Latvia were operating in Latvia and 18 banks registered in Latvia and two branches of foreign banks had rights to provide investment services. In 2009, six inspections of investment service providers were carried out, including planned inspections and targeted inspections in response to complaints by customers. In view of the detected weaknesses, the Commission determined the measures to improve internal processes and documentation procedures and controlled their implementation. In future, the Commission would pay particular attention to information that would be provided to customers about financial instruments and their inherent risks as well as to determining suitability and appropriateness of an investment service to a particular customer and his/her interests by taking into account the customer's knowledge, experience and financial ability to assume risk.

To ensure information to customers about the protection of their rights when receiving an investment service, the Commission had introduced a section "Customer Protection" on its website where it had placed informative material about the framework that had been transposed into Latvian regulatory requirements in relation to Directive 2004/39/EC of the European Parliament and Council on markets in financial instruments (MiFID).

Issuers of the Financial Instruments Admitted to Trading on the Regulated Market

At the end of the reporting year, one regulated market was operating in Latvia organised by the JSC "NASDAQ OMX Riga" (Stock Exchange). At the end of the year, shares of 34 issuers were listed on the Stock Exchange: shares of five issuers were in the official listing and of 29 issuers in the second listing. Listing of debt securities included 13 issuers for a total of 76 various debt securities: Government securities (56), corporate debt securities and bonds (8) and mortgages (12).

In 2009, the Commission followed, on a regular basis, the information disclosed by issuers (the Commission performed nine inspections) to verify whether issuers disclose information in full amount and in a timely manner. Where the Commission detected weaknesses, issuers were required to correct the deficiencies (in five cases) and four administrative processes were instituted for the violations of mandatory information disclosure and administrative rulings to this effect were issued; a fine of 1 000 lats was applied to one issuer and warnings were issued to three issuers.

Trading in Financial Instruments

At the end of 2009, the share market capitalisation of the Latvian regulated market organised by the Stock Exchange had increased by 12.9% in comparison with the end of 2008, but trading activity was low throughout 2009. In 2009, the total number of transactions in the share market had decreased by 9% compared with 2008, but total turnover in the share market was 9.8 million lats, 51% less than in 2008.

In 2009, the Commission monitored trading continuously by following and analysing the instructions submitted to the Stock Exchange and the transactions carried out therein to identify and prevent market manipulation and using of inside information in transactions with financial instruments. In one case information about possible market manipulation was sent by the Commission to law enforcement bodies for assessment.

In 2009, the Commission inspected whether the persons listed as holders of inside information had complied with the law as to notifying the Commission; violations were uncovered and in three cases administrative rulings were issued by warning the persons. As a result of inspections whether the acquisition or disposal of a qualifying holding had been notified to the Commission in due course of law, the Commission issued administrative rulings in three cases and warned the persons. In two administrative cases when shareholders had failed to notify the acquisition of a holding in due time and had acquired a holding of more than 50% of a company's shares, and had failed to make a mandatory share buyout offer in due course of law, the Commission applied a fine of 5 000 lats and of 6 000 lats.

Preventing Money Laundering

In the area of preventing money laundering, in 2009 the Commission's representatives continued participation in the work of the Committee on the Prevention of Money Laundering and Terrorist Financing of the European Commission and of the joint 3L3 Task Force on Anti Money Laundering (AML/TF) of three EU committees (Committee of European Banking Supervisors, Committee of European Securities Regulators and Committee of European Insurance and Occupational Pension Supervisors). In 2009, the Commission's representatives also participated in the activities of the Selected Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL).

In the reporting year, the Commission carried out 11 inspections in banks as well as in 12 cases it assessed and presented an opinion about the internal control procedures developed by market participants for preventing money laundering. In two cases a fine was applied to credit institutions (of 10 000 lats and of 50 000 lats) for violating the Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing. The Commission reported 10 suspicious financial transactions to the Financial Intelligence Unit (Office for the Prevention of Laundering of Proceeds Derived from Criminal Activity).

Supervision of Information System Security

In the reporting year, the Commission carried out seven on-site inspections to assess the security of the information systems of market participants in line with the overall economic situation in banks. In 2009, the following security aspects of information systems ranked high in the supervision process: managing of security incidents to quickly eliminate their consequences and plan preventive security measures, maintaining and developing adequate security level with reduced resources, and outsourcing of information system security services. The Commission also performed risk mitigation measures for market participants in restructurisation, including participation in the management of non-cooperation risk.

Reviewing Customer Complaints

During the crisis, along with the deteriorating solvency of market participants the number of customer complaints increased notably. Where in 2008 the number of complaints received was 247, of which 109 were in relation to banks, **in 2009 the number grew to 404, of which 254 complaints were about banks.**

In line with the World Bank recommendations regarding improving the protection of consumer rights in Latvia and educating clients, in 2009 the Commission cooperated with the Consumer Rights Protection Centre to review the complaints received, demand explanations from banks about each situation and prepare explanatory answers to customers. As there was no single regulation governing the replying process to clients in Latvia, in December 2009 the Commission sent a letter to all banks requesting them to provide replies to their clients in accordance with the best practice, i. e., no later than within 30 days.

The largest number of complaints was received from the customers of the banks with the largest credit portfolios, and the complaints most often were about loan restructuring, execution of liabilities ahead of maturity, increase in interest rates on loans and possibilities to apply various legal provisions. In most cases customer dissatisfaction was caused by lack of understanding of the conditions of banking services and inappropriately assessed risks of bank offers, lack of knowledge about the concluded contracts that, inter alia, estab-

lished that interest rates should be revised in view of the current financial market situation. The Commission urged banks to take account of the complicated economic situation in Latvia, the rapid and notable reduction in real estate prices bringing about the reduction in the value of the collateral, and to offer solutions to their customers that would be based on long-term relationship.

Bank customers had often lodged complaints without contacting the bank. In those cases the Commission acted as an intermediary and urged the parties to agree by negotiating. There were also cases when during the verification of customer information in the Credit Register of the Bank of Latvia banks uncovered that customers had submitted false information about the true amount and number of their liabilities with different credit institutions. While discussing restructuring of their loans, such customers submitted complaints to the Commission, and they were reviewed and explanations provided in view of the fact that a customer had become a very risky counterparty.

With the assistance of the Commission's specialists, in June 2009 amendments to the Consumer Rights Protection Law were made whereby a lender was prohibited from applying sanctions to a borrower who had not violated the contract significantly and the characteristics of a significant violation were established: the payment had been overdue for more than 60 days or more than three times within a year for more than 30 days in each case, and failure to use the loan for the indicated purpose. In 2009, the Commission developed "Principles and guidelines for out of court consumer mortgage workouts" that were binding on market participants.

International Cooperation

Participation in the Work of EU Bodies

In 2009, the issues of financial sector stability and of financial services that were in the competence of the Commission remained high on the agenda of various EU institutional fora, e. g., the European Council, the Economic and Financial Affairs Council, the Economic and Financial Committee and the Financial Services Committee. Among them, developing of the legal framework for action in the financial crisis (e. g., transfer of assets, availability of crisis management tools in Member States, early intervention, gradual withdrawal of state aid measures a. o.), as well as elaborating of prudential supervision and of risk management tools were the most important issues. To ensure presentation of Latvia's position in these fora, the Commission elaborated about 100 national positions and instructions.

In 2009, the most topical issue was reforming the supervision of the EU financial sector. The aim was to establish a new two-tier supervisory system by the beginning of 2011 wherein macro-supervision would be ensured by the European Systemic Risk Board, whereas micro-supervision would be vested with the European System of Financial Supervision. The new supervisory bodies would replace the current Level 3 committees of the Lamfalussy framework, i. e., Committee of European Banking Supervisors, Committee of European Securities Regulators and Committee of European Insurance and Occupational Pension Supervisors.

In 2009, the Commission's staff participated in the work of 54 committees and working groups of the European Union Lamfalussy framework. In parallel, work was organised also in separate sectors: banking (amendments to the capital requirements directive, introducing Pillar 2 standards in Member States, pro-cyclicality issues, establishment of colleges of supervisors a. o.), securities (introduction of the new regulation for credit rating agencies and for undertakings for collective investment in transferable securities, improving the information disclosure principles set out in the financial market directive, clearing and settlement, observance of corporate management principles in the financial market a. o.) and insurance (developing a proposal for Solvency II Tier 2 regulatory provisions, group supervision within the existing regulatory framework, improving information to be provided to consumers about insurance products a. o.).

The Commission's employees participated in the survey by the Committee of European Banking Supervisors on disclosing information about the major EU bank groups, and in the research by the European Commission and the Committee of European Banking Supervisors on the possible influence of the introduction of additional indicators governing bank performance, such as leverage ratio and core funding ratio, on the volume of loans issued and on the asset increase and their influence on ensuring liquidity where compliance with the said indicators had been requested earlier. The research uncovered that these indicators, even if they had been introduced earlier, would not have affected lending.

The Commission's representative was attending the meetings of the Board of Directors of the European Investment Bank (EIB) during which the projects submitted to the Board were assessed as to their compliance with the priorities of the EIB. Overall, opinions were prepared on 316 written projects and on 153 projects that were submitted for discussion at Board meetings.

The Commission's staff also participated in the self-evaluation held by the Committee of European Insurance and Occupational Pension Supervisors and collected and prepared information about compliance of information exchange and cooperation of insurance supervisory authorities with the General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the European Union and with the Helsinki Protocol relating to the collaboration of the supervisory authorities of the Member States of the European Union with regard to the application of Directive 98/78/EC on the supplementary supervision of

insurance undertakings in an insurance group and with the conditions laid down in "10 Common Principles for Colleges of Supervisors".

Cooperation with the Supervisory Authorities of the Financial Sector and International Institutions

In 2009, six new cooperation and coordination agreements were signed with respect to group supervision of SNORAS, Skandinaviska Enskilda Banken (SEB), Swedbank, "Latvijas Biznesa banka", Danske Bank and UniCredit. At the end of 2009, negotiations were completed about signing a regional Nordic-Baltic Memorandum on crisis management issues among the bank supervisory authorities, central banks and ministries of finance of the region, and it would have to be signed in the first half of 2010.

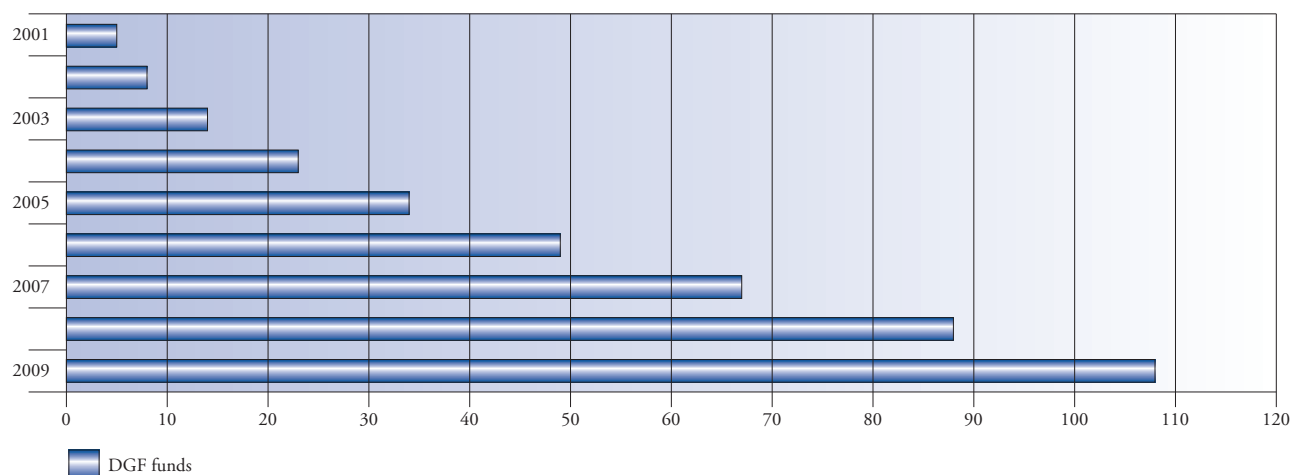
Activities of Guarantee Funds

Deposit Guarantee Fund (DGF)

In Latvia, the operations of the deposit guarantee system and of the DGF were governed by the Deposit Guarantee Law that was amended in 2009. The most essential aspects of the amendments related to the deadline for the payment of the guaranteed compensation that should be not later than 20 business days after the day when deposits had become unavailable, and the payments by deposit takers to the DGF whose amount should be based on the risks inherent in a particular deposit taker. In 2009, the guaranteed compensation to Latvian bank customers (both legal and natural persons) was 50 000 euro in each bank. The funds accumulated in the DGF as of its establishment had never been used to pay compensations because there had not been any cases of deposit unavailability (see Chart 6).

Chart 6

Growth dynamics of DGF funds, 2001-2009 (as at the end of the year; in million lats)

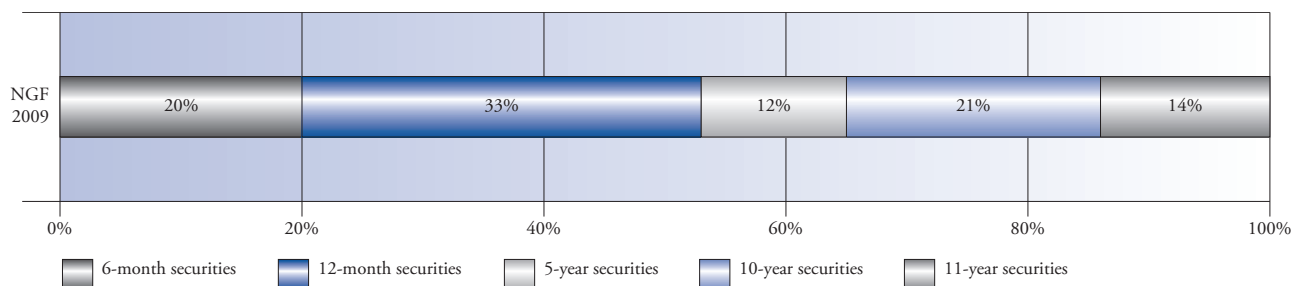


	Amount	Share, %
Total number of depositors	2 372 012	100.0
of which not exceeding the guaranteed compensation amount	2 349 586	99.1
of which exceeding the guaranteed compensation amount	22 426	0.9
Average amount of deposits	7 030 387	100.0
of which not exceeding the guaranteed compensation amount	2 063 096	29.3
of which exceeding the guaranteed compensation amount	4 967 291	70.7
Deposits guaranteed by the DGF	2 851 146	3.8

At the end of 2009, 108.3 million lats were accrued with the DGF. During the year, the funds of the DGF **had increased by 20.7 million lats** as a result of payments by deposit takers, investment of the DGF in Latvian government securities and interest payment received for cash balances in the settlement account (see Chart 7).

Chart 7

DGF investment structure, 2009 (as at end of the year; %)

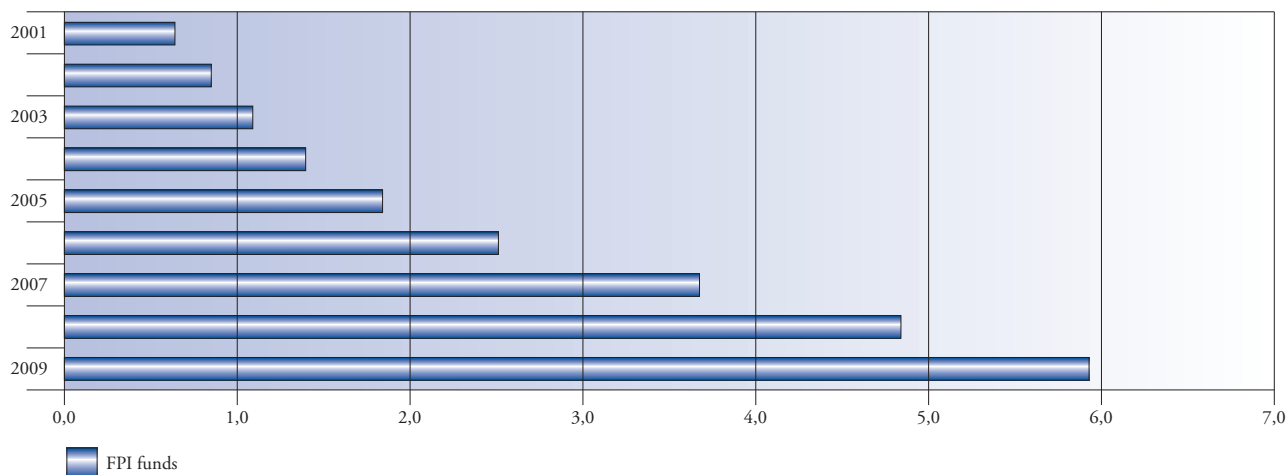


Fund for the Protection of the Insured (FPI)

The funds of the FPI were comprised of deductions of 1% of insurance undertakings from the total gross insurance premiums received from natural persons for the types of insurance specified in law. At the end of 2009, 5.9 million lats were accrued in the FPI (see Chart 8).

Chart 8

Growth dynamics of FPI funds, 2001-2009 (as at the end of the year; in million lats)



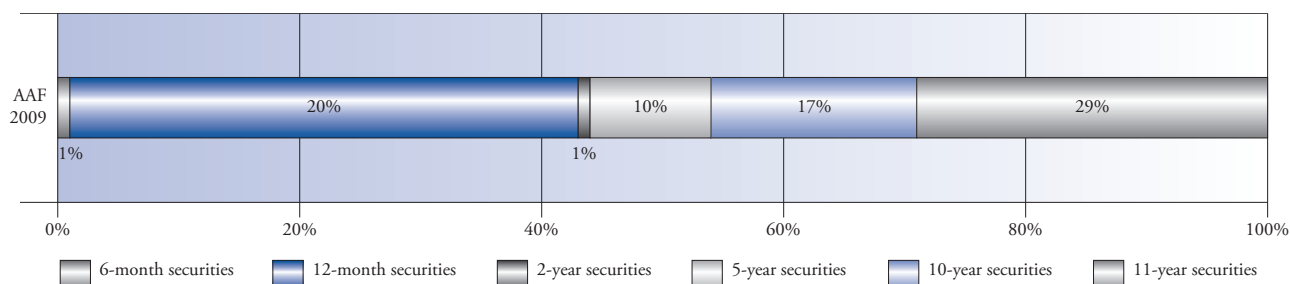
As of the beginning of its operation, 8 671 lats had been used to pay guaranteed compensations. In the case of an insurer's default, the compensation could be paid only to a policyholder that is a natural person:

- 1) for life insurance, 100% of the insurance compensation but not more than 2 000 lats per policyholder excluding insurance in respect of a market-related life insurance policy;
- 2) for other types of insurance set out in law, 50% of the insurance compensation but not more than 2 000 lats per policyholder.

In 2009, the funds of the FPI increased by 1.1 million lats as a result of instalments by the fund's participants, investment of the FPI in Latvian government securities and interest payment received for cash balances in the settlement account (see Chart 9).

Chart 9

FPI investment structure, 2009 (as at the end of the year; %)



Protection of the Customers of the Financial Instruments Market (Investors)

In 2009, a compensation amounting to 90% of the value of irreversibly lost financial instruments or of the loss as a result of a failure to provide an investment service was guaranteed to each investor but not more than 20 000 euro (14 056 lats).

In contrast to the DGF and the FPI, the mechanism for protecting investors - where an investment service provider failed to meet its liabilities - established that, instead of accumulating funds for compensations, the Commission calculated the proportion of the payment by each market participant for the provision of compensations on the basis of the quarterly reports submitted by other providers of investment services.

In 2009, the Commission started establishing the **Fund Management Committee**. The Committee would be directly responsible to the Board of the Commission and its aim would be to coordinate the processes related with the management of funds by increasing their efficiency during likely unavailability of deposits, bankruptcy of insurers or cases when compensations should be paid to investors.

Major Tasks of the Financial and Capital Market Commission in 2010

Continuing the reforms started in 2009 to harmonise the regulatory provisions governing the global financial system and to establish a new supervisory framework, in 2010 amendments to the Credit Institution Law, Law on the Financial Instruments Market, Civil Law, Law on Insurance Companies and Supervision Thereof, Reinsurance Law and Insurance Contract Law will be introduced. Amendments to the Credit Institution Law and the Law on the Financial Instruments Market will supplement the definition of a group of connected clients and establish restrictions for interbank transactions, as well as lay down provisions for the cooperation of supervisory authorities in respect of cross-border groups under normal conditions and in emergency.

As well, further changes will be made in the Commission's regulatory framework governing the Latvian financial and capital market: the "Regulations for Calculating the Minimum Capital Requirements" will be amended to clarify the calculation of capital requirements and of own funds, the "Manual for Assessing Banking Risks" and the risk assessment system will be improved; as well, work will continue to develop the methodology for inspections of insurance undertakings and standardised working documents to ensure efficient control of the process.

The Commission will continue to perform tasks deriving from the action plan for implementing the programme for stabilising the Latvian economy and restoring its growth and the documents signed with the International Monetary Fund and the European Commission; as well, the Commission will complete the establishment of the Fund Management Committee that will coordinate the processes for managing the DGF, the FPI and the investor protection system in relation to possible cases of compensation payments. The reviewing of the management strategy of the DGF and the FPI will continue and the development of the information integrity inspection system in respect of the guaranteed deposits of credit institutions will be completed.

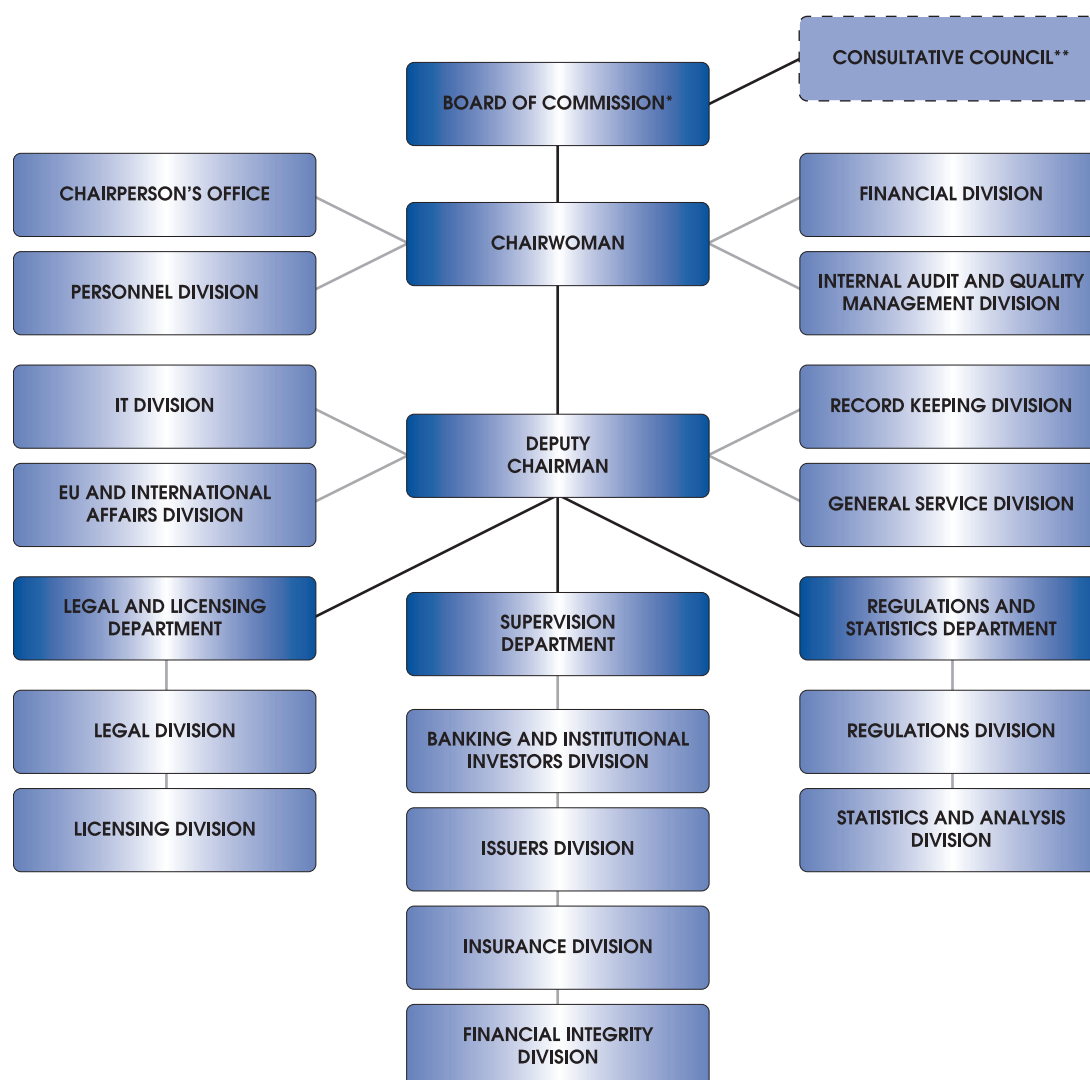
In 2010, new remuneration principles for the Commission's staff and the procedure for financing the Commission's activities will be introduced by amending the Law on the Financial and Capital Market Commission. To assess performance of employees in order to determine their salary, the "Procedure for Assessing the Performance of Employees" will be worked out.

In line with the World Bank's recommendations for improving the protection of consumer rights, the Commission will work together with the Consumer Rights Protection Centre in order to review the complaints submitted by the customers of market participants

and to provide explanations, and will take part in educating customers both in the internet and by providing guest lectures in the events held in cooperation with the BA School for Business and Finance and other educational establishments.

In 2010, the Commission will continue its work to improve the system for processing and analysing statistical information to make it more user-friendly and efficient in respect of data processing.

Structure of the Commission



*The Board of the Commission ensures that the functions of the Commission as established by law are performed by taking decisions on issues that are within the Commission's competence in accordance with the Law on the Financial and Capital Market Commission. The Board is comprised of five Board Members: Chairwoman of the Commission, Deputy Chairman of the Commission and three Board Members who are also Heads of Departments.

**The Consultative Council is established on a parity basis and is an advisory body that is comprised of the representatives of the Commission and heads of public organisations (professional associations) of the financial and capital market participants.