LATVIA: REVIEW OF THE FINANCIAL SYSTEM

April 2016

OECD

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

LATVIA: REVIEW OF THE FINANCIAL SYSTEM

This review of Latvia by the OECD Committee on Financial Markets is part of a series of reviews of the financial system. The Committee was requested to examine Latvia's position with respect to core principles related to financial systems.

The present report was finalised on the basis of information available in April 2016. It is released on the responsibility of the Secretary General of the OECD.

TABLE OF CONTENTS

REVIEW OF LATVIA BY THE COMMITTEE ON FINANCIAL MARKETS 2

I. Overview 5
A. Macroeconomic context 5
B. Recent trends in financial markets 6
II. Financial infrastructure 11
A. Central bank and monetary policy framework 11
B. Payment System 11
III. Banking system: structure and operations 13
A. Financial institutions and financial groups 13
B. Concentration of the banking system 16
C. Banks specialised in non-resident deposits 16
D. State-ownership of financial institutions 18
IV. Capital markets: structure and operation 20
A. Capital market intermediaries 20
B. Recent developments 20
C. Custody, clearing and settlement 21
V. Financial supervision and regulation 22
A. Supervision of market and intermediaries 22
B. Financial stability oversight and macroprudential surveillance 27
C. Financial consumer protection and education 31
E. International surveillance assessment (2012) 33
VI. International financial integration 34
A. Recent developments in cross-border investment 34
B. Securities and other financial market instruments 34
C. Market access for foreign institutions and investors 35
VII. Compliance with the OECD legal instruments on financial markets 36

ANNEX: FSAP RECOMMENDATIONS 38

I. Overview

A. Macroeconomic context

1. After a deep recession that originated in the wake of the global financial crisis, Latvia's GDP grew 4.7% in 2011-2013 on average, making Latvia one of the fastest growing economies in the EU. Economic growth was above 2% in 2014 – 2015 (2.4 % in 2014 and 2.3 % in the 1st half of 2015). Economic activity has been mainly driven by private consumption and exports with limited contribution from investment.

2. Both imports and exports suffered due to the closure of the largest company in the metal industry resulting in a neutral overall impact on the trade balance. Macroeconomic policy makers are seeking to redirect financial resources to the economy and particularly to small and medium-sized enterprises.

3. In recent time, private consumption has been supported by favourable developments in the labour market, while investment growth continues to be dampened by uncertainties in the external environment. At the same time, relatively high diversification of Latvia's export markets and favourable competitive position supported 2.8% y-o-y growth of export value of goods and services in the 1st half of 2015.

Figure 1. Latvia: selected macroeconomic indicators

	2008	2009	2010	2011	2012	2013	2014
National accounts	(percentage change, unless otherwise indicated)						
Real GDP	-3.2	-14.2	-2.9	5.0	4.8	4.2	2.4
Private consumption	-8.0	-16.2	3.1	2.9	3.0	6.2	2.3
Gross fixed capital formation	-9.2	-33.3	-20.0	24.2	14.2	-5.2	1.3
Exports of goods and services	2.4	-12.9	13.4	12.0	9.8	1.4	2.2
Imports of goods and services	-10.7	-31.7	12.4	22.0	5.4	-0.2	1.6
Nominal GDP (billions of euros)	24.4	18.9	18.2	20.3	22.0	23.2	24.1
GDP per capita (thousands of euros)	11.2	8.8	8.7	9.9	10.8	11.5	12.1
Savings and Investment	(percent of GDP)						
Gross national saving	19.7	30.5	21.4	19.3	21.9	21.0	21.1
Gross capital formation	34.0	21.4	19.4	24.3	26.0	23.8	24.2
Private	26.9	17.7	14.5	17.1	20.4	19.0	18.7
HICP inflation							
Period average	15.4	3.5	-1.1	4.4	2.3	0	0.6
End-period	10.5	-1.2	2.5	4.0	1.6	-0.4	0.2
Labour market							
Unemployment rate	7.7	17.5	19.5	16.2	15.0	11.9	10.8
Real gross wages	4.5	-7.2	-2.4	0.0	1.4	4.6	6.2
Consolidated general government	(percent of GDP, unless otherwise indicated)						
Total revenue	33.0	34.5	35.9	35.5	35.7	35.3	35.5
Total expenditure	37.0	43.4	44.0	38.8	36.5	36.0	36.9
Basic fiscal balance (cash-flow)	-3.1	-6.8	-6.3	-3.2	0.2	-0.5	-1.7
ESA balance	-4.0	-9.0	-8.1	-3.3	-0.8	-0.7	-1.4
General government gross debt	18.6	36.4	46.8	42.7	40.9	38.2	40.0

Sources: Central Statistical Bureau of Latvia (CSB), the Treasury, Eurostat

4. Inflation has stabilised since 2009, which was especially important given Latvia's joining the euro in January 2014. As inflation reached 15.4% in 2008, and then dipped to -1.1% in 2010, there has been some considerable volatility of inflation in recent years. Since 2013, inflation has remained low (0% in 2013; 0.6% in 2014 and 0.5% in August 2015) due to global commodity price developments that

outweighed influence of growing income. Unemployment has decreased to 9.8% in the 2nd Q of 2015, which is higher than the 7.7% level in 2008, but is a decline from the 19.5% level in 2010.

5. Latvia joined the euro in 2014 and thus is no longer independent from the European Central Bank's (ECB) decisions.

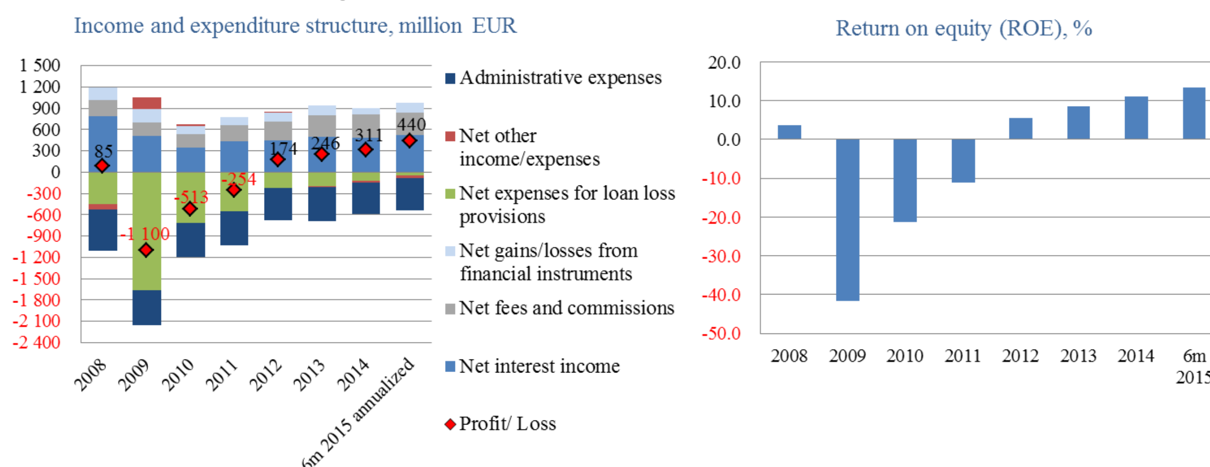
6. While Latvia's financial system is well developed, it experienced some difficulty in the aftermath of the financial crisis, with access to finance by private enterprises becoming difficult and credit growth turning negative. Further, capital flows halted as global liquidity tightened, and led to Latvia seeking financial assistance of EUR7.5 billion from the IMF, EU, World Bank and regional neighbours in December 2008. Having regained stabilisation of the economy, in December 2011 Latvia was able to make an early redemption from the international loan programme. Since 2011, Latvia has returned to the international capital markets with bonds issues.

B. Recent trends in financial markets

7. Latvia is a small, open economy and its financial sector is small with local demand for global financial market services limited. The banking sector in Latvia is split in two segments: domestic-centred banks, where Scandinavian banks and their branches have a dominant role, and banks which are focusing mainly on servicing non-residents while having no close links with the domestic economy. The latter banks are mainly domestically owned (only 3.6 % of banking sector capital originates from Russia and 7.1% - from the CIS). Overall non-resident share in banks' capital is high at 85.8% (June 2015). Foreign direct investment mostly flows into manufacturing industry, wholesale trade, financial and insurance services.

8. Since Latvia joined the European Union in 2004, the banking sector has grown rapidly and dominates the financial system (accounting for 90.2% of total assets of the financial system). During 2005-2007, there was a 50% per annum growth in loans which contributed to the increase in banking income and profitability, with ROE reaching 24-27%. In the aftermath of the financial crisis, the banking sector suffered significant losses from 2009 to 2011 due to the significant need for loan provisions.

Figure 2. Income and expenditure of banks, and ROE



Source: FCMC

9. In 2014, the banking sector reported profits of EUR 311 million with the majority of Latvian banks reporting profits. Profitability of the banking sector improved further and the ROE reached 11.1% at year end. The operating income of the banking sector totalled EUR 916 million in 2014, representing a

slight year-on-year decrease over 2013 (-3.1%). Interest income continued to decline, and given the decrease of liabilities to monetary financial institutions (MFIs) by almost one-fifth over the year and the low interest rate environment, banks were able to reduce their interest expenditures on leverage; however, the net interest income decreased by 2.0% in comparison to 2013.

10. The banking sector posted a total profit of EUR 258 million in the first seven months of 2015 (a growth of 22% compared to the same period in 2014). 14 Latvian banks and five foreign bank branches, which together account for 94% of banking assets, reported a profit. The increase in profit was affected by a rise in net commission fees and decreasing charges for loan loss provisions and administrative expenses.

Figure 3. Latvia: Financial soundness indicators

Table 5. Republic of Latvia: Financial Soundness Indicators, 2006–14

(in percent, unless otherwise indicated)

	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14
Commercial banks									
Capital Adequacy									
Regulatory capital to risk-weighted assets 1/	10.2	11.1	11.80	14.6	14.6	17.4	17.60	18.9	17.9
Regulatory Tier I capital to risk-weighted assets 1/	8.8	9.8	10.50	11.5	11.5	14.2	15.20	17.3	17.9
Capital and reserves to assets	7.6	7.9	7.30	7.4	7.3	7.5	9.36	9.9	9.9
Asset Quality									
Annual growth of bank loans	56.2	37.2	11.2	-7.0	-7.1	-8.1	-10.9	-6.5	-6.1
Sectoral distribution of loans (in % of total loans, stock)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture, hunting and related service activities	1.8	1.6	1.7	1.6	1.6	2.0	2.4	3.2	2.8
Construction and real estate activities	18.9	18.8	19.6	20.8	20.4	20.0	18.6	18.1	17.9
Industry and trade	22.0	21.6	23.1	22.3	22.0	22.0	24.3	24.2	22.0
Financial intermediation	8.0	6.0	6.0	4.5	3.2	2.8	2.7	3.6	4.7
Households	39.4	40.0	38.4	39.3	39.8	40.0	39.1	38.4	37.8
Non-residents	9.9	12.1	11.2	11.4	13.1	13.2	12.9	12.6	14.0
Loans past due over 90 days	0.5	0.8	3.6	16.4	19.0	17.5	11.1	8.3	6.9
Loans to households			4.7	16.8	18.4	19.3	15.2	12.0	9.5
Loans to corporations			2.8	18.5	20.8	16.2	9.7	7.0	5.9
Earnings and Profitability									
ROA (after tax)	2.1	2.0	0.3	-3.5	-1.6	-0.9	0.6	0.9	1.1
ROE (after tax)	25.6	24.3	4.6	-41.6	-20.4	-11.2	5.6	8.7	11.1
Liquidity									
Liquid assets to total assets	23.9	25.0	21.6	21.1	27.3	27.4	32.3	36.5	39.9
Liquid assets to short term liabilities	51.1	55.7	52.8	62.8	67.9	63.9	59.8	64.4	63.1
Customers deposits to (non-interbank) loans	71.3	68.2	58.8	61.9	77.5	84.1	106.3	124.9	158.4
Sensitivity to Market Risk									
FX deposits to total deposits 2/		70.7	69.4	74.5	72.6	73.5	76.2	75.9	40.3
FX loans to total loans 2/		81.8	85.0	87.1	88.9	86.3	84.5	88.5	13.0
Memorandum Items									
Number of banks dealing with residents 3/	9.0	9.0	14.0	15.0	15.0	17.0	13.0	13.0	11.0
Number of banks dealing with non-residents 3/	14.0	14.0	13.0	12.0	14.0	13.0	16.0	15.0	15.0
Assets of banks dealing with residents/Total banking system assets 3/	51.1	60.8	63.9	78.4	66.6	63.3	54.5	54.8	49.2
Assets of banks dealing with non-residents/Total banking system assets 3/	48.9	39.2	36.1	21.6	33.4	36.7	45.5	45.2	50.8

Source: CSB, BoL, FCMC, Latvian Leasing Association, staff calculations

1/ Regulatory Tier 1 capital to risk weighted assets as from Dec 2009 is calculated as Tier 1 capital (including deduction)/risk-weighted assets

Regulatory capital to risk-weighted assets and Regulatory Tier 1 capital to risk-weighted assets in the column of Dec 2014 uses data from Sep 2014.

2/ Euro-denominated positions are included in and before 2013, but not in 2014.

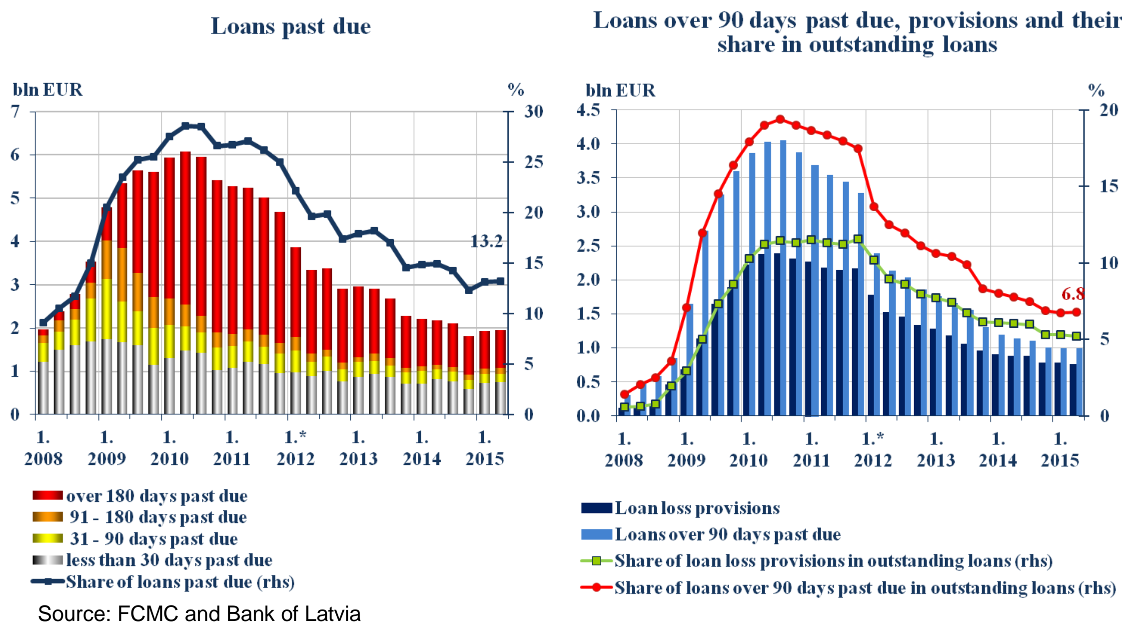
3/ Banks dealing with residents (non-residents) are defined as banks in which non-resident non-MFI deposits are below (above) 20 percent of their assets.

Source: IMF, 2015 Article IV Consultation (May 2015).

11. Credit risk is decreasing as economic recovery continues. The share of loans 90 days overdue of the total loan portfolio decreased to 6.8% at the end of July 2015 after peaking at 19.4% in 2010. Loan loss provisions covered 70.2% of 90 days overdue household loans at the end of July 2015.

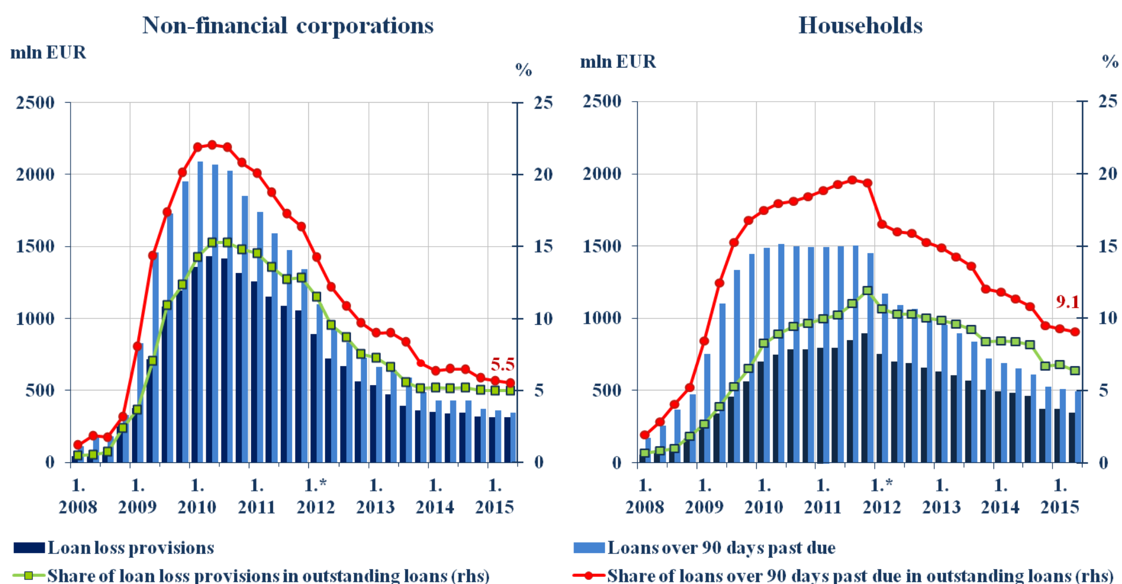
12. The deleveraging process continues but at a slower pace resulting in a 4.8% annual decrease in the household loan portfolio at the end of July 2015.

Figure 4. Non-performing loans



Source: FCMC and Bank of Latvia

Figure 5. Non-performing loans by sector



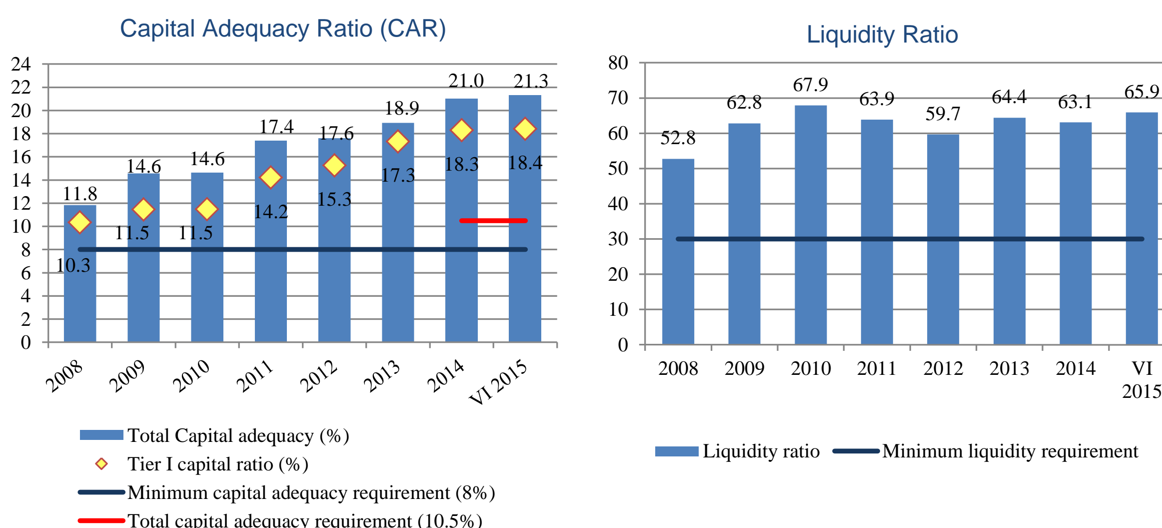
*The bank's licence of *Parex banka* was withdrawn in 2012 Q1 and that of *Latvijas Krājbanka* – in 2012 Q2
Source: FCMC

13. Since 2014, the decrease of industrial loans has been gradually slowing and reaching a positive annual growth of 0.2% in June 2015. Commercial loans decreased by 3% in June 2015.

14. In July 2015, banking sector loans to SMEs declined 3.6% compared to 2014. SMEs have become more conservative, starting to use other sources of financing more actively (own funds, EU funds' financing etc.). Non-bank lending services are dominated by financial leasing (mostly leasing loans) provided largely by subsidiaries of Latvian banks.

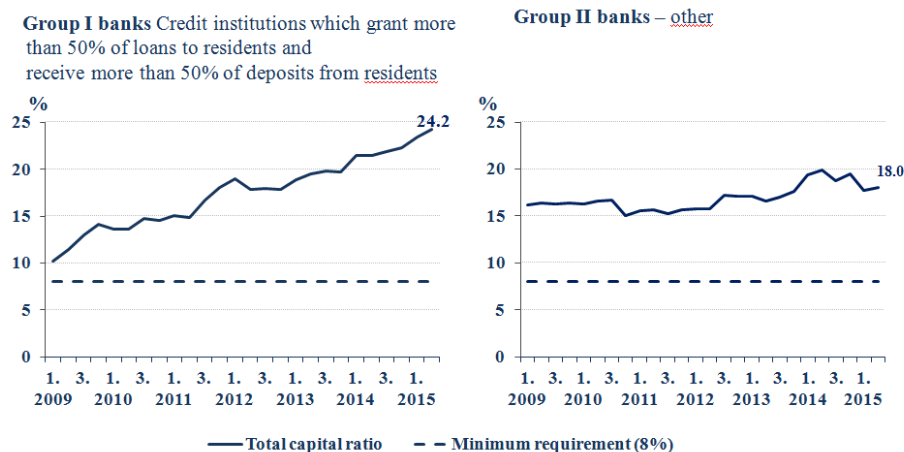
15. The banking sector total capital ratio exceeds the regulatory minimum capital requirement by more than twofold. The tier 1 capital ratio has been gradually increasing, and reached 18.4% in the second quarter of 2015. Liquidity ratio is high, and stands at 65.9% at June 2015. Despite the increasing share of demand deposits, liquidity risk remains limited due to increasing amounts of liquid assets.

Figure 6. Capital adequacy and liquidity ratio



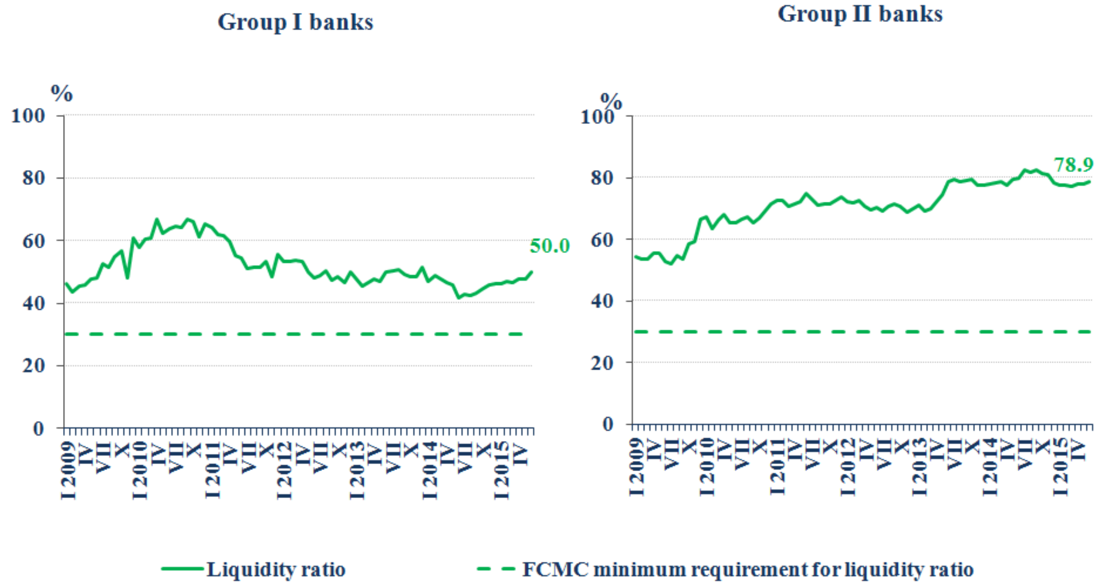
Source: FCMC

Figure 7. Capital adequacy ratio by type of bank



Source: FCMC

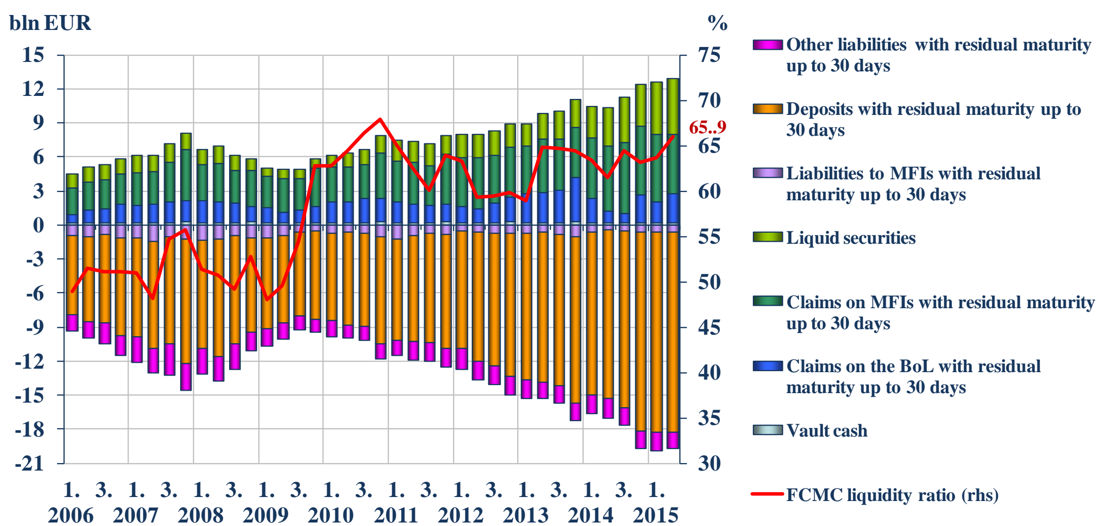
Figure 8. Liquidity ratio by type of bank



Source: FCMC

16. Debt funding from parent banks stabilised, inching up by 0.8% by end of July 2015 on a year-on-year basis. Deposits have increased by 10.2%, including 7.4% growth in resident non-financial corporate deposits and 9.3% growth in resident household deposits. Government deposits shrunk by 59.7% (due to repayment of government debt). Annual growth rate of non-resident deposits corrected for exchange rate was 5.8% in July 2015 and due to weakening of the euro at the end of 2014 and beginning of 2015 non-resident deposits in terms of euro increased by 21.0%. Debt securities issued by banks remain low, although issuance activity has increased. The value of debt securities has grown by 45.0% over the year, reaching EUR 633 million in July 2015.

Figure 9. Structure of assets and liabilities forming FCMC liquidity ratio



Source: FCMC

II. Financial infrastructure

A. Central bank and monetary policy framework

17. On 1 January 2014, Latvia joined the euro area where the single monetary policy is implemented by the participating national central banks and the European Central Bank, together forming the Eurosystem. As a part of the Eurosystem, the Bank of Latvia participates in the formulation of the single monetary policy as well as in making and implementing related decisions, fulfilling the objective of maintaining price stability as laid down in the Treaty on the Functioning of the European Union. The Law on the Bank of Latvia forms the legal basis for Bank of Latvia and its operations.

18. As for the Bank of Latvia, the appointment procedure, length of the mandate and reappointment of the Governor and other members of the Council of the Bank of Latvia are stated in the Law on the Bank of Latvia. The Governor, Deputy Governor and other members of the Council of the Bank of Latvia are appointed by an open vote of the Saeima (Parliament). The Governor is appointed upon the recommendation of at least ten members of the Saeima, which is composed of 100 members, while the Deputy Governor and other members of the Council are appointed by the Saeima upon the recommendation of the Governor. The Council of the Bank consists of eight persons: the Governor, the Deputy Governor and six members of the Council, and is chaired by the Governor.

19. The Governor of the Bank of Latvia, the Deputy Governor and members of the Council hold office for six years. In case any member of the Council resigns or his/her office is otherwise terminated before his/her term of office has expired, a new member of the Council of the Bank of Latvia is appointed for a term of office of six years. There are no limitations or prohibitions in the law regarding the reappointment of the Governor, the Deputy Governor or other Council members of the Bank of Latvia.

20. The Governor of the Bank of Latvia, the Deputy Governor and members of the Council of the Bank of Latvia may be relieved from office by the Saeima before the term of office only in the following circumstances: 1) he/she has submitted his/her resignation; 2) he/she has been guilty of serious misconduct pursuant to Article 14.2 of the Statute of the European System of Central Banks and of the European Central Bank; or 3) on grounds of dismissal stipulated by Article 14.2 of the Statute of the European System of Central Banks and of the European Central Bank.

21. The Governor may refer the Saeima's decision on his/her dismissal from office to the court as prescribed in Article 14.2 of the Statute of the European System of Central Banks and of the European Central Bank. The Deputy Governor or a member of the Council may refer the Saeima's decision on his/her dismissal from office to the court as prescribed by Administrative Procedure Law.

22. Upon joining the Eurosystem, the structure of the Bank of Latvia's balance sheet has been changed in line with the breakdown used by other central banks of the Eurosystem and in drafting the consolidated financial statements of the Eurosystem. The new structure of the balance sheet is more detailed, with the breakdown by residence (euro area residents and non-euro area residents), by currency (euro and foreign currencies) and major type of operations (e.g. monetary operations).

B. Payment System

23. Bank of Latvia operates two payments systems: TARGET2-Latvija component and Electronic Clearing System (EKS). TARGET2 is the real-time gross settlement system owned and operated by the Eurosystem. It is a systemically important payment system and a service relevant for the Eurosystem's statutory tasks of promoting the smooth operation of payment systems, implementing monetary policy and

maintaining financial stability. Payment transactions in TARGET2 are settled one by one on a continuous basis, in central bank money with immediate finality.

24. EKS is compliant with the Single Euro Payments Area (SEPA). EKS is developed, owned and operated by the Bank of Latvia. It is used for the handling of retail payments and enables the execution of SEPA credit transfers within one working day with final settlement taking place in TARGET2. EKS is an Automated Clearing House system where payment handling is fully automated and only electronic documents are accepted and processed. EKS has seven clearing cycles per business day and it operates in accordance with the TARGET2 business day calendar. To ensure inter-operability with other payment infrastructures of the SEPA and reachability of EKS participants, EKS exchanges cross-border credit transfer messages with the Euro Banking Association system STEP2. EKS clearing cycles are aligned to STEP2 clearing cycles to process payments in the same day.

25. In 2014, the Eurosystem assessed TARGET2, including TARGET2-Latvia component, for its compliance with the CPSS IOSCO *"Principles for financial market infrastructures"* (PFMI). The assessment was done to get an early overview of TARGET2 compliance with the new oversight standards, and thus to facilitate TARGET2 compliance with the Regulation of the European Central Bank on oversight requirements for systemically important payment systems (ECB/2014/28) (SIPS Regulation). In 2015, the assessment of TARGET2 compliance with the SIPS Regulation is ongoing. The Bank of Latvia currently assesses EKS for its compliance with the PFMI. The assessment will form a part of the Eurosystem's comprehensive assessment of all euro retail payment systems in EU.

III. Banking system: structure and operations

A. Financial institutions and financial groups

26. Financial and capital market participants in Latvia are issuers, investors, banks, insurers, insurance brokers, reinsurers, reinsurance brokers, private pension funds, regulated market organizers, depositories, investment firms, investment management companies, alternative investment fund managers, credit unions, external credit assessment institutions (rating agencies), payment institutions and electronic money institutions according to legislation. The Financial and Capital Market Commission (FCMC) regulates and monitors the functioning of the financial and capital market participants.

27. Banks dominate the financial system of Latvia with a 90 per cent market share in total assets of the financial system (see Table 1). Roughly 5 per cent are assets in the State funded pension scheme investment plans and 2.4 per cent in the insurance sector.

Table 1. Financial market participants in Latvia

	31.12.2013.			31.12.2014.		
Market Participants	Assets (mln. EUR)	% of total assets	Number	Assets (mln. EUR)	% of total assets	Number
Banks and foreign bank branches	29 192	90.2	19+9	30 815	89.9	17+9
Credit unions	22	0.1	35	23	0.1	32
Insurance companies and foreign insurance companies branches	771	2.4	7+13	811	2.4	7+14
Private pension funds	3	0.0	7	3	0.0	6
Pension plans	236	0.7	19	283	0.8	18
Investment management companies	37	0.1	12	35	0.1	12
Investment funds	417	1.3	37	211	0.6	33
State pension scheme investment plans	1 686	5.2	23	2 035	5.9	20
Alternative investment managers		0.0		1	0.0	6
Alternative investment funds		0.0		50	0.1	11
Investment brokerage companies	6	0.0	4	7	0.0	5
Insurance brokerage companies			90			88
Payment institutions			36			34
Electronic money institurions			14			14
JSC NASDAQ OMX Riga			1			1
Latvian Central Depository			1			1
Total	**32 371**	**100**	**327**	**34 273**	**100**	**328**

Source: FCMC

28. Among others, there are also non deposit-taking intermediaries such as consumer credit providers (non-bank financial institutions) that are supervised by the Consumer Rights Protection Centre, and intermediaries that provide investment service using internet platforms (for forex and CFD transactions), which are supervised by the FCMC. Supervision of investment intermediaries that provide investment service using internet platforms is a challenge because they often do not have an establishment in Latvia and are thus not authorised to provide the relevant services, the FCMC has limited capacity to regulate or terminate their activity. The FCMC has issued public warning of unauthorised service providers to raise risk awareness and discourage investors from using unauthorised services.

29. In 2014, of the total resident credit portfolio, bank loans constituted 86.9% and loans from non-banks were 13.1% of the portfolio, which is an increase of 3.5% compared to 2013, totalling EUR1.8

billion. Data collected by the Consumer Rights Protection Centre also shows that non-bank lending increased 16.1% in 2014 amounting to EUR 0.4 billion.

30. Crowdfunding or collective financing platforms are forms of alternative financing that have experiences rapid development in Latvia in recent years. In order to facilitate alternative financing in Latvia, the Ministry of Finance has initiated development of a new regulation on the peer-to-peer lending and amendments to develop investment crowdfunding (or equity crowdfunding). The new regulation will establish regulatory requirements, such as rules for management compliance, AML requirements and other prudential measures to address the risks of peer-to-peer lending platforms, and existing regulation will be amended to accommodate the specific issues of equity crowdfunding platforms.

31. Cross-sector activity of the banking, insurance and securities sector is relatively low in Latvia. In addition, banks are entitled to provide non-financial services only to the extent that these services are linked with financial services.

32. At the end of 2014, 12 financial groups were controlled by commercial banks (81% of market share in terms of assets). All together these financial groups have 113 subsidiaries, 92 of which are operating in Latvia. Total assets of the bank subsidiaries at the end-2014 accounted for 9.6% of total assets of parent banks. The majority of assets of subsidiaries were from leasing companies (22.7%), auxiliary undertakings (21.7%), banks (42.8%) and other financial institutions (11.6%).

Table 2. Subsidiaries of banks (December 2014)

	Banks consolidated groups	Total	Leasing companies	Banks	Investment management companies	Investments firms	Pension funds	Other financial institutions	Auxiliary undertakings
Latvia	ABLV Bank	27		1	1	1		4	20
	Baltic International Bank	2						1	1
	Bank M2M Europe	1			1				
	Citadele banka	25	3	2	2	2	1	1	14
	Rietumu Banka	23	1					7	15
	Meridian Trade Bank	1						1	
	TRASTA KOMERCBANKA	7	2					2	3
Nordic	DNB banka	9	1		1				7
	SEB banka	3	1		1		1		
	Swedbank	4	2				1		1
Ukraine	PrivatBank	5	1						4
Russia	NORVIK BANKA	6	1	1	1			2	1

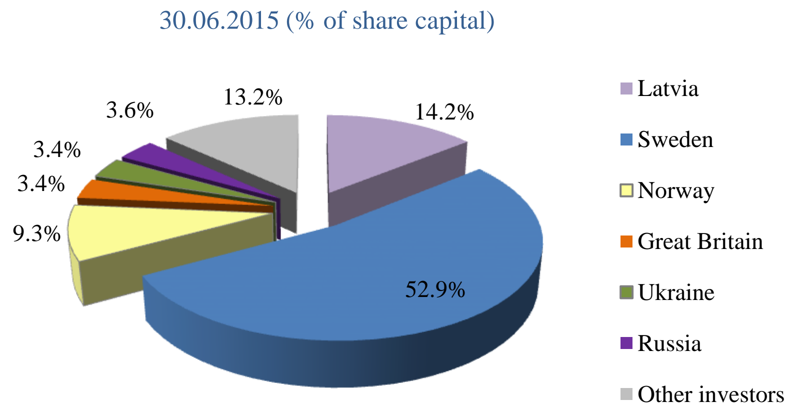
Source: FCMC

33. Banks in Latvia can be classified into foreign (mainly Scandinavian) owned banks, which focus on servicing residents and dominate in the resident loans and deposits market and banks, and those which specialise in servicing non-residents, and which are mainly domestic private person-owned banks. The Law on Financial Conglomerates establishes the definition of conglomerates and the supplementary supervision, although currently there are no financial conglomerates under the supervision of FCMC.

34. There are 17 banks and 10 branches of foreign banks operating in Latvia at the end of June 2015 and 85.8% of total capital originates from outside of Latvia. The three EEA bank subsidiaries and 10 EEA

bank branches comprise 48% of banking sector assets and 81% of resident loan portfolio, all with Nordic parent banks.

Figure 10. Share of foreign ownership of banks in Latvia



Source: FCMC

35. Foreign banks, mostly Nordic, have been shifting their banking structure in the Baltics, and some European banks have pulled out of Latvia as a result of the small potential in a crowded market. Latvian banks have a very limited presence overseas, with branches in Estonia, Lithuania, Italy and Cyprus[1] and subsidiaries in Lithuania, Switzerland, Luxembourg and Russia.

Table 3. Cross-border bank activity in Latvia

Items		31.12.13.	30.06.14.	31.12.14.	30.06.15.
Banks and branches of foreign banks, incl.		28	26	26	27
	branches of foreign banks	9	9	9	10
	subsidiaries of foreign banks in Latvia	7	5	5	5
Assets of branches of foreign banks (in EUR millions)		3,434.9	3,837.8	3,939.0	3,869.8
Branches of Latvian banks abroad, incl.		9	6	6	5
	Estonia	2	1	1	1
	Italy	1	1	1	1
	Cyprus	3	2	2	2
	Lithuania	2	1	1	1
	Portugal	1	1	1	0
Assets of branches of Latvian banks abroad (in EUR millions)		32.3	36.2	31.6	20.8

1 . Note by Turkey.
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".
Note by all the European Union Member States of the OECD and the European Union
The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Branches of Latvian banks in Latvia	164		161	
Settlement groups of Latvian banks in Latvia	155		152	
Representative offices of Latvian banks abroad	27		27	
Banking staff, average*	9,845		9,362	

Source: FCMC

B. Concentration of the banking system

36. FCMC verifies the identity of the shareholder of a financial institution. There is a legal duty to provide information to FCMC to enable this verification, and any founder should be financially stable, and, if necessary, be able to provide additional capital to the financial institution.

37. There are no rules requiring financial institutions to be widely held. The financial institution can also be held by a sole investor, as some financial institutions are.

38. Concentration of the banking sector is limited, with the market share of the five largest banks at 63.5% for assets, 76.3% for loans and 64.7deposits. None of the banks are dominant in Latvia with healthy competition present in the banking market.

Table 4. Market share of five largest banks (%)

	2008	2009	2010	2011	2012	2013	2014
Assets	69.5	68.2	59.3	58.4	62.8	64.1	63.5
Loans	74.5	74.2	67.1	67.3	74.2	77.0	76.3
Deposits	63.4	59.9	54.9	59.3	63.1	66.7	64.7

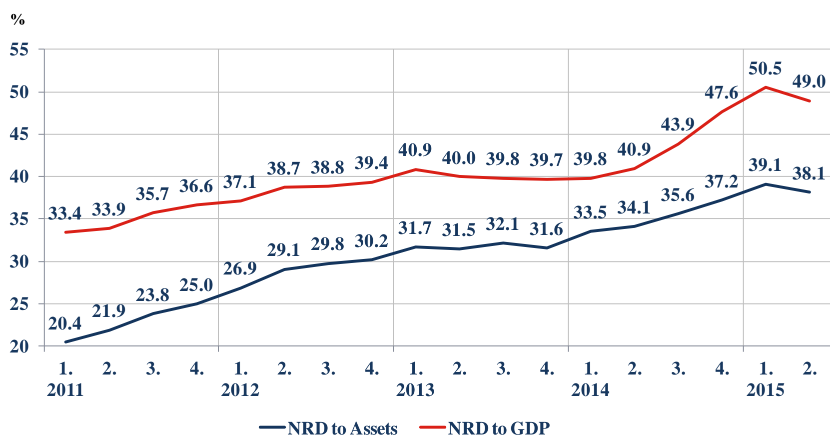
Source: FCMC

C. Banks specialised in non-resident deposits

39. Non-resident deposits (NRDs) have been gradually increasing since the early 2000s. A sharp inflow of non-resident deposits was observed in the post-Lehman period of late 2007, which was then followed by an outflow of those deposits in 2008. The collapse of Parex bank in late 2008, which was one of the banks focused on servicing NRDs (see following Section 41. Given the risks associated with a large, non-resident deposit base, Latvia should continue to focus on reducing risk exposures in this area and strengthening risk-management practices in relation to foreign currency deposits. It is recommended that the authorities closely monitor banks which have a large proportion of non-residential deposits.

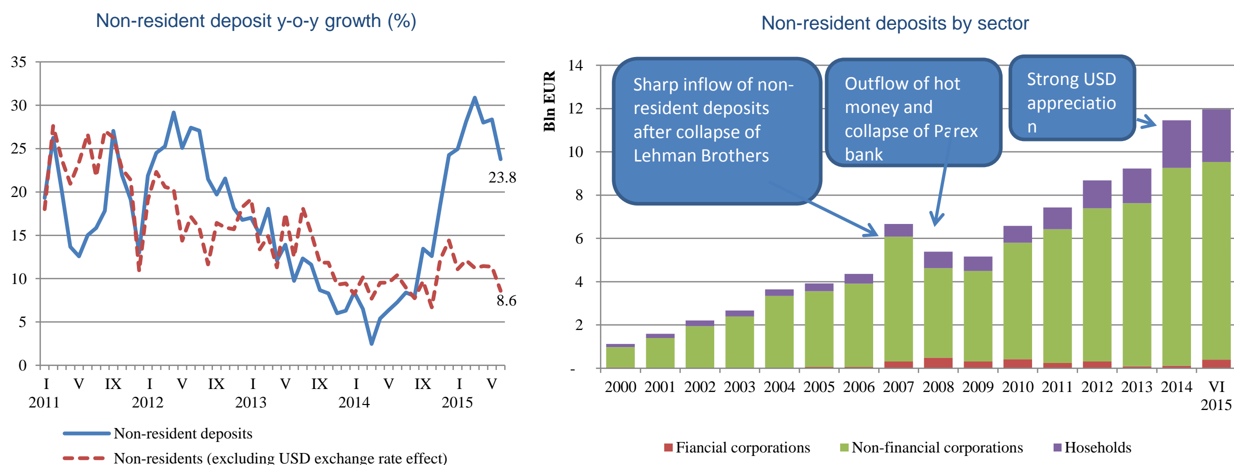
D. State-ownership of financial institutions), mainly determined the temporary outflow of non-resident deposits. The corporate sector accounts for the majority of non-resident deposits while the share of household deposits is slightly increasing reaching 20.3% as of July 2015.

Figure 11. Total non-resident deposits to assets and GDP



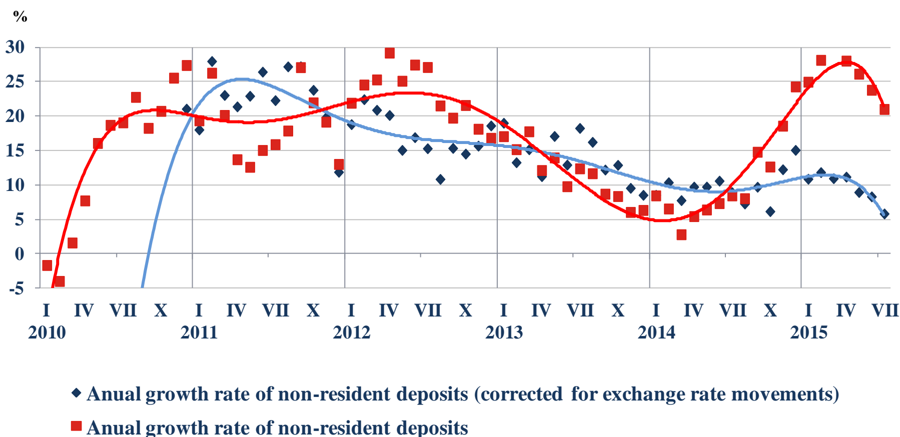
Source: Bank of Latvia

Figure 12. NRB deposit growth and deposit by sector



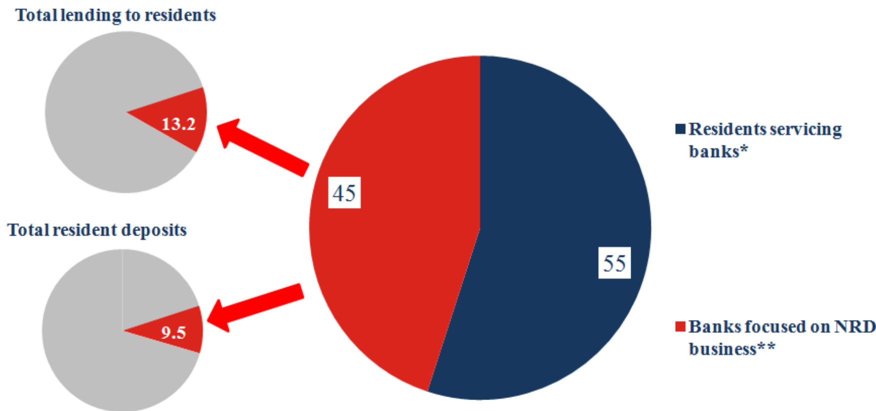
Source: FCMC

Figure 13. Non-resident deposit annual growth with correction for exchange rate



Source: Bank of Latvia

Figure 14. NRBs focus of business (July 2015)

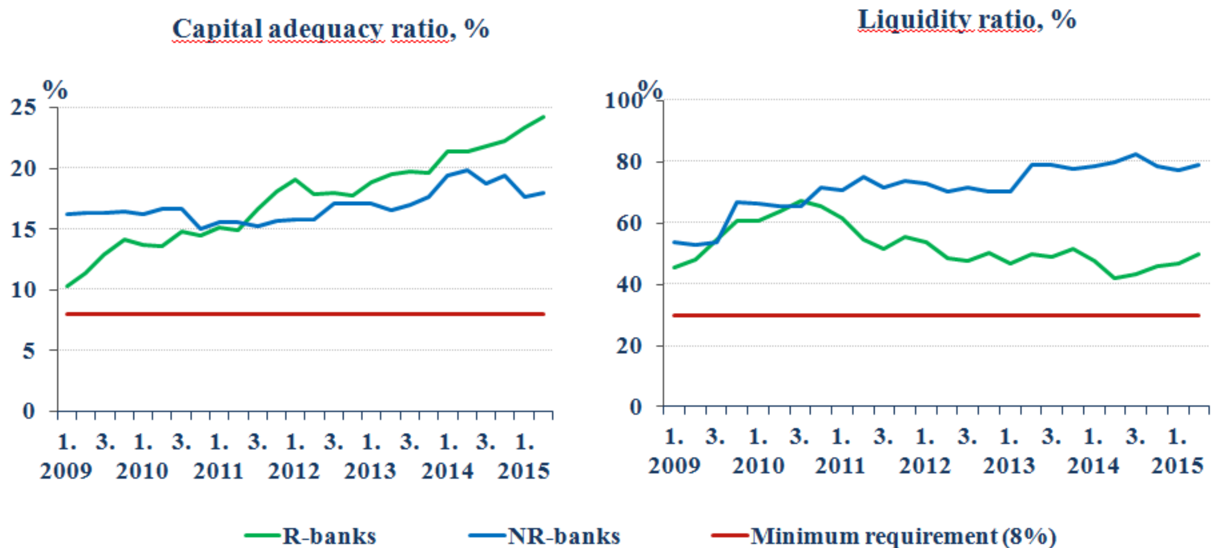


* Credit institutions which grant more than 50% of loans to residents and receive more than 50% of deposits from residents
** Other banks

Source: Bank of Latvia

40. In first half of 2015, the capital adequacy ratio of NRBs decreased by 1.4 percentage points due to the increase of the total risk exposure. Most NRBs are comfortably above the individual liquidity ratios, which are remained high and stable during the last two years, fluctuating at around 80%.

Figure 15. NRB capital adequacy and liquidity ratio



Source: FCMC

41. Given the risks associated with a large, non-resident deposit base, Latvia should continue to focus on reducing risk exposures in this area and strengthening risk-management practices in relation to foreign currency deposits. It is recommended that the authorities closely monitor banks which have a large proportion of non-residential deposits.

D. State-ownership of financial institutions

42. One of the casualties of the financial crisis was the second largest bank of Latvia at the time, Parex Bank, which lost 240 million lats (USD427 million) in deposits in the six weeks leading to the

government taking it over.[2] 40% to 50% of Parex's deposits were held by non-residents while its loan portfolio was with residents. In the aftermath of the Lehman crisis and the subsequent recession, non-resident depositors lost confidence in Parex, which did not have a strong parent bank, leading to a massive deposit withdrawal.

43. Following the takeover of Parex Bank in November 2008, the government participated in the rescheduling of the bank's syndicated loans, and agreed with the EBRD that the EBRD would take a 25% shareholding in Parex and the remaining 75% would be owned by the Republic of Latvia (via the state joint stock company Latvian Privatisation Agency). As part of the restructuring, on 1 August 2010, Parex was split into two banks – with the performing assets being transferred to the newly established Citadele Bank and the non-performing assets remaining in Parex Bank. As a result, the market share of government-owned bank Citadele Bank comprised 5.6 per cent of the total Latvian banking sector share capital.

44. In March 2012, FCMC approved Parex Banka's request and cancelled the bank licence for the bank that took over the non-performing loans. In May 2012, after the status and name change of the bank, it re-established itself as Reverta, which manages distressed assets. Currently, the Latvian Privatisation Agency owns 84.15 % of Reverta, EBRD 12.74% and minority shareholders 3.11%.

45. In July 2013, the government of Latvia decided to resume the process of attracting investors for the sales of Citadele Bank. As a result of an international tender process led by the Latvian Privatisation Agency in co-operation with its financial advisor Société Générale and legal advisor Linklaters, the government selected a group of investors led by Ripplewood Advisors LLC for the sale of 75% stake in Citadele Bank. EBRD retained its 25% stake in the bank. The share purchase agreement was signed in November 2014, closing the sales transaction in April 2015.

46. Another state-owned bank which was established in 1993 is the Mortgage and Land Bank of Latvia (Mortgage Bank). The objective of Mortgage Bank was to finance the agrarian reform and grant long-term mortgage loans, mainly for financing of construction works. It is positioned by the government as a housing development bank.

47. On 9 December 2013, the shareholder of Mortgage Bank surrendered the bank's licence effective 1 January 2014. From January 2014, Mortgage Bank has continued its operations as the State-owned Joint-Stock Company "Latvian Development Financial Institution Altum", with operations focussing on implementation of state support and development programmes. On 15 April 2015, the State-owned Joint-Stock Company "Latvian Development Financial Institution Altum" was merged with other development institutions - State Limited Liability Company "Latvian Guarantee Agency", State Joint Stock Company "Rural Development Fund", now carrying a new brand name State Joint Stock Company "Development Financial Institution Altum". The "Development Financial Institution Altum" currently has 9 branches and 16 Development Programme Consulting Centres in different regions of Latvia that provide customer services throughout the territory of Latvia. It currently provides state support programs in form of loans and guarantees.

[2] More detailed information is available at: http://www.fktk.lv/texts_files/Parnemsanas_apskats_02.02Eng.pdf.

IV. Capital markets: structure and operation

A. Capital market intermediaries

48. The capital market of Latvia is small with limited capitalisation in both the stock and bond markets. Market capitalisation of equity shares was EUR860.0 million at end 2014. Turnover of shares traded in 2014 was EUR 17.2 million. No new capital was raised by shares during 2014.

49. Only domestic entities operate in the bond market, of which two of the bond issuers are state-owned and 10 are private companies. The bonds of five new private sector issuers were including in the bond market list in 2014. Market capitalisation of private sector bond issuers was EUR693.3 million at end 2014, and EUR 811.8million when including the state issued bonds.

50. There are two trading platforms operating in Latvia – a regulated market (NASDAQ OMX Riga) and the Multilateral Trading Facility (MTF) First North Latvia (MTF First North Latvia is operated by NASDAQ OMX Riga). NASDAQ OMX Riga is owned by NASDAQ OMX Group. First North Latvia is not a regulated market, so compliance with the requirements of the Law on Financial Instrument is voluntary for issuers. Companies can choose whether to be listed on NASDAQ OMX Riga or on First North, but so far only Baltic Telekom is listed on First North. Bond listing is due to start in First North in 2015.

51. The main types of investment firms in Latvia are: a) banks, b) investment brokerage firms and c) investment management companies (asset management companies). Banks and investment brokerage firms are allowed to provide all types of MiFID services: execution and transmission of orders, financial advice, custody, corporate finance, discretional portfolio management, securities placement and underwriting, operating of multilateral trading facility, trading on own account. Investment management companies are only allowed to provide portfolio management and investment advice (personal recommendation). Only investment management companies are allowed to manage investment funds (UCITS funds). An alternative investment fund manager is allowed to manage alternative investment funds (funds that are not UCITS under EU directive 2009/65 EC). Investment management companies are allowed to manage alternative investment funds if they have obtained licence for AIF management or registered for such management. In Latvia, there is no strict distinction between what is deemed to be usual banking activity (incl. deposits-taking) and investment banking, as all banks may provide investment services. Investment brokerage firms however are not allowed to take deposits; they are only allowed to hold investors' money passed for transactions in financial instruments. All types of investment activities carried out by these firms are to be licensed and supervised by the FCMC.

B. Recent developments

52. Several banks have issued mortgage-linked notes, but their sales volume has not been significant. The structured securities market is not developed in Latvia. Average figures for transactions in 2013 are: approximately 170 deals per quarter, with an average value of products sold at EUR6 million.

53. In February 2013, a primary dealer system was implemented for government securities. Five primary dealers have the right to participate in auctions, and certain obligations in the primary and secondary market. Regular dialogue between the Treasury and primary dealers has ensured better match between the government securities offered and the securities in demand. In addition, the primary dealers system has facilitated the growth of activity and liquidity in the secondary market for government securities.

54. Domestic government borrowing consists of T-Bonds, T-Bills and savings bonds.

- In 2013 and 2014, gross issuance of T-Bonds and T-Bills was 447.6 million EUR and 373.0 million EUR, respectively. The net issuance was 6.0 and 79.9 million EUR, respectively. On September 18, 2015, year-to-date gross issuance and net issuance were EUR393.3 and EUR141.1 million respectively.

- Yields for 6 and 12 month T-Bills in auctions declined during the period and reached record-lows in the end of 2014 (0.068% for 12 month T-Bills). In April 2015, yield for 12 month T-Bills reached new lows in negative territory and was -0.012%. Yields of T-Bonds exhibited similar trends and their yields continued declining in 2015: in an auction on 22 April 2015, the yield for a bond maturing on 23 January 2018 was 0.181%.

55. Savings bonds are a new instrument since June 2013 for retail savers. Savings bonds are essentially comparable to bank deposits, however the income gained from savings bonds is not subject to personal income tax similarly to income gained from other government securities. In mid-2014, sales of savings bonds in post offices commenced through the cooperation with the state owned company "Latvijas Pasts" (Latvian National Post Office) in addition to the existing distribution channel of a dedicated website. By mid-2015, the total amount of savings bonds sold exceeded EUR5 million.

- Savings bonds have maturities of 6- and 12-months, 5- and 10-years.

- The most popular savings bonds are with maturity of 10 years.

C. Custody, clearing and settlement

56. The Latvian Central Depository (LCD) is the sole central securities depository in Latvia. The operations of the LCD are supervised by the Financial and Capital Markets Commission. The Bank of Latvia oversees the security settlement systems in Latvia.

57. There are two types of settlement used by the LCD to settle trades: net settlement and gross settlement. The LCD offers delivery-versus-payment (net and gross) and free of payment to settle securities transfers between the LCD participants. Simultaneous net settlement of cash and gross settlement of securities (DVP) is used to settle the RIG auto-matched trades and negotiated trades with settlement day T+1 and more. Automatically matched NASDAQ OMX Riga trades, as a default, are settled on the third day after the trade (T+3), where T is the day of conclusion of the transaction. The ownership right to securities is transferred on the settlement day.

58. All securities registered with the LCD are in the book-entry form. The LCD provides safe-custody of financial instruments for intermediaries – banks and brokerage companies maintain both their proprietary and customer accounts. Banks and brokerage companies – who act as custodians – are licensed and supervised by the Financial and Capital Market Commission and are participants in the national Investor Compensation Scheme (which covers investments up to EUR20 000).

59. In 2015, NASDAQ OMX Group, Inc. made a decision to consolidate three Baltic CSDs into new legal entity Nasdaq CSD registered in Latvia with branches in Estonia and Lithuania. NASDAQ OMX Group, Inc. intends to acquire licence for Nasdaq CSD under CSD Regulation in Latvia. Nasdaq CSD operational model will be based on three Securities Settlement Systems (SSSs). Three SSSs will operate under the Estonian, Latvian and Lithuanian law. NASDAQ OMX Group, Inc. intends to start operations of licensed Nasdaq CSD, its three SSSs and migration to T2S by the beginning of 2017.

V. Financial supervision and regulation

A. Supervision of market and intermediaries

60. The goal of the FCMC's activities is to protect the interests of investors, depositors and the insured, and to promote the development and stability of the financial and capital markets. The FCMC is governed by its Board that is comprised of five members: the Chairperson of the FCMC, his/her Deputy and three members, who are also directors of the FCMC's Departments. The Parliament appoints the Chairperson and his/her Deputy for a period of six years upon a joint proposal of the Minister of Finance and the Governor of the Bank of Latvia.

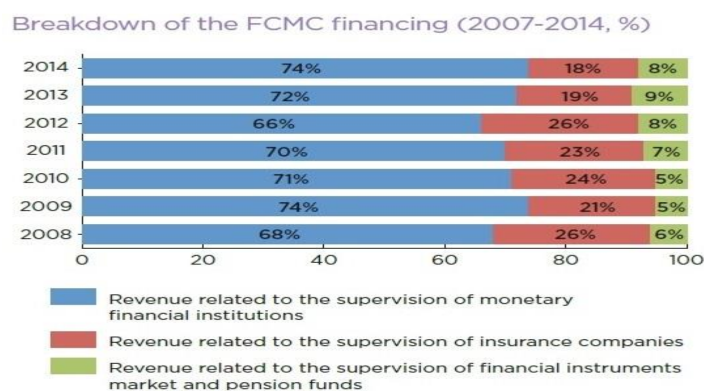
61. A person may be appointed to the position of Chairperson, Deputy Chairperson or a Board member provided that he/she is competent in financial management; is of good repute; and has at least five years' experience in financial and capital markets. The position of Chairperson, Deputy Chairperson or Board member shall not be taken by a person who has a criminal record, irrespective of its annulment or removal; and has been deprived of the right to engage in a particular or any type of entrepreneurial activity.

62. The Parliament shall dismiss the Chairperson or Deputy Chairperson from his/her position before the end of their terms only if an application of resignation is submitted by the respective person; a court judgment whereby the Chairperson or his/her Deputy is conviction of a criminal offence becomes effective; the Chairperson or Deputy Chairperson is not able to officiate for a period of six consecutive months due to illness or for any other reason; an application submitted jointly by the Governor of the Bank of Latvia and the Minister of Finance on his/her early dismissal has been received.

63. The FCMC shall make independent decisions within the limits of its authority, execute functions assigned to it by law, and be responsible for their execution. No one shall be entitled to interfere with the activities of the FCMC (however, law-enforcement authorities have the right to ask for necessary information). To take administrative action, the FCMC is not required to consult with another authority or a government minister.

64. Regarding control of the FCMC's activities, the Law on the Financial and Capital Market Commission states that the FCMC shall annually – but no later than 1 July – file with the Parliament and the Ministry of Finance a written report on its performance during the preceding year and full annual accounts audited by a sworn auditor. The FCMC shall publish its balance sheet statement and the opinion of the sworn auditor in the official journal Latvijas Vestnesis no later than July 1 following the end of the reporting year.

Figure 16. Structure of FCMF financing



Source: FCMC

65. The Activities of the FCMC are fully financed from the payments made by market participants. The basis of these payments and maximum percentages are set in sectorial laws. The Board of the FCMC annually sets percentages for payments of market participants taking into account the cost for supervising the respective sector and the sector's ability to ensure the necessary amount of financing. The annual budget of the FCMC is approved by the Board, before which a draft is reviewed by the Consultative Council of the FCMC.

66. The budget of the FCMC allows it to attract and retain experienced and qualified staff as well as to ensure necessary ongoing training. Salaries for staff are set taking into account the outcome of an independent research on the level of remuneration in the financial market, provided by a human resource management company. The Personnel Policy of the FCMC provides regular training of the employees. Each year the Personnel Division evaluates the training needs for employees and draws up the Training plan.

67. As part of joining the Banking Union, the three largest Latvian banks are under direct supervision of the ECB as of November 2014. Other banks are under indirect supervision of the ECB.

68. Since January 2014, all banks and investment firms have started to apply the new capital adequacy package (CRR) as the solvency framework. The areas of major importance covered by the Basel III which are directly incorporated in the CRR are: definition of own funds/minimum capital requirements for credit risk, counterparty credit risk, market risks, operational risk, liquidity requirements and requirements to monitor the level of the leverage ratio. The CRR contains a completely revised definition of regulatory capital which clearly distinguishes three categories of own funds: Core Tier 1 capital (CET 1 capital), additional Tier 1 capital (AT 1 capital) and Tier 2 capital (Tier 2 capital). The CRR follows a substance-over-form approach, *i.e.,* a capital instrument is classified under a certain capital class solely on the basis of the criteria of the CRR and irrespective of the relevant institution's legal form.

69. To strengthen capital adequacy, not only quantitatively, but also qualitatively, CET 1 capital now assumes particular significance. According to Article 96 of the CRR, institutions must, at all times, satisfy the following own funds requirements:

(a) a Common Equity Tier 1 capital ratio of 4.5%;

(b) a Tier 1 capital ratio of 6 %;

(c) a total capital ratio of 8 %.

70. The Capital Requirement Directive IV (CRD IV) and the Credit Institution Law provide for the possibility to impose several capital buffers. Amendments of the Credit Institution Law have enabled capital buffers to be implemented as of 28 May 2014. In addition to minimum Pillar 1 requirements, capital conservation buffer requirement of 2.5% (CET1) has to be met without a transitional period. The FCMC may set a systemic risk capital buffer requirement and from January 2016 also a countercyclical capital buffer requirement, a capital buffer for institutions (banks and investment firms) recognised as global systemically important institutions and a capital buffer requirement for institutions recognised as other systemically important institutions. CRR introduces two liquidity ratios: the liquidity coverage ratio (LCR) to ensure short-term liquidity for a period of 30 days, while the net stable funding ratio (NSFR) addresses medium-to-long-term liquidity. The LCR is applicable from 1 October 2015 and the NSFR will apply from 2018.

71. Two banks (subsidiaries of the EU parent banks) have permission to apply the IRB approach to calculate the Pillar 1 capital requirement for credit risk, and one of these banks also has permission to apply the AMA approach for calculation of the capital requirement for the operational risk. Other institutions apply the standardised approach to calculate the capital requirement for credit risk, and basic

indicator or standardised approach to calculate the capital requirement for operational risk. All institutions calculate capital requirement for market risk using the standardised approach.

72. There is a subset of banks that have focused on servicing non-resident customers (non-resident banks – NRBs) (see Section *III.C. Banks specialised in non-resident deposits* and below Box 1 for more details on NRBs). To address risks stemming from such a business model, Pillar 2 tools are used with capital add-on, depending on the share of loans to non-residents and the growth rate of lending to non-residents, as well as share and growth rate of NRDs, and individual liquidity ratio depending on the proportion of a non-resident bank's assets funded by non-resident deposits. Specifically, banks with more than 20% of assets funded by non-resident deposits are subject to:

- Additional Pillar 2 capital requirements which are based on a predefined quantitative criteria taking into account both the share of non-resident deposits and loans to non-residents in the balance sheet, as well as their growth rate;
- Annual review by the FCMC of additional capital requirements on an annual basis in order to ensure that any increase in risks is adequately reflected in capital add-on, monitored quarterly and adjusted if deemed necessary;
- On 1 November 2015, the reviewed minimum individual capital requirements for NRBs came into force which range from 0.4 to 7.6 percentage points.

73. Individual liquidity ratios are also set for non-resident banks:

- Within Pillar 2 individual minimum individual liquidity ratios (40%, 50%, 60%) for banks with more than 20% of assets funded by non-resident deposits introduced in March 2013

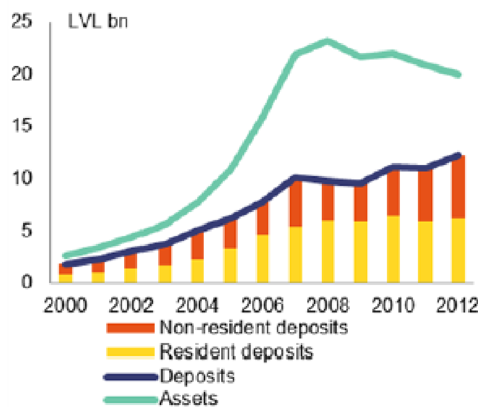
Non-resident deposits to total assets ratio	From 20% up to 40%	Greater than 40% up to 70%	Greater than 70%
Individual liquidity ratio	40%	50%	60%

- Individual liquidity ratio is to be set once a year for the upcoming 12 months monitored monthly and adjusted in relevant cases
- As of 1 November 2015, the 60% individual liquidity ratio is set for eight banks, 50% for five banks and 40% for one bank.

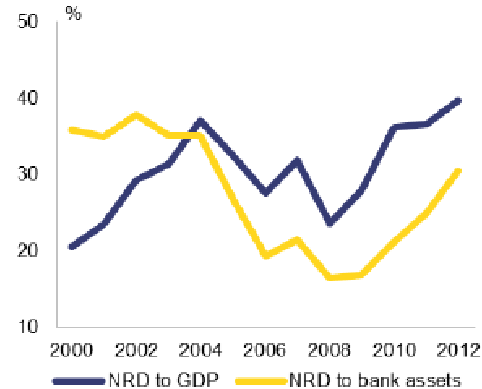
Box 1. Non-resident deposit and their impact on the Latvian banking sector
(Cited from European Commission, ECFIN Country Focus, Volume 11, Issue 6 (April 2014))

Non-resident banking in Latvia has enjoyed a long tradition and several competitive advantages, data for 2014 show that due to the crisis in 2008, there is renewed growth in this sector. Non-resident deposits are nearly half of all deposits, or 40% of GDP. While foreign banks are funded mainly from the parent bank, local, domestically-owned banks are reliant on non-resident deposits and specialize in financial services to non-residents.

Graph 1: Latvian bank indicators



Graph 2: Non-resident deposits (NRD)



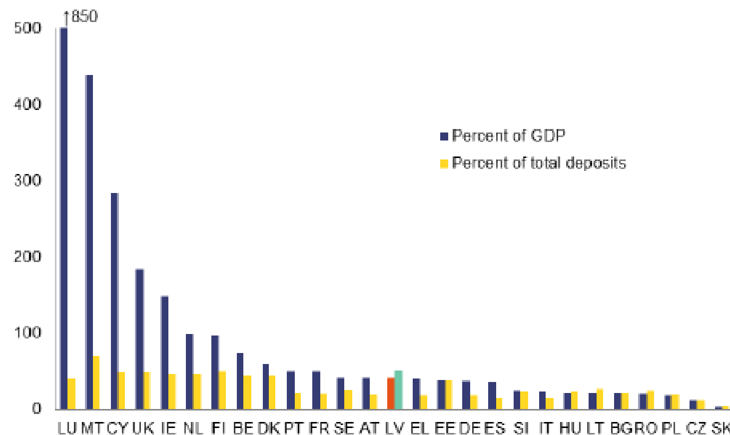
Source: Bank of Latvia

The ratio of bank assets to GDP at 130% is rather low compared to the average of EU banks at 352%, and far low than popular EU non-resident hubs like Luxembourg, Cyprus, Malta and Ireland. The FCMC has defined 14 banks as specialised in non-resident banking, with their assets accounting for less than 40% of total bank assets, but their share in total loans is less than 25%. However, their share in total deposits was more than 55%, thus marking an increase even since the last FSAP in 2012. Two thirds of assets and deposits of the non-resident banking segment are controlled by three banks: ABLV, Rietumu, and the state-owned Citadele. For ABLV and Rietumu, about 80% of their assets and liabilities are linked to non-resident deposits.

Loans to non-residents are skewed towards Commonwealth of Independent State (CIS) countries, with more than half of these loans having a residual maturity of less than a year.

The maturity of non-resident deposits is very short, with more than 85% being on-demand, primarily held for corporate transaction purposes (trade, insurance, salary payments). According to the FCMC 2013 estimates based on the indicated place of residency of the beneficial owners, around 80% of total non-resident deposits are de facto attributable to CIS businesses and individuals.

Graph 4: Non-resident deposits, end-2012



Source: National central banks

Engagement of non-resident banking entails significant risks, as Latvia itself has seen the costly bankruptcies of two banks focussed on non-resident banking. The failure of Parex triggered a deposit outflow and necessitated a request for international financial assistance.

While non-resident lending is less of a concern, the difficulty of assessing credit risk due to geographical and cultural barriers is of particular concern. The nature of non-resident deposits makes liquidity risk higher, especially as the deposits are larger and concentrated. There is also a recapitalisation risk, as individually-owned non-resident banks may face unstable funding availability.

There are three approaches that could be taken to limit the various risks associated with non-resident banking:

1. Limiting the size of this business relative to the financial sector and GDP, although this may impinge on equal treatment and free movement of capital, as well as having a limited effect.

2. Separating non-resident banking from the domestic economy to minimise negative spill-overs should things go wrong.

3. Specific regulatory oversight: several measures have been taken but should be reviewed regularly and developed further. Additional liquidity requirements were introduced by the FCMC in March 2013. Significant capital buffers have been established, but the leverage ratio (assets to equity) of non-resident banks is higher at 13 to 8 for resident banks.[3] FCMC has already started to apply differentiated Pillar 2 capital adequacy requirements to non-resident banks.

Source: European Commission, ECFIN Country Focus, Volume 11, Issue 6 (April 2014).

74. The Latvian authorities require that banks focused on NRBs business are subject to additional, much stricter, prudential capital and liquidity requirements (within Pillar II) – based on pre-defined quantitative criteria taking into account both the share of non-resident deposits and loans to non-residents in bank's balance sheet as well as their growth rate.

75. The FCMC requires all banks to carry out periodic liquidity stress-tests based on FCMC's prescribed scenarios to ensure that comprehensive contingency funding plans are in place to deal with adverse liquidity shocks. Contingency funding plans have to include:

- description of trigger events;
- detailed action plan, including measures to be taken and required timeframe; and
- potential accessible sources of funding and amounts that could be raised in case of adverse scenario.

76. The efficiency of existing contingency funding plans has to be reviewed at least once a year.

77. Banks and insurance companies have a duty to prepare public quarterly reports in order to inform the public regarding their activities and relevant financial indicators. The public quarterly reports must be published on their websites. The framework for financial reporting by listed companies is based on the Law on the Financial Instruments Market. It sets out when International Financial Reporting Standards are mandatory applicable and when Annual Accounts Law can be applied. Financial statements recognise reserves on the basis of IAS/IFRS as endorsed by the European Commission. Law on the Financial

[3] Banks with a non-resident business model may be more exposed to mispricing risks, as their leverage ratio (assets to equity) is above 13, which compares with a ratio of below 8 for resident banks. The high leverage is partly explained by the large share of foreign assets in the balance sheets of non-resident banks, which are mostly claims on foreign financial institutions and investments in foreign securities, so as to manage risks from the large proportion of demand deposits. The differentiated capital adequacy requirements to non-resident banks are meant to address these specific risk profiles.

Instruments Market requires listed companies to announce significant events of the company (through The Central Storage of Regulated Information).

78. Loan loss provisioning for supervisory purposes is regulated by the Credit Institution Law, Law on the Financial Instruments Market, and Regulation on Asset Quality Evaluation and Provisioning issued by the FCMC. It foresees that each bank has a written comprehensive loan review system, which ensures that the bank is able to assess its credit risk and estimate expected losses, and recognise provisions according to IAS/IFRS as endorsed by the European Commission. Banks shall also assess whether the accounting provisions are adequate to cover expected losses. In the event of material differences between the provisions for financial reporting purposes and supervisory purposes, which arise in situations where the expected losses exceed incurred losses, an entity's own funds are adjusted accordingly for the purposes of calculating capital requirements.

79. Exposures to a single counterparty or a group of connected counterparties are subject to a limit of 25% of the eligible capital of an institution, after taking into account credit mitigation. Where that client is an institution or where a group of connected clients includes one or more institutions, the value of exposures shall not exceed 25% of the institution's eligible capital or EUR150 million, whichever the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation, to all connected clients that are not institutions does not exceed 25% of the institution's eligible capital. Where the amount of EUR 150 million is higher than 25% of the institution's eligible capital, the value of the exposure shall not exceed a reasonable limit in terms of the institution's eligible capital. That limit shall be determined by the institution to address and control concentration risk. This limit shall not exceed 100 % of the institution's eligible capital.

80. Exposures of an institution to its parent company and its own subsidiaries can be exempted from the application of the large exposure limits in so far as such companies have been included in the consolidated supervision and the FCMC permits it.

81. An institution must report to the FCMC all large exposures. The ten largest exposures to others institutions and ten largest exposures to unregulated financial sector entities on a consolidated basis in any event should be reported. Section 43 of the Credit Institution Law and Section 122 of the Law on the Financial Instruments Market requires institutions to set the limits for transactions with persons related to an institution as 15% of eligible capital to the total of exposures to the persons related to the institution. This restriction shall not apply to intra-group exposures and the holdings of an institution in the share capital of those commercial companies in which the institution holds participation.

82. An institution shall develop sound procedures for management and collection information about exposures to related parties in order to identify and register in a timely manner all exposures of persons related to the institution and to supervise such exposures in accordance with the institution's policies in relation to the restriction of exposures including restrictions on exposures of persons related to the bank.

B. Financial stability oversight and macroprudential surveillance

83. Financial stability is monitored in cooperation of several institutions, in particular the Bank of Latvia, FCMC and the Ministry of Finance. Bank of Latvia is the macroprudential authority, while FCMC is the competent authority with microprudential tools and the designated authority with the macroprudential tools.

84. The Macroprudential Council was established in June 2013 as a collegial body based on a cooperation agreement between the Bank of Latvia, FCMC and the Ministry of Finance to discuss and cooperate on macroprudential issues. The Macroprudential Council has the power to issue non-binding

(comply or explain) recommendations. The FCMC has the more direct powers to implement any decisions that the Macroprudential Council might take. Bank of Latvia is entitled to receive necessary information for the execution of its tasks from the FCMC and other public institutions.

85. Currently, a number of macroprudential related requirements are being imposed on banks.

Table 5. Current macroprudential measures and microprudential measures with macroprudential impact

Instrument	Date of introduction
Additional capital requirements within Pillar 2 for the banks with the business model focused on servicing non-residents	June 2011 /January 2012
Individual liquidity ratio requirement for the banks with the business model focused on servicing non-residents	February 2013
Recalibration of additional capital requirements within Pillar 2 for the banks with the business model focused on servicing non-residents	November 2014
Early introduction of capital conservation buffer of 2.5%	May 2014
Setting of the countercyclical capital buffer for exposures with Latvian residents at 0%	January 2015
Introduction of the institution specific countercyclical capital buffer without the transitional period	January 2016
Cap of 90% LTV for newly issued mortgage loans to households exceeding 100 minimum wages	June 2007
Maximum LTV limit of 95% for household mortgage loans that are supported by a state guarantee	July 2014

Source: Bank of Latvia

86. The FCMC decided upon a countercyclical capital buffer rate for exposures to Latvian residents on a quarterly basis from January 2015. Considering the still weak credit developments, the countercyclical capital buffer for the exposures to Latvian residents was set at 0%, which will come into force in February 2016. Locally licensed banks will have to hold institution-specific countercyclical capital buffers from January 2016.

87. Latvia has developed the Action Plan for future financial crisis which is signed by the Ministry of Finance, the Bank of Latvia and the FCMC to reduce the likelihood of systemic financial crises and facilitate a possible financial crisis management and coordination of the activities of the institutions involved through a working party. The working group comprises the Minister of Finance, Governor of the Bank of Latvia and Chairman of the FCMC. The aim of this Action Plan is to provide rapid and systematic work and cooperation of all public authorities involved in the settlement of a possible financial crisis. The Action Plan defines the scope of the financial sector (in the narrow sense - banks, but in a broader sense - the investment firms, insurance companies and other financial institutions as well as companies where they can pose a threat to the stability of the financial system), financial markets, and payment and settlement systems. In case of a cross-border financial crisis, the relevant systemic assessment is to be carried out in accordance with the common set of guiding principles corresponding to the Latvian situation.

88. Macroprudential supervision includes tools to mitigate cyclical and structural systemic risks. The toolkit of macroprudential supervision includes capital buffer requirement for systemic risk, capital buffer requirement for systemically important institutions, countercyclical capital buffer requirement, and possibility to set higher risk weights, tighter large exposure limits, and liquidity requirements and to increase the frequency of disclosure or mandate additional disclosures by banks on the basis of financial

stability considerations. Additionally maximum LTV limit of 90% for all residential mortgage loans which equal or exceed 100 times minimum monthly wage is set in the Law on the Protection of Consumer Rights.

89. The implementation of CRD IV and CRR and Latvia's participation in the Banking Union along with its joining the EMU has brought big changes both in terms of micro- and macro-prudential regulation. Within the Single Supervisory Mechanism (SSM), the European Central Bank (ECB) takes part in micro- and macro-prudential oversight of Latvia's banking system and can introduce tighter macro-prudential measures. The three largest banks in Latvia are under the direct supervision of the ECB. Latvia's participation in the SSM brings a number of benefits: more effective supervision *inter alia* enhanced capability to counter excesses of the credit cycle; strengthened cooperation and synergy between national supervisors and the ECB. A single oversight system and single rulebook helps to minimise market distortions of competition arising from regulatory arbitrage opportunities and secure a level playing field in terms of competition among big cross-border and smaller domestic-oriented banks. Joining the euro area implies access to all liquidity support measures provided by the ECB.

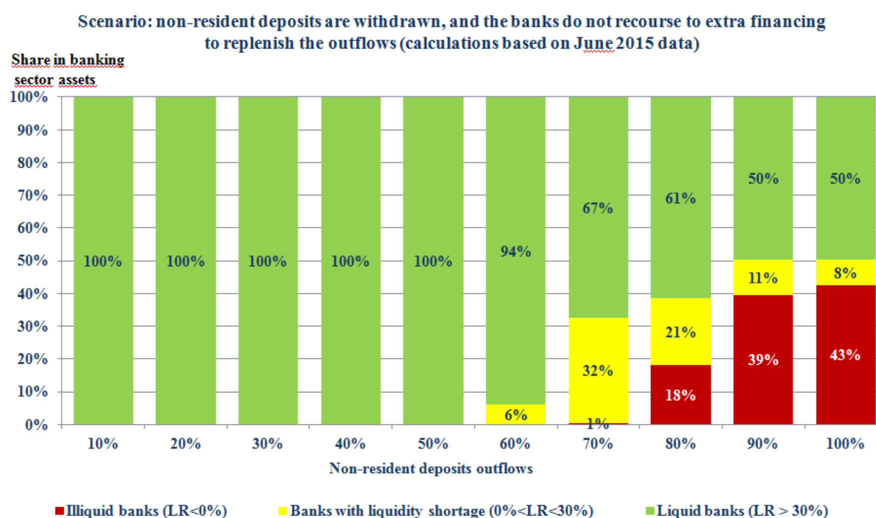
90. Participation in the Single Resolution Mechanism (SRM) along with implementation of the requirements of the new Bank Recovery and Resolution Directive is instrumental for addressing possible resolutions of systemically significant banks, as it will require a bail-in and will be backed by a common resolution fund financed by the industry. Latvia transposed the EU Recovery and Resolution Directive into national legislation on 16 July 2015. Thereby, the risk of adverse impact on the sovereign and the real economy will be substantially minimised. The SRM will have the capacity to handle large banks and complex situations in case such need arises.

91. Regular stress testing is an essential part of the financial stability assessment framework in Latvia. The Bank of Latvia conducts regular sensitivity analysis and stress tests in order to measure the resilience of credit institutions to different types of adverse shocks and shares the results with the FCMC. Stress tests include macroeconomic stress tests, liquidity stress tests (both conducted on a quarterly basis), stress tests based on market risk shocks (quarterly for foreign exchange risk and semi-annual for interest rate risk) and *ad hoc* stress tests based on specific assumptions (e.g. household vulnerability stress tests). Quarterly liquidity stress tests are based on various scenarios used for assessing the potential effects of the funding outflow on the banks' ability to fulfil their liabilities.

92. The FCMC conducts stress tests with the purpose to estimate impact of various adverse events on banking system or respective bank. The FCMC also supervises and assesses stress testing performed by individual banks.

93. One of the stress test scenarios has been if all banks could withstand a potential outflow of non-resident deposits of up to 60% (which is significantly higher than the one observed during the past crisis).

Figure 17. Liquidity stress test results of June 2015 for up to 60% outflow of non-resident deposits



Source: Bank of Latvia

94. As for macroeconomic stress tests, the stress scenario analysed the response of Latvia's economy to a combination of three shocks: a 10% fall in external demand, deterioration of investor confidence resulting in a 20% decrease in investments and 5% drop in private consumption. The stress test period covers four quarters from 1Q 2015 to 4Q 2015. The scenario assumes that the shocks of the decrease in external demand and investments affect the Latvian economy in the first quarter of 2015. The decline in private consumption caused by weakening consumer confidence follows with a lag of one quarter.

95. It is additionally assumed that in 2015 PD for the loans to residents of Russia, Ukraine and other CIS countries will grow to 25%, while LGD will constitute 75%. The same assumptions have been made in relation to securities issued by the CIS countries and claims on MFIs of the CIS countries.

96. To reflect the potential losses arising from investments in the CIS countries more accurately, the amount of investments made in these countries was specified according to the data provided in country risk reports.

Table 6. Results of macroeconomic stress test (December 2014)

Ratio	Stress scenario
Number of credit institutions with the total capital ratio below 8%	-
Number of credit institutions with the total capital ratio below 10.5%	1
Additionally required capital (millions of euro)	-
Potential losses (millions of euro)	618.8
Assets of those credit institutions whose total capital ratio is below 8% (% of total credit institution assets)	-
Additionally required provisions (% of total credit institution assets)	2.0

Source: Bank of Latvia

97. Under the stress scenario, the share of loans past due over 90 days would expand by 7.2 percentage points (to 14.3%) in the resident loan portfolio by the end of 2015. The quality of loans to non-residents is projected to deteriorate in accordance with assumed stressed PD.

98. Under the Deposit Guarantee Law, the FCMC ensures accumulation of funds with the Deposit Guarantee Fund, management of the Fund and payment of compensation to depositors in case of bank's insolvency. In exceptional circumstances, in order to ensure sufficient accumulation of funds in the Fund, the FCMC is entitled to increase the payments of deposit takers to the Fund providing that financial situation of a deposit taker does not deteriorate.

99. According to the Law on Recovery and Resolution of Credit Institutions and Investment Firms and Credit Institution Law, the FCMC as a national resolution authority has power to:

1) impose restrictions on bank activities;
2) apply bail-in procedure
3) apply asset separation tool;
4) arrange a takeover by another bank (sale of business or bridge institution tool);

100. Nevertheless FCMC exercises the granted powers as a supervisor as well, considering whether in specific cases it is necessary to apply to the court for insolvency procedure or withdraw a licence.

101. The FCMC have the mandate and powers to decide, whether or not to take resolution action in relation to failed institutions, or to liquidate it according to normal insolvency procedure, submitting appropriate application to the court.

102. At the beginning of 2013, the FCMC encouraged banks to develop their recovery plans and to submit them to the FCMC for review. The recovery plans were examined by the FCMC and the assessment was communicated to the particular banks. In some cases the banks were asked to make certain improvements in their recovery plans. The recovery plan should be reviewed once a year and this will be required by the law. On 16 July 2015, the law transposing the EU Recovery and Resolution Directive into national legislation came into force establishing that the FCMC is the national resolution authority responsible for preparation of resolution plans. However, with the Single Resolution Mechanism becoming applicable in Latvia from 1 January 2016, the Single Resolution Board will take over the responsibility for preparing resolution plans for significant banks and groups that are subject to ECB direct supervision and other cross-border banking groups. On 4 November 2014 Latvia ratified Intergovernmental Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, an essential part of the Single Resolution Mechanism, which can be used for resolution of banks.

C. Financial consumer protection and education

103. The Consumer Rights Protection Centre (CRPC), which is part of the Ministry of Economy, is the primary supervisory authority for consumer protection in financial services. As a member of the European Union, regulations concerning consumer protection in Latvia are in line with the European Union legislation.

104. CRPC supervises consumer credit, and licenses non-bank credit providers. CRPC can suspend the operation of a licensed non-bank credit provider up to six months and/or cancel the license if the company does not comply with requirements, has committed serious infringements in the field of data protection or consumer protection legislation or has provided false information to the CRPC. CRPC can impose fines of up to EUR14228.8.

105. On 28 May 2015, the Parliament has adopted amendments to the Consumer Rights Protection Law regarding online and SMS loans[4]. The proposal aims is to strengthen the requirements for the

[4] These are loans that can be borrowed through the exchange of SMSs.

assessment of the consumer's credit worthiness, to cap the total costs of the credit, restrict unreasonable default interest rates, "balloon payments" and the signing of credit agreements between 23:00 and 7:00. The amendments will come into force on 1st January 2016.

106. The Law on the Financial Instruments Market and Law on the Investment Management Companies states that financial service providers should provide consumers with key information of the fundamental benefits, risks and terms of the product, as well as should act in the best interest of client, ensure best execution requirements, avoid conflicts of interests and observe conduct of business rules.

107. The FCMC's Recommendations for Offering Packaged Investment Products to Retail Investors require that before executing a transaction (signing a contract), life insurance companies and banks provide to their customers or potential customers, who do not have the relevant experience, knowledge and competence in the area of finances, information about the nature of a packaged investment product, its objectives and related investment policy, risks, previous performance and likely future results as well as all costs of the product. Packaged investment product means the financial instruments where the amount repayable to the retail investor is subject to fluctuations in reference values or in the performance of assets which are not directly purchased by the retail investor. The FCMC monitors the correct application of the Recommendations.

108. FCMC receives complaints from clients in different financial sectors, reviews the complaints and checks the financial institution's conformity with the laws and its internal procedures. In case of breach of the normative regulations, an administrative case is initiated against the financial institution. If the client is of the opinion that the contract has not been properly accomplished and has caused damages, the client has the right to apply to a court to protect his interests.

109. In February 2014, strategic partners signed the memorandum on the implementation of the National Strategy for Financial Literacy in Latvia 2014–2020 aimed at promoting a progressive rise in the public financial literacy. Agreement on further cooperation was reached by the FCMC, Ministry of Education and Science, National Centre for Education, BA School of Business and Finance, Consumer Rights Protection Centre, Association of Commercial Banks of Latvia and Latvian Insurers Association. One of the strategic objectives in the area of financial literacy is to ensure provision of fair financial services adequate to the needs of consumers and encourage consumers to make weighted and informed choices based on risk-awareness and responsibility.

110. There are two dimensions for financial education in Latvia – enhancement of the general education curriculum based on competencies (including financial literacy) and lifelong education activities for adults. Regarding the first dimension – after public discussion "Directions for public finance education" (11/09/2012) hosted by the FCMC, an agreement was reached that the content of financial education will be worked out jointly by the financial sector and the Ministry of Education and Science of Latvia – the existing school curricula and educational programs will be developed by integrating the teaching materials and interactive tools enhanced by governmental institutions (including supervisory authorities) as well as financial sector participants. The next step of enhancement will be provided by National Education Centre (under the Ministry of Education and Science) taking into consideration Core Competencies Framework for Youth elaborated by OECD and International Network on Financial Education. The OECD PISA 2012 results presented in the summer of 2013 confirmed that the financial literacy level of Latvian schoolchildren is average at 501 points (the average level is 500). As to the second dimension – current lifelong financial education activities in Latvia are provided by all of the partners. Latvia is mostly focusing on adult's education via internet for widespread access. For example, in 2011, the FCMC launched an educational website CLIENT SCHOOL where consumers can find detailed information and descriptions of the main financial products, in 2015 the Client ABC and self-testing exercises were added.

In 2013 the Bank of Latvia launched another educational website "Money School" with teaching materials and interactive tools with a focus on money in economy.

111. Taking into account the results of the first National Survey on Financial Literacy (based on OECD Core Questionnaire), the FCMC has developed a new measurement system the Index of financial literacy for Latvian residents. Interactive tool was published on website. In addition, FCMC has compiled a summary of indicators featuring the Latvian household financial stability sustainability and comments on the situation as from year 2004 that would be useful information to understand the macroeconomic developments in the household context over the past decade.

E. International surveillance assessment (2012)

112. The IMF carried out a FSAP in June 2012, with key recommendations made to Latvia (Annex I). In terms of the banking sector, the FSAP notes that banks are hampered by a legacy of high non-performing loans from the crisis and lingering weaknesses in debt resolution framework. The overhang of NPLs, which reached 19% of total loans in 2011, has impacted loan provisions and its affordability, with interest spreads widening from 5% in 2008 to 9% in 2011. New lending often requires collateralisation and often for short terms.

113. The IMF report also points out that bank funding base remains reliant on foreign sources, which reduces the sustainability of credit growth going forward and creates a risk of deleveraging, which could translate into a continued progressive reduction in credit.

114. While a stronger legal framework implemented since the crisis has ensured better creditor rights and insolvency procedures, lingering weaknesses remain as to the capacity of the judiciary which results in higher costs and longer debt resolution. Recovery rates remain low, with higher than expected loan losses.

115. In the FSAP review, the Latvian authorities claim that policy making to curb excessive lending in 2004 – 2007 was constrained both by the EU legal framework and the single market for financial services, which provided ample opportunities for circumvention of national measures. Analysis of potential policy tools clearly demonstrated that they were either incompatible with the *acquis communautaire* or would provoke redistribution of market shares (branches vs subsidiaries, regulated lenders vs unregulated) without affecting the aggregate result. The problem has been addressed via the implementation of the macroprudential instruments from the CRDIV toolkit into Latvian legislation and introduction of reciprocity requirement (mandatory recognition for CCB (countercyclical capital buffer) up to 2.5%, while full voluntary reciprocity for CCB and other exposure based macroprudential tools promoted by ESRB and within Nordic-Baltic region) to ensure the effectiveness of national measures in future.

116. The IMF report also suggests that the Latvian authorities could consider the appropriateness of implementing measures aimed at encouraging banks to gradually expand their funding to local sources such as local bond markets.

VI. International financial integration

A. Recent developments in cross-border investment

117. Latvia's measure imposing higher liquidity and capitalisation requirements for banks offering non-resident deposits creates a disincentive for the conclusion of such operations. As such it is a restrictive measure and a reservation is being proposed under item XI/A (Operation by non-residents of accounts with resident institutions) of the CLCM.

118. Net foreign assets (foreign assets minus foreign liabilities) excluding official reserves were EUR21.1 billion (91.5% of GDP). At the end of Q3 2013, net FDI stock in Latvia was 44.4% of GDP.

119. Below outlines the preferential treatment that EU/EEA countries are afforded by Latvia:

- Preferential treatment for EU/EEA countries, required by EU law: Latvia maintains measures constituting restrictions under the OECD Codes of Liberalisation and introducing discriminatory treatment vis-à-vis non-EU parties in compliance with EU law regarding foreign investment regarding an incorporation requirement to offer depositary services in Latvia for UCITS and alternative investment funds (AIFs) (covered by items I/A of the CLCM and E/7 of the CLCIO).

B. Securities and other financial market instruments

120. Capital inflows are mostly in the form of foreign direct investments, attracting foreign institutional investors who are looking to diversify their investment portfolios. The most popular (by volume) and liquid assets are Latvian government eurobonds. Capital outflows (or stop in inflows) were recorded for 2009 and 2010 after a decade of high inflows. In recent years, capital inflows moved to a more sustainable and stable level (capital account deficit was 2.5% of GDP in 2012).

121. MFIs (monetary financial institutions) account for the largest share of foreign assets and liabilities. Foreign assets held by the MFI sector constitute 38.1% of total foreign assets, whereas MFI foreign liabilities are 36.2% of the total foreign liabilities. The main positions in foreign liabilities are non-resident deposits and Scandinavian parent bank funding, with non-resident deposits expected to continue growing.

122. Regarding depositary services of alternative investment fund (AIF), Latvia proposes to lodge a reservation under item E/3 Settlement, clearing and depositary services of the Code of Liberalisation of Current Invisible Operations (CLCIO) to reflect the provision set in article 21 of the EU Directive 2011/61/EU and in article 47 of the Law on Alternative Investment Funds and Managers.

123. Regarding the establishment of depository, EU Directive 65/2009/EEC (with EEA relevance) requires that a depository of an undertaking for collective investment in transferable securities (UCITS) must either have its registered office in the same EU country as that of the undertaking or be established in the EU country if its registered office is in another EU country. As this requirement is mandatory, Latvia proposes to lodge a reservation under item I/A of the Code of Liberalisation of Capital Movements (CLCM) and item E/7 (conditions for establishment and operation of branches, agencies, etc. of non-residents investors in the banking and financial sector) of the Code of Liberalisation of Current Invisible Operations (CLCIO).

C. Market access for foreign institutions and investors

124. There is no difference in regulatory requirement between domestic and foreign service providers with establishment. The only difference in the tax treatment between domestic credit institutions (banks) and all other domestic companies is the possibility for banks to reduce the taxable base for amounts transferred into special provisions for bad debts. Branches of foreign banks can also use this option to create a special provision for bad debts.

125. Non-EEA financial institutions are not permitted to carry out cross-border transactions with Latvian residents. Only through establishment of a branch or incorporation they can provide financial services.

126. For alternative investment funds and managers from non-EEA countries to carry out cross-border operations, the home country should not be listed as a non-cooperative country and territory by the Financial Action Task Force. The country in which the fund is established should conclude an agreement that is in line with the OECD Model Tax Convention on Income and Capital.

127. There is no difference in fit and proper tests, including for the general manager of the branch or agency, for foreign entities seeking initial authorisation as a branch or agency, in comparison with the requirements for domestically incorporated providers. There is no difference in capital and surplus requirements, or financial guarantees for foreign entities seeking initial authorisation as a branch or agency, in comparison with the requirements for domestically incorporated providers.

128. There is no difference regarding investor protection measures for foreign entities seeking initial authorisation as a branch or agency, in comparison with the requirements for domestically incorporated providers.

VII. Compliance with the OECD legal instruments on financial markets

Recommendation of the Council on High-Level Principles on Financial Consumer Protection

Latvia accepts this recommendation.

Recommendation of the Council on a Policy Framework for Effective and Efficient Financial Regulation

Latvia accepts this recommendation.

Recommendation of the Council on Good Practices on Financial Education and Awareness Relating to Credit

Latvia accepts this recommendation.

Recommendation of the Council on Principles and Good Practices for Financial Education and Awareness

Latvia accepts this recommendation.

Recommendation of the Council concerning the Minimum Disclosure and Procedure Rules to be Complied with before Securities may be Offered to the Public

Latvia accepts this recommendation.

Recommendation of the Council concerning Regulations for the Public Offer and for Stock Exchange Listing or Quotation of Foreign Securities

Latvia accepts this recommendation.

Recommendation of the Council concerning Disclosure Requirements and Procedures to be Applicable to all Publicly Offered Securities

Latvia accepts this recommendation.

Recommendation of the Council concerning the Review of any Restrictions which Member Countries Impose on Portfolio Investment in Unlisted or Unquoted Securities

Latvia accepts this recommendation.

Recommendation of the Council concerning Standard Rules for the Operations of Institutions for Collective Investment in Securities

Latvia accepts this recommendation.

Recommendation of the Council on International Security Issues

Latvia accepts this recommendation.

ANNEX: FSAP RECOMMENDATIONS

BANKING SECTOR		
Banking sector	- Maintain close monitoring of NPLs, addressing impending obstacles for effective resolution (see insolvency framework recommendations below).	Immediate
	- Actively seek to reduce the risk of de-leveraging through close coordination with other Baltic authorities, and collaboration with Scandinavian and European counterparts aimed at avoiding excessive withdrawal of parent funding or the deleveraging from Latvia.	Immediate
	- Monitor closely the evolution of the loan-to-deposit ratio and promote progressive reduction – albeit avoiding provoking undue deleveraging by banks.	Immediate
	- Develop measures to reduce dependence on foreign funding, including:	
	a) Develop measures to encourage increased domestic savings and depositors' confidence, including efficient handling of depositor claims stemming from Kraijbanka.	Immediate
	b) Encourage banks to issue bonds in the local capital markets to reduce dependence on foreign funding.	Medium Term
GOVERNMENT PROGRAMS		
Government support programs	- Consolidate the various programs supporting access to finance to the private sector under a single agency to avoid duplicity and enhance efficiency.	Immediate
	- Avoid providing a banking license to such agency so as not to create unfair competition with private banks.	Immediate
	- Avoid or minimize direct lending by government support institutions to leverage the existing expertise and networks of private financial institutions and avoid creating undue competition and market distortions. Any direct lending should be made transparently and with regular reviews to ensure that government support programs are not crowding-out commercial lenders.	Short term
	- Implement a formal monitoring and evaluation framework to a) clearly identify the market gaps or deficiencies that the programs are aiming to address; b) measure the	Short term

	additionality of support programs; c) assess the effectiveness of the support programs in reducing targeted market gaps, and; d) quantify the impact of support programs on the companies benefiting from their support. - Consider the introduction of streamlined processes for the provision of PCGs. - Consider the feasibility of a portfolio or hybrid guarantee approach, which would reduce the cost and time of loan guarantee approvals. - Reconsider the need for introduction of Mezzanine loans, assessing a) whether these instruments indeed address a market gap, b) the impact that these instruments have on firms as they may lead to higher financing costs, c) whether a market gap could be covered through other instruments such as PCGs.	Short term Short term Short term
NON BANK FINANCIAL INSTITUTIONS AND CAPITAL MARKETS		
Leasing	- Improve the implementation of repossession laws to reduce the burden on overloaded courts and facilitate the development of leasing of non-movable assets such as machinery. - Consider the introduction of a "Deed Registry", which would enhance certainty for leasing firms by allowing registry of their ownership of leased assets (such as machinery and equipment) and prevent use of such assets by lessors as collateral on other loans. - Consider the introduction of a Leasing Act, which would benefit judges, lenders, and customers by defining an expedited process in the case of default.	Immediate Short term Medium term
Factoring	- Consider temporarily extending the Export Credit Guarantees provided by LGA to cover EU markets following the experience of other Baltic countries, and given a) the importance of these markets for Latvian exports, b) the increased risk of default by European wholesale buyers of Latvian products and, b) the lack of similar instruments provided by commercial trade credit insurers at present. - Consider the creation of a "Deed Registry", for the registration of the receipt and transfer in ownership of accounts receivable.	Short term Short term
Capital markets	- Consider a yearly reporting of capital gains instead of a quarterly reporting for investors with small positions. - Assess the need to privatize state owned companies and list them on the NASDAQOMX Riga. This may result in increased appetite from domestic and foreign investors to consider investments in Latvia and the Baltic region and lead to spin-offs like the creation of a Baltic SME fund or a Baltic Exchange Traded Fund. - Make increased use of the domestic capital markets for public issuances, with the objective to maintain an active benchmark curve and market at all maturities. - Enforce disclosure regulations and exchange rules. This may increase transparency and confidence of investors and thus increase trading activity. One possibility is to establish specialized courts of arbitration. Also training judges may	Short term Medium term Medium term Medium Term

	be helpful, to ensure they have the required expertise in corporate and securities law.	
Pension Funds	- Restore the contribution rate to the 2nd pillar, among others, to maintain a sizable institutional investors' base. - Revise the investment regulation of pension funds to ensure that the objectives of pension fund managers are aligned with the long-term objectives of contributors.	Short term Short term
CREDIT MARKET INFRASTRUCTURE		
Credit information	- Expand the scope and coverage of credit information in the country to a) include information from non-financial creditors and, b) enable access to commercial creditors to debtors' relevant credit history with financial institutions.	Short term
Insolvency framework	- Specialize a number of judges in dealing with commercial and insolvency cases and provide judges with higher number of training courses related to commercial law, insolvency and basic financial issues. - Enhance procedural rules by: (1) establishing alternative means of notification of enforcement to debtors who cannot be found or whose actual domicile is unknown; and, (2) precluding postponement of court hearings due to frivolous request of the parties (3) reducing auction publication costs and the bailiffs fees scale, in particular for auctions of high value real estate. - Amend the housing legislation to facilitate the eviction of tenants and the transfer of possession to buyers of property sold in auction. - Reconsider plans to grant priority over all other claims, including secured credits to building administration expenses and debts for heating and natural gas supplied to a homeowner.	Immediate Short term Short term Short term
Payment Systems	- Consider stimulating the use of e-money instruments by 1) investigating the added value of these instruments for payments in rural areas; and 2) developing a central bank strategy to increase the availability and use of these instruments.	Medium term
Consumer Protection	- Consider enhancing the institutional capacity of CRPC to undertake adequate oversight of money lenders - Enhance consumer protection trough collection and publication of APRs charged by moneylenders.	Short term Immediate
Enterprise sector	- Undertake an assessment of informality aimed at identifying causes and devising strategies or instruments to reduce it as a way to facilitate the development of sustainable cash flow based credit practices.	Short term