

Financial Sector Development Plan 2021-2023

Content

Summary	5
1. Background	6
2. Objective and courses of action of the plan	12
3. Availability of financing and investment potentialities	13
3.1. Lending	13
3.2 Capital market	16
3.3 Developing the use of alternative forms of financing	21
3.4 Pension funds	22
3.5. Insurance	25
3.6. Household savings and investment	27
3.7. JSC “Development Financial Institution Altum” support programmes	28
3.8. International Financial Institutions Financial Mechanisms	29
4. Digitisation and accessibility to innovative services	44

4.1. EU policies to promote the digital transition and innovative financial services.....	44
4.2. Financial sector innovation and digitalisation of financial services.....	47
4.3. Non-bank financial sector	51
4.4. Data openness and digitisation in Latvia	55
5. Sustainable finances.....	64
5.1. EU initiatives on climate change and sustainable finance	65
5.2. Green bonds in Latvia	68

ABBREVIATIONS USED

ALTUM	JSC Development Financial Institution Altum
BIS	Bank for International Settlements
CFCA	Central Finance and Contracting Agency
ECB	European Central Bank
EIB	European Investment Bank
EC	European Commission
MoE	Ministry of Economics
CEB	Council of Europe Development Bank
EBRD	European Bank for Reconstruction and Development
EU	European Union
ESG	Environmental, Social and Governance issues
FATF	Financial Action Task Force
FIS	Financial Intelligence Service
FCMC	Financial and Capital Market Commission
MoF	Ministry of Finance
FSDB	Financial Sector Development Board
MoI	Ministry of the Interior
IFC	International finance corporations
MoES	Ministry of Education and Science
LAI	Latvian Association of Insurers
AFSAL	Alternative Financial Services Association of Latvia
BoL	Bank of Latvia
FLA	Finance Latvia Association
IDAL	Investment and Development Agency of Latvia
MoW	Ministry of Welfare
LMENA	Association of Payment Services and Electronic Money Institutions of Latvia

LVCA	Latvian Venture Capital Association
Cabinet	Cabinet of Ministers
MONEYVAL	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
SMES	Small and Medium Enterprises
Nasdaq	Nasdaq Baltic Exchange
NFRD	Non-financial Reporting Directive
OECD	Organisation for Economic Cooperation and Development
PKC	Cross-Sectoral Coordination Centre
OCMA	Office of Citizenship and Migration Affairs
PSD2	Payment Services Directive
CRPC	Consumer Rights Protection Centre
SEPA	Single Euro Payments Area
IFI	International Finance Institutions
MoT	Ministry of Transport
STARTinLV	Latvian Association of Start-up Companies
MoJ	Ministry of Justice
RE	Register of Enterprises
MEPRD	Ministry of Environmental Protection and Regional Development
SRS	State Revenue Service
Treasury	The Treasury
SP	State Police
NIB	The Nordic Investment Bank

Summary

In Paragraph 17 of the Declaration on the intended activities of the Cabinet of Ministers headed by Arturs Krišjānis Kariņš, the parties forming the Government have agreed to implement a financial market policy that promotes the competitiveness of the financial sector and digital development by supporting economic growth.

In order to determine the objectives of the financial market policy and measures for the development of the financial sector in the medium term, the Financial Sector Development Plan for 2021-2023 (hereinafter - the Plan) has been developed, providing an assessment of the financial sector performance and setting achievable priorities and results, at the same time stating the responsible entities for the fulfilment of tasks, indicating completion dates for the tasks, results to be achieved and procedures for monitoring execution of the plan.

The measures included in the plan aim to continue to support an innovative and accessible financial sector that promotes and supports sustainable economic development by identifying the following priority development directions:

- Availability of financing and investment potentialities;
- Digitisation and accessibility to innovative services;
- Sustainable finances.

1. Background

During the development of the plan, the Covid-19 pandemic has caused a widespread and severe public health crisis and the restrictions imposed to reduce the spread of the pandemic have a significant impact on economic activity. Since the beginning of 2020, more than 2 million lives have been lost worldwide due to Covid-19, and this number continues to rise. The scale of the health crisis and the policy measures taken to contain the pandemic are unprecedented. In light of high uncertainty as to the time required for containing Covid-19, the economic development forecasts of both the world and Latvia have undergone quite harsh corrections and such corrections are still on the agenda. Until the vaccine or appropriate drugs are widely available, the situation will be characterised by high uncertainty and risks. According to the EC's autumn 2020 economic forecast, the recovery is slowing down as the resumption of the pandemic deepens uncertainty. Economic activity in Europe experienced a severe turmoil in the first half of 2020, but recovered sharply in the third quarter as restrictive measures were gradually lifted. However, the resumption of the pandemic is causing growth to slow as new restrictions are introduced. According to the autumn 2020 economic forecast, the Eurozone economy will shrink by 7.8% in 2020, while it will grow by 4.2% in 2021 and by 3% in 2022. According to this forecast, the EU economy in 2020 will shrink by 7.4%, while it will grow in 2021 by 4.1% and in 2022 by 3%¹. Compared to the summer 2020 economic forecast, growth forecasts for both the Eurozone and the EU are slightly higher for 2020 and lower for 2021. Neither the Eurozone nor the EU is expected to return to pre-pandemic levels by the end of 2022. According to the International Monetary Fund's October 2020 GDP forecasts, global GDP will decline by 4.4% in 2020, which is a slightly smaller decline in GDP than forecast in June.² This is mainly due to data from the second quarter of 2020, which show a smaller decline in GDP in developed countries than previously forecast. The medium-term macroeconomic development scenario for 2020-2023 developed by the Ministry of Finance in June 2020 has been developed on the basis of conservative assumptions, taking into account GDP data for the first quarter of 2020 and short-term macroeconomic information available until June 2020, as well as the support measures approved by the Government to mitigate the effects of the Covid-19 crisis on the economy. According to this scenario, Latvia's gross domestic product will decrease by 7.0% in 2020 and in 2021 Latvia's gross domestic product will increase by 5.1%.

In response to the virus crisis, Latvia and other EU Member States have introduced emergency restrictions and financial support measures to mitigate the effects of the restrictions. The turmoil caused by the pandemic was simultaneous but asymmetric for EU economies, as tougher

¹ https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/autumn-2020-economic-forecast_en

² <https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020#Full%20Report%20and%20Executive%20Summary>

measures to limit the spread of the pandemic in the affected countries resulted in a major economic shock. The slowdown in economic activity and the support measures introduced will lead to much higher budget deficits and an increase in the level of government debt. The EU Member States have agreed that, for the first time since 2011, when the Stability and Growth Pact includes a general exception clause, all the preconditions for the entry into force of this exception clause have been met.³ This will allow Member States to channel financial resources to the healthcare system and to mitigate the economic consequences of Covid-19. According to the EC's autumn 2020 forecast, the general state budget deficit in the Eurozone is projected to increase from 0.6% of GDP in 2019 to around 8.8% in 2020. The ratio of total Eurozone government debt to GDP will increase from 85.9% of GDP in 2019 to 101.7% in 2020. The Annual Sustainable Growth Strategy 2021 published by the EC envisages the continuation in 2021 of the general exception clause from the provisions of the Stability and Growth Pact, launched in the context of Covid-19.

In response to the harsh deterioration of the economic situation due to the Covid-19 crisis, the central banks of the countries of the world have strengthened the monetary stimulus. On 15 March 2020, the US Federal Reserve System reduced the basic interest rate to 0-0.25%, but, on 23 March, announced the acquisition of government securities in an unlimited amount to help overcome the effects of the Covid-19 crisis. On 19 March 2020, the ECB, in turn, launched the government and corporate bond - buying programme (Pandemic Emergency Purchase Programme, PEPP) in the amount of 750 billion euros. The ECB also increased the volume of its existing asset acquisition programme, eased the conditions for longer-term targeted operations, and launched longer-term targeted operations in a pandemic. In June and December 2020, the volume and duration of the PEPP programme were further increased to 1,850 billion euros and at least until the end of March 2022. In Latvia, several credit institutions participated in longer-term targeted operations III. At the June and September auctions, they requested and received a total of 1.26 billion euros in loans. As the Covid-19 crisis lasted, longer-term targeted operations III were also recalibrated, both by extending the special grace period for these operations and by carrying out additional longer-term targeted operations in 2021.

In early April of 2020, the Eurogroup agreed on three EU-level financial support instruments that provide more than 500 billion euros to support employees, businesses and government at the national level with support measures implemented in the EU countries that are adversely affected by the Covid-19 crisis. The ESM credit line, launched in May, provides immediate lending potentialities to Eurozone countries of up to 2% of a

³ The general exception clause allows Member States to take budgetary measures to deal adequately with this situation. As regards the preventive part, Articles 5 (1) and 9 (1) of Regulation (EC) No. 1466/97 state that “a period of severe economic recession in the Eurozone or in the Union as a whole may temporarily allow Member States not to make the targeted adjustment path towards the medium-term objectives with the precondition that fiscal stability of the medium-term is not jeopardised” - Communication from the Commission to the Council on the mobilisation of the general exception clause of the Stability and Growth Pact - <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid = 1591119459569 & uri = CELEX: 52020DC0123>.

specific country's GDP to cover health care and socio-economic costs related to the Covid-19 crisis. The ESM credit line totals 240 billion euros. In May, the EIB set up a Pan-European Guarantee Fund in support of EU business, in particular small and medium-sized enterprises, which aims to attract investments in the amount of around 200 billion euros. The EIB Fund provides guarantees or investments in corporate capital. In September, a 100 billion euro European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) was launched, giving Member States the opportunity to borrow from the EC.

In May 2020, the EC presented a proposal for a European Recovery Instrument, a unique instrument for raising short-term additional funding to support the EU economy in overcoming the Covid-19 crisis. Its funding complements that of the EU's multiannual budget. According to the agreement reached by the European Council on 17-21 July 2020, the European Recovery Instrument will generate 750 billion euros (at 2018 prices, 807 billion euros at current prices) in the issue of debt securities at the EU level: 390 billion euros (421 billion euros in current prices) will be paid out as grants and 360 billion euros (386 billion euros in current prices) will be granted to Member States in the form of loans and financing will be integrated into the EU budget and used for the financing of the EU budgetary framework, including the Recovery and Sustainability Mechanism. The EU's borrowing in international financial markets is scheduled to be repaid by 2058. The 30% climate target will be applied to the total expenditure of the EU's multiannual budget and the European Recovery Instrument, and this will be reflected in the relevant targets in sectoral legislation. Within the framework of the programmes financed by the European Recovery Instrument, Latvia could receive grants of up to 2.3 billion euros (2018 prices, of 2.5 billion euros in current prices) in total and up to 2.3 billion euros (2018 prices, of 2.5 billion euros) in loans.

In the last two years, the Latvian banking sector, which is the main intermediary institution for lending to companies and individuals and providing payment services, has been changing the composition of its owners, market shares and operating models. The number of foreign customers and the volume of services provided to them has decreased significantly. As a result of these changes, credit institutions' profits have declined, but credit institutions' average returns are above the EU average. In 2019 and 2020, corporate and individual crediting was weak. While the cautious crediting supply and demand remains, it could have a detrimental effect on the recovery of economic growth following the crisis caused by the Covid-19 pandemic. The Latvian capital market is still underdeveloped. Judging by the stock market capitalisation against GDP, Latvia is in last place among the EU countries, lagging significantly behind the neighbouring countries as well. As there are relatively high barriers to entry in the financial services sector, the support of supervisors is also crucial in fostering innovation and the entry of new players into the market. For some alternative financial service providers, such as mutual lending platforms, the licensing process is still ongoing, which creates confusion about the regulatory framework until the relevant licence is issued. It must be taken into account that in accordance with the regulatory framework at EU

level⁴, from 10 November 2021, it will also be possible to license European crowdfunding providers.

The year 2019 in the Latvian financial sector was marked by the implementation of Moneyval and FATF recommendations. Within the framework of the Moneyval and FATF evaluation processes, which was concluded in February 2020, it has been recognised that Latvia is the first Moneyval member state and the second country in the world to be assessed as at least “largely compliant” with all 40 FATF recommendations. Experts have acknowledged that Latvia has established a strong and sustainable financial crime prevention system, as a result of which Latvia's inclusion on the “grey list” has been prevented, which could have caused significant damage to Latvia's reputation. The positive assessment, confirming the country's ability to make significant changes in the financial system in a relatively short period of time, has strengthened Latvia's role as an important international partner in the international arena. The high assessment is based on the fact that the regulation of the prevention of money laundering and terrorist and proliferation financing has been significantly improved, the capacity of the competent authorities has increased and their performance has improved, and risk tolerance has decreased. Therefore, it is important to continue work in the field of anti-money laundering and terrorist and proliferation financing during the term of this plan and appropriate policy measures are included in the “Action Plan for the Prevention of Money Laundering, Terrorism and Proliferation Financing in the period from 2020 until 2022 approved by the Cabinet of Ministers”⁵ and supplemented by a plan of measures approved by the Financial Sector Development Council on 27 November 2020 to strengthen a proportionate approach by meeting the requirements for the prevention of money laundering and terrorist and proliferation financing. The implementation of the measures included in the plan approved by the Cabinet of Ministers and the Financial Sector Development Council will promote the effective and risk-based implementation of anti-money laundering and anti-terrorist and anti-proliferation financing requirements, which would ensure the further sustainable development of the sector and ability to finance the economy.

To strengthen the anti-money laundering and anti-terrorism and anti-proliferation framework at the EU level, EC proposals for a legislative package on anti-money laundering, anti-terrorist and anti-proliferation financing are expected in 2021. It is important for Latvia to implement EU-level measures in this area, improving the EU-level monitoring system and strengthening cooperation with third countries. We also see the need to set up an independent and institutionally independent anti-money laundering supervisory authority at the EU level and to strengthen the EU legal framework with uniform requirements by drafting a new regulation to complement existing directives in this area. At the same time, we support the further strengthening of cooperation between Member States' financial intelligence services, including by promoting the research and

⁴ Regulation No. 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for businesses and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937

⁵ <https://likumi.lv/ta/id/317729-par-pasakumu-planu-noziedzigi-iegotu-lidzeklu-legalizacijas-terorisma-un-proliferacijas-finansesanas-noversanai-laikposmam>

development of technological solutions to strengthen financial intelligence, crime identification and prevention.

At the end of 2019, the EC launched the European Green Deal, a roadmap for making the EU economy sustainable, using climate and environmental challenges to create opportunities in all policies and making restructuring fairer and more inclusive for all. The European Green Deal covers all sectors of the economy, in particular transport, energy, agriculture, ICT and chemicals. Achieving the goals of the European Green Deal will require significant investment. The financial system has a key role to play in this process and can be part of the solution to a greener and more sustainable economy. The financial sector has developed rapidly in terms of sustainable finance and sustainability. The reorientation of private capital towards more sustainable investments requires a comprehensive change in the functioning of the financial system:

- reorient capital flows towards sustainable investment to ensure sustainable and inclusive growth;
- manage the financial risks arising from climate change, resource depletion, environmental degradation and social problems;
- promote transparency and a long-term perspective on financial and economic activity.

In April 2019, during the spring meeting of the Governors of the World Bank and the International Monetary Fund, a voluntary organisation, the Coalition of Finance Ministers for Climate Action, was established. The Coalition currently has 52 countries, 15 of which are EU Member States (Austria, Cyprus, Denmark, Finland, France, Germany, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Spain, Sweden and Portugal). The aim of the Coalition is to promote national and global action to mitigate the effects of climate change through fiscal policy, public financial management and attracting private financing, as well as promoting investments and the development of a financial sector that supports climate change mitigation and adjustment policies. To this end, the exchange of national experiences on relevant policy-making will be facilitated and a forum will be provided for the promotion of common standards and best practices. Latvia joined the Coalition on 24 September, 2019.

The financial sector is the largest user of digital technologies and a major contributor to the digitalisation of the economy and society. Although financial innovation is not new, investment in technology and the pace of innovation have increased significantly. In particular, the impact of Covid-19 has led to an increase in demand for digital services, which existing financial and capital market participants have successfully met by offering flexible financial services solutions adapted to a changing environment. Financial technology solutions are changing widely, altering the financial sector and the way consumers and businesses access services. Financial technology presents both opportunities and new challenges for regulatory compliance and supervision. Financial technology also poses risks related to cyber security, data, consumer and investor protection,

and market integrity.

Since 2014, the “National Strategy for Financial Literacy in Latvia 2014-2020” has been implemented. Within this framework, the FCMC, as the national coordinating institution, regularly monitors financial literacy, evaluates the achievement of the set goals, conducts a financial literacy survey of the Latvian population and determines the financial literacy index of the population. Available data show that the set financial literacy targets are partially met: household savings are increasing, the number of participants in tier 3 of the pension system has increased, the number and volume of household overdue loans and household non-bank overdue loans has decreased significantly, and the household loan-to-deposit ratio is improving. However, the Financial Literacy Index developed by the FCMC, within which the attitudes and habits of the population are analysed, indicates that it is necessary to promote the financial literacy of the Latvian population even more purposefully. The index is gradually increasing: In 2015, the average population result was 21.2 points (out of 99), but in 2019 - 21.7, however, faster growth is needed. Improvements in savings and investment are particularly important for citizens to ensure their financial resilience to external disadvantages, to be able to compare different services and to make informed decisions, including borrowing responsibly, avoiding financial fraud attacks and being able to track the digitalisation of services.

2. Objective and courses of action of the plan

The plan is designed to determine the medium-term development directions of the financial sector policy, providing an assessment of the financial sector's performance and determining the priorities and results to be achieved.

The measures included in the plan aim to continue to support an innovative and accessible financial sector that promotes and supports sustainable economic development by identifying the following priority development directions:

- Availability of financing and investment potentialities;
- Digitisation and accessibility to innovative services;
- Sustainable finances.

3. Availability of financing and investment potentialities

An efficient financial sector is an important factor in economic development in order to be able to channel funding to companies that are well-capitalised, managed and pay taxes in good faith, while also stimulating savings by enabling free funds to make money. It must be concluded that the ability of the Latvian financial sector to perform this function cannot currently be assessed as fully effective. Credit institutions remain the main source of funding, while the capital market and other alternative sources of funding are less developed.

The economic recovery will largely depend on the future spread of Covid-19. Preventing the effects of the spread of the virus and the availability of funding in the future will be key factors in preventing the current recession from becoming an economic depression. The Latvian financial sector has been able to respond effectively - moratoriums were promptly adopted during Covid-19 (deferred liabilities exceed 1 billion⁶), most services were provided remotely, seniors were given the opportunity to pay bills by telephone, etc. In the long run, the normalisation of policies and a self-sustaining economy will be important, as will the ability of the financial sector to effectively access financing, especially for the SMEs that were hit the hardest by the pandemic.

3.1. Lending

Although in Latvia the indicators of capital and liquidity, asset quality and return on capital and assets of credit institutions are better than the EU average⁷, Latvia is a Eurozone country and directly benefits from the ECB's supportive monetary policy, lending activity remain low. At the end of 2019, the banks' loan portfolio has shrunk to around 32% of GDP, and lending activity remain on a negative trend.

⁶ <https://www.financelatvia.eu/news/moratoriju-terminu-ietvaros-saistibu-izpilde-atlikta-11-miljarda-eiro-apmera/>

⁷ <https://eba.europa.eu/risk-analysis-and-data/risk-dashboard>

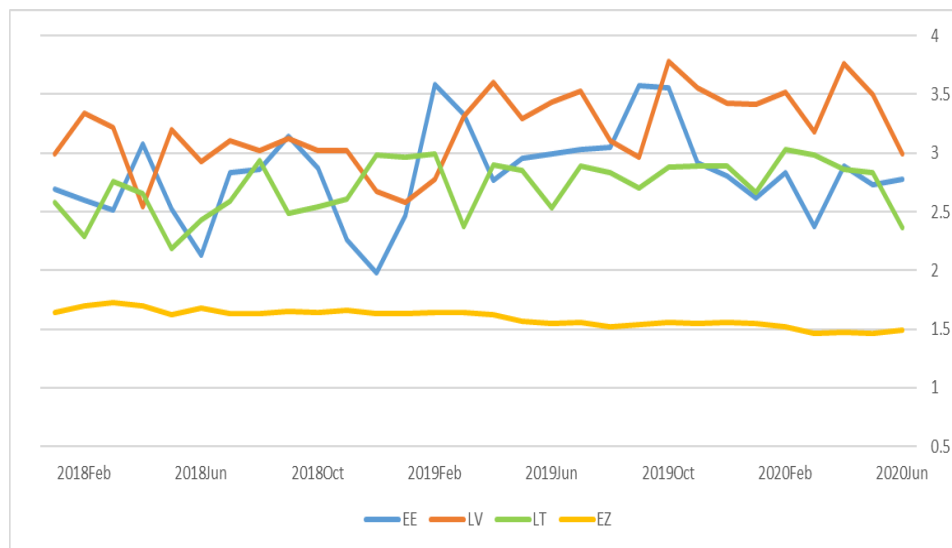


Illustration 2 Total borrowing costs for companies in the Baltic states and the Eurozone, annual interest (source: ECB)

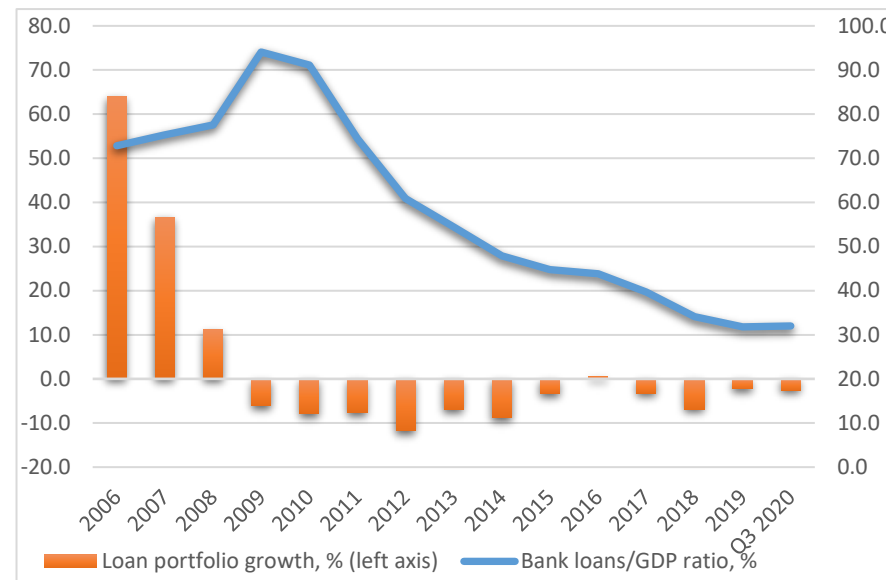


Illustration 1 Outstanding loans of credit institutions to GDP (source: FCMC)

As a result of accommodative monetary policy, borrowing costs in the Eurozone have fallen to relatively low levels on average. However, borrowing costs in the Baltic states are higher than the Eurozone average. Since the beginning of 2019, there has been an increase rather than a decrease. Borrowing costs for housing are generally more stable, but, like business loans, are on average above the Eurozone average. Data from the euro area bank lending survey about the lending development trends conducted by the Bank of Latvia in cooperation with the ECB⁸ shows that in the first two quarters of 2020, credit standards for corporate loans have become stricter, as well as the refusal rate is increasing, thus further reducing the availability of financing during the crisis caused by the Covid-19 pandemic.

⁸ https://datnes.latvijasbanka.lv/publ/BLS_2020_jul_LV.pdf

CHANGES IN LOAN APPROVAL RATE, CREDIT STANDARDS AND DEMAND AND ANNUAL GROWTH RATE OF LOANS FOR ENTERPRISES

(net percentage of banks reporting increased loan approval rate, easing credit standards and higher demand; annual growth rate of loans; %)

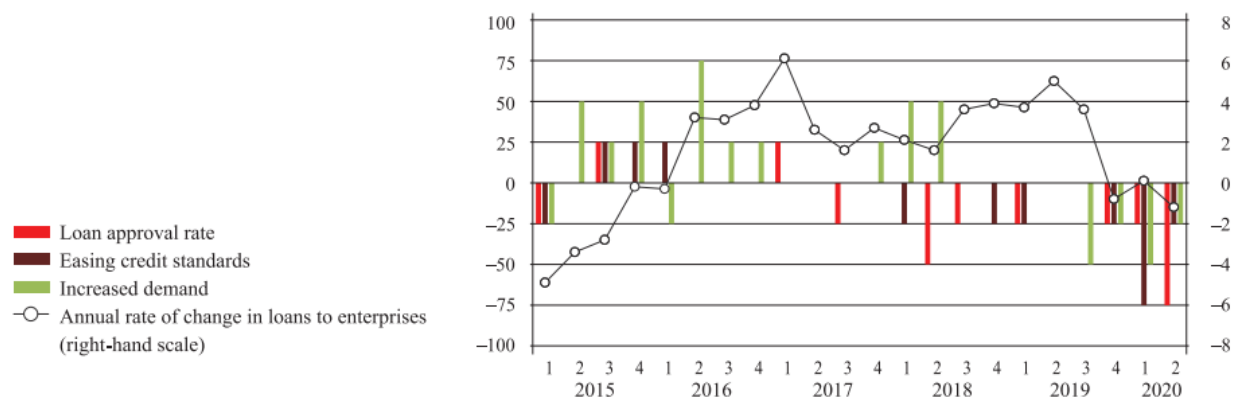


Illustration 3 Data from the ECB euro area bank lending survey for Latvia's Largest Banks and ECB's Statistical Data Warehouse

It should be noted that there are a number of factors that negatively affect the lending activity of credit institutions, including the shadow economy, corporate creditworthiness, efficiency of insolvency proceedings, and some of them are addressed in other policy planning documents, including solving of tax policy issues by National Tax Policy Guidelines 2017-2021, for combatting the shadow economy - Action Plan to Reduce Shadow Economy for 2016–2020, as well as for the improvement of insolvency policy - Guidelines for the Development of Insolvency Policy for 2016–2020. Although some factors have improved, such as the capitalisation of companies, significant insolvency reforms are under way, and it is important that this work continues, especially in areas where progress has been slower, such as the fight against the shadow economy. It is also necessary to further improve the business legal environment, given that 59% of all legal entity proceedings are completed with a statement of non-existence of the property, while the costs of insolvency proceedings, although improving in recent years, remain very high⁹, as well as to emphasise the improvement of the functioning of the early warning system. The impact on lending should also be taken into account when assessing the impact of draft legislation on economic development.

⁹ Report of the Insolvency Control Service for 2019, page 26, http://mkd.gov.lv/lv/parmums/link_part_201/

At the same time, however, when assessing the situation in the credit institutions sector, it can be concluded that, overall, there are some structural problems with access to credits in certain segments, for example, difficulties for SMEs in accessing finance still remain. Although a relatively large number of credit institutions operate in Latvia, 84% of loans issued by banks are issued by the four largest credit institutions¹⁰, while the capacity of other smaller, credit institutions, including the capital position, is not sufficient to significantly affect the total lending activity, as well as the banks' risk appetite is different. Although loans are available to larger companies, access to finance is limited for the SME segment.

According to the compilation made by the Finance Latvia Association, the willingness and ability of credit institutions to finance is determined by the following aspects:

- credit institutions want to lend more while promoting responsible lending;
- risk models and pricing policies are not local - there is a single group model defined at the Baltic level and accepted by regulators
- the interest rate of the loan is primarily determined not by the desire to earn, but by an assessment of risks based on real data (economic cyclicality, shadow economy, possibility of debt recovery, legal environment, etc.);
- the ability of companies to borrow when analysing capital adequacy and profitability indicators is assessed as weak;
- debts of natural persons (Means of Support Guarantee Fund, debts for utilities, tax debts, cases transferred for recovery according to a court ruling).

3. 2 Capital market

Latvia is among those countries where there is still great potential in the development of the capital market. Judging by the stock market capitalisation against GDP, Latvia is in last place among the EU countries, lagging significantly behind the neighbouring countries as well. This shows that Latvia lags significantly behind its potential in the field of stock market development, which would be corresponding with the level of development of our economy. In Latvia at the end of 2019, capitalisation has increased to 2.7% of GDP, however, this indicator is still very low.

¹⁰ <https://www.financelatvia.eu/nozares-dati/>

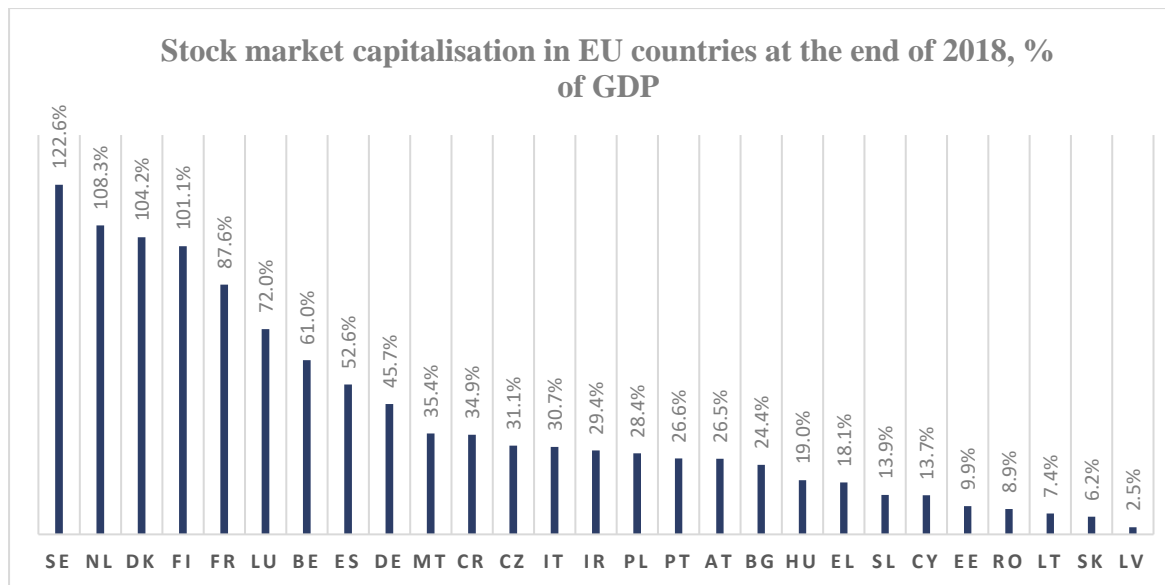


Illustration 4 Stock market capitalisation in EU countries at the end of 2018, % of GDP (source: ECB, Eurostat, World Federation of Stock Exchanges, Nasdaq)

It should also be noted that in comparison with the stock trading turnover, Latvia lags significantly behind the neighbouring countries, whose stock exchanges, despite the similar economic structure and size, have nevertheless been able to achieve a higher level of development.

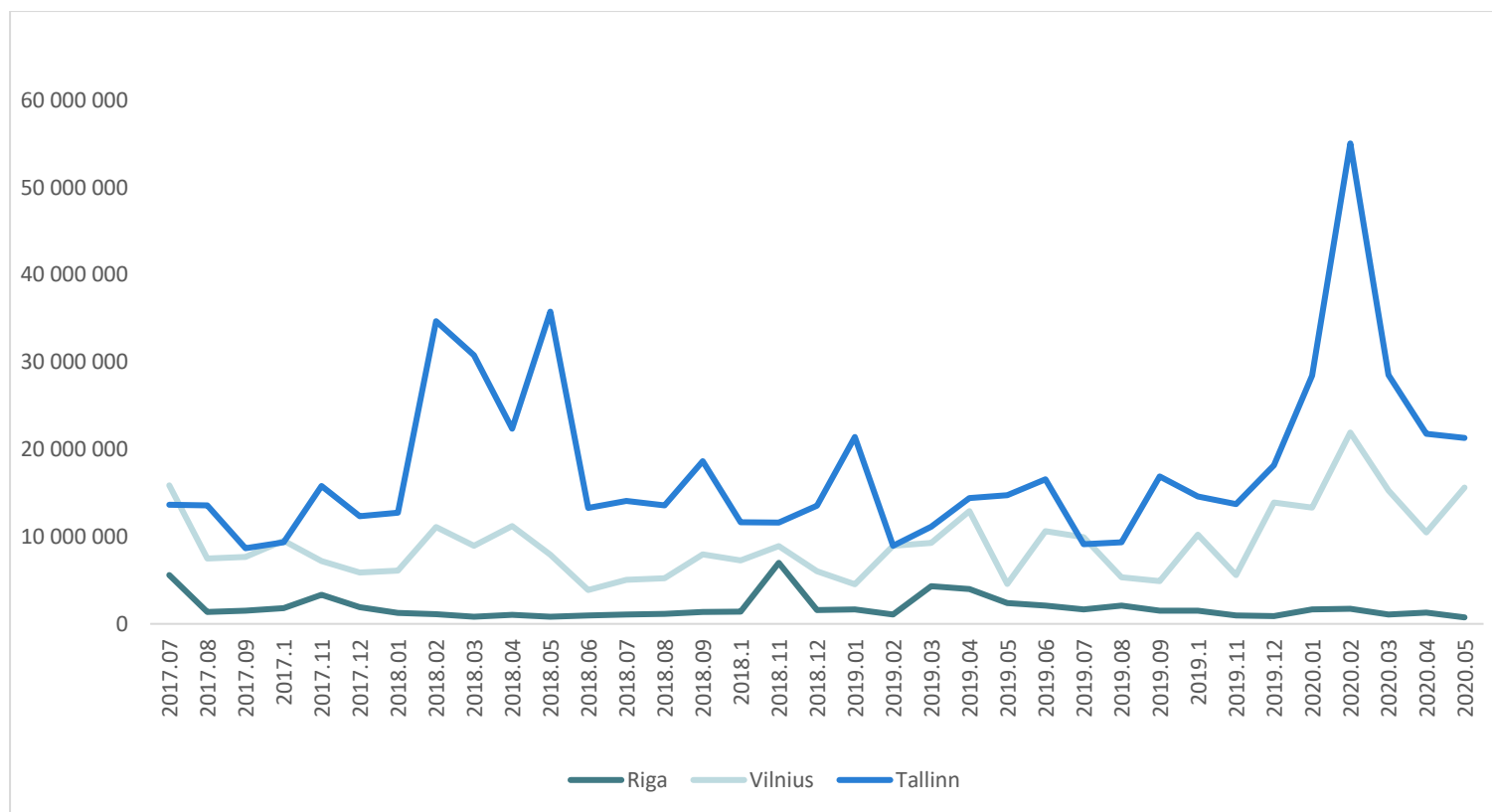


Illustration 5 Share trading turnover, EUR (source: Nasdaq)

A number of initiatives have been launched in recent years that could have a positive impact on capital market growth in the longer term. In 2020, a state support programme for the listing of SMEs on the stock exchange was launched, and nine companies applied for support in the first round¹¹, of which four projects were supported. Under the programme, companies can receive a grant that partially covers the preparation costs of a share

¹¹ <https://www.cfla.gov.lv/lv/jaunumi/2020/liela-interese-par-es-fondu-atbalstu-uznemumu-akciju-emisijai>

or bond issue. As a result of this programme, both the development of the capital market will be promoted, and the interest of companies in raising funds in the capital market will be promoted, thus diversifying the sources of financing. Therefore, the continuation of this programme is essential. Also, the Ministries of Finance of Latvia, Lithuania and Estonia are currently working with the EBRD on a project financed by the European Structural Reform Support Service to set up an acceleration fund (Baltic IPO Fund) to invest in companies planning to make a public listing of shares to further strengthen the development of capital markets in all three Baltic states. Such a joint initiative of the three Baltic states is part of the regional capital market development initiative, which the countries undertook to establish by signing a Memorandum of Understanding on 6 November 2017. Within the framework of this memorandum, the three Baltic states hold regular coordination meetings for the establishment of a regional capital market in order to promote market capitalisation, liquidity and the availability of investment products in the regional market.

At the same time, it should be emphasised that the overall size of the market is also very important for the development of the capital market. At the current level of capitalisation, Latvia is not included in any international index, and even without the presence of the index, a small and non-liquid market is not attractive enough for investors. Thus, it is important that larger companies also enter the market and are able to generate a significant increase in capitalisation and turnover. In order to achieve these goals, it is important to evaluate the possibilities of listing the shares of state capital companies on the stock exchange in accordance with the development and financing needs of these capital companies. It should be noted that both Lithuania and Estonia have positive examples of listed public sector companies, such as five state-owned and municipally-owned energy companies on the Vilnius Stock Exchange, the Port of Tallinn and Tallinn Vesi (a municipal water-supply company that was partially privatised) on the Tallinn Stock Exchange.

EU-level initiatives for a capital market union are also important for the further development of the capital market. EC Action Plan: A capital markets union for people and businesses, published on 24 September 2020,¹² the aim is to get money – investments and savings – flowing across the EU so that it can benefit consumers, investors and companies, regardless of where they are located. The development of the capital markets union will enable smaller capital markets to reach larger and more developed markets, while allowing local businesses, especially SMEs, to diversify their sources of financing for business, thus providing alternative financing to banking sector loans. Capital market-based financing will be an important element in promoting economic recovery and sustainable economic growth by contributing to the EU's long-term climate goals and the digital switchover:

- to ensure that the EU's economic recovery is green, digital, inclusive and resilient, by making finance more accessible to European businesses, especially SMEs;

¹² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:590:FIN>

- to support long-term private savings and investments;
- to integrate national capital markets into the EU-wide single capital market.

To achieve these goals, the EC proposes a set of 16 targeted actions to make progress in completing the Capital markets union, including:

- create a single point of access for companies to corporate data;
- support insurers and banks to invest more in EU companies;
- strengthen investment protection to support greater cross-border investment in the EU;
- promote the greater harmonisation of insolvency rules within the EU;
- make progress on supervisory convergence and the consistent application of the single set of rules for financial markets in the EU.

In order to promote the development of the Latvian capital market, the FCMC, in cooperation with Latvian capital market participants and other involved parties, gathered views on the situation in the capital market in Latvia, obstacles to capital market development and necessary measures to promote capital market development. Based on the main conclusions from all those involved in the process, the FCMC developed a ten-step programme for the development of the local capital market:

- Investment of State Funded Pension Scheme (VFPS) funds in the Latvian capital market, incl. in state capital companies;
- Providing quality information to potential capital market issuers;
- Promotion of passive investments in the Latvian capital market;
- Regulatory burden audit and streamlining;
- Improving the protection of investors' interests and reviewing the FCMC's supervisory priorities;
- Identification of well-managed capital market participants;
- Promotion of investment activity in the Latvian capital market;
- Promotion of Latvian society's financial literacy about investments;
- Provision of objective and analytical information on investment risks;
- Promotion of the involvement of investment service providers in the Latvian capital market.

The ten-step programme developed by the FCMC is integrated into the tasks of this plan for the period from 2021 to 2023.

3. 3 Developing the use of alternative forms of financing

For the successful development of the capital market, it is necessary to ensure and create favourable conditions for companies to use various types of financing. From 2010-2019 the private and venture capital sector has developed rapidly, playing a key role in diversifying corporate financing. According to the Baltic Private and Venture Capital Market Review conducted by Deloitte in cooperation with Latvian, Estonian and Lithuanian venture capital associations¹³, the cumulative amount of venture capital investments in Latvian companies at the end of 2019 was 105 million euros. In 2019, investments were made in 72 companies. The establishment of venture capital funds in Latvia, as in other Central European countries, takes place through co-investments from the state budget, EU funds, the EBRD and the European Investment Fund, pension funds of the Baltic states and other countries, and private investment funds. Research shows that further development of the private and venture capital sector still requires public investment support, especially in the early stages of venture capital.

¹³ <https://www2.deloitte.com/en/en/pages/about-deloitte/articles/baltics-private-equity-and-venture-survey.html>

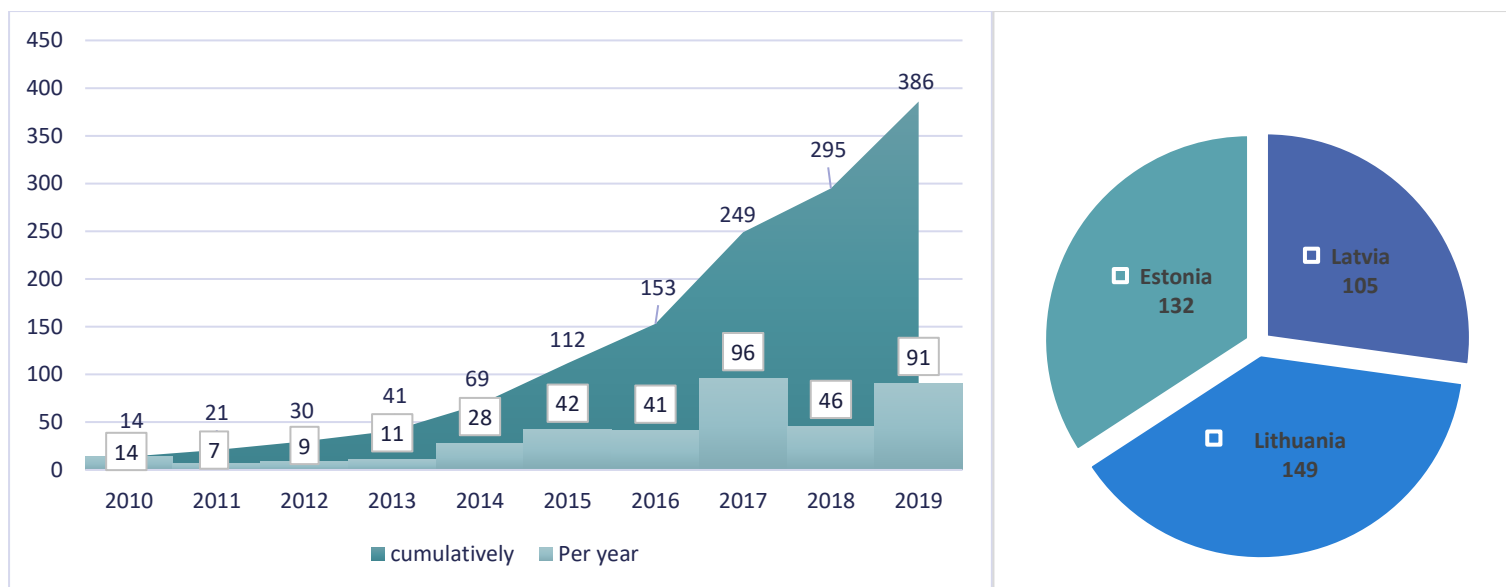


Illustration 6 Annual and cumulative amount of risk capital investments in the Baltic states

In order to ensure the functioning of the private and venture capital sector, in addition to public financial support, it is essential to create conditions that encourage institutional and private investors to invest in venture capital funds, including raising entrepreneurs' awareness of the availability of various types of funding and compliance of these types to the company development strategy and phase, as well as to promote sustainable investment growth.

3.4 Pension funds

OECD data¹⁴ shows that in relation to GDP, at the end of 2019 Latvia's pension savings in all types of pension products (16.7%) exceeded Lithuania's (8.3%), but slightly lagged behind Estonia (18.5%), while the OECD total pension fund assets account for 92% of GDP. It should be noted that the growth rate of assets in all Baltic countries is faster than the OECD average. Most of the pension fund assets in Latvia consist of

¹⁴ <http://www.oecd.org/daf/fin/private-pensions/globalpensionstatistics.htm>

funds accumulated in state-funded pension plans, which at the end of December 2020 had already reached 5.08 billion euros¹⁵. At the end of the 3rd quarter of 2020, the total assets of private pension funds according to the FCMC were 566 million euros. OECD statistics show that, on average, the real performance of pension funds (both tier 2 and tier 3) has been low over the years and even negative over the last 15 years, and has been among the lowest among OECD countries. However, it is the long-term efficiency of the funds over 20, 30 or 40 years that is important, as it will be the determining factor in the size of pensions in the future.

	Nominal rate			Real rate		
	5-year average (Dec 2014 - Dec 2019)	10-year average (Dec 2009 - Dec 2019)	15-year average (Dec 2004 - Dec 2019)	5-year average (Dec 2014 - Dec 2019)	10-year average (Dec 2009 - Dec 2019)	15-year average (Dec 2004 - Dec 2019)
Austria	3.4	4.0	3.4	1.8	2.1	1.5
Belgium	5.1	6.0	5.7	3.3	4.1	3.7
Czech Rep.	0.9	1.6	2.0	-1.0	-0.2	-0.2
Denmark	4.7	6.4	5.8	4.0	5.1	4.2
Estonia	2.9	3.6	2.6	0.9	1.2	-0.5
Finland	5.4			4.7		
Germany	3.5	3.9	3.9	2.2	2.6	2.5
Italy	2.3	3.1	3.2	1.7	2.0	1.8
Latvia	2.4	3.3	3.1	0.5	1.5	-0.5
Lithuania	3.7			1.6		
Luxembourg	2.5	3.6		1.0	1.9	
Netherlands	6.3	8.0	6.5	4.7	6.2	4.8
Poland	1.6			0.2		
Portugal	3.0	3.0	3.6	2.3	1.8	2.3

¹⁵ www.manapensija.lv

Slovakia	2.3	2.2	1.0	0.6
Slovenia	4.2	4.8	3.2	3.5
Spain	2.6	3.5	1.7	2.3

Table 1 Nominal and real geometric average annual margin rate on funded and private pension plans for the last 5, 10 and 15 years as of 31 December 2018. Source: OECD Global Pension Statistics

It should be noted that reforms have been implemented in 2018 and 2019, which may have a positive impact on the profitability of pension funds in the long run. With regard to funded pension investments, the limits have been raised since 2018, allowing active funds to invest up to 75% of their assets in equities (compared to 50% so far), which has the potential to provide higher long-term returns. Also in previous years, the fee limits charged by state-funded pension funds were reformed, which, together with active competition from administratively cheaper index fund plans, led to a significant reduction in commissions, which in turn has a positive effect on the net profitability of plans. The OECD assessment of the Latvian pension system published in 2018 indicated that in 2016 the commissions for voluntary pension funds were 1.8%, but for funded pension funds 1.4% of the assets, which were among the highest indicators among OECD countries. In comparison, in mid-2018, according to OECD data, state funded pension commissions had decreased to 0.6% of assets. Also comparing the total expense ratio, which is reflected in the SSIA reports for 2016-2019, one can see a tendency of cost reduction from about 1.6% to about 0.5% of the annual average amount of assets.¹⁶

¹⁶ <https://www.vsaa.gov.lv/pakalpojumi/stradajosajai/2-pensiju-limenis/parskati-par-valsts-fondeto-pensiju-shemas-darbibu/>

3.5. Insurance

Assessing the insurance market, it must be concluded that although the volumes of written premiums are gradually increasing, the market is not sufficiently developed compared to the EU and OECD countries. In terms of premiums, life insurance has the largest market share, followed by MTPL, health insurance and CASCO.

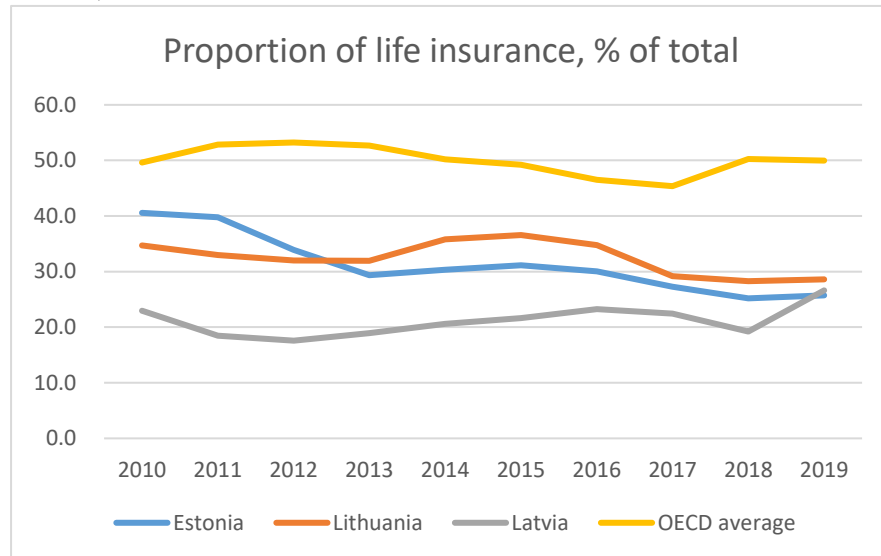


Illustration 8, Proportion of life insurance (Baltic states and OECD average), % of total (source: OECD)

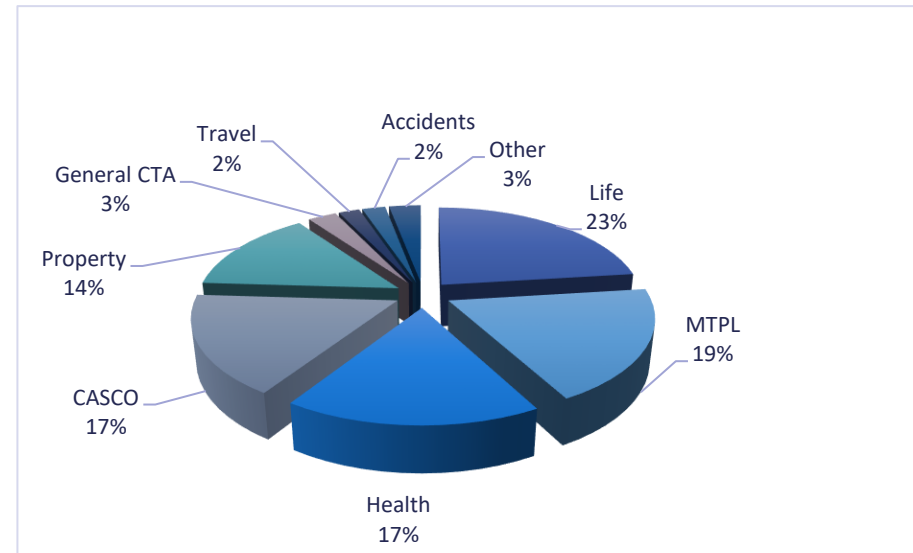


Illustration 7 Amount of premiums written in Latvia by insurers (local companies and foreign branches) operating in Latvia in 2019 (source: Latvian Association of Insurers)

It should be noted that according to the OECD and other international institutions, the development of the life insurance sector, in addition to the benefits it provides to individuals to increase their personal well-being, also has a number of economic benefits. Private life insurance can supplement state social security. With thousands of policyholders, insurance companies are able to attract significant financial resources, which are important for supporting investment and the national economy. Insurers serve as financial intermediaries between investors and entrepreneurs who do not have sufficient funding, which makes a significant contribution to the development of financial markets. In OECD countries, insurance companies are the largest institutional investors.

The structure of the insurance market differs in each country depending on the market structure and social system, however, in most developed countries life insurance accounts for the majority of total written premiums, thus concluding that the role of life insurance as a savings instrument and social security in Latvia is still developing. It should be noted here that life insurance is only one of the savings instruments, therefore it should be considered in connection with the general tendencies of household savings. Also, when analysing the development of the life insurance market in Latvia, it is necessary to take into account the changes in the personal income tax regulation, which came into force in 2018, with regard to accumulative insurance premiums.

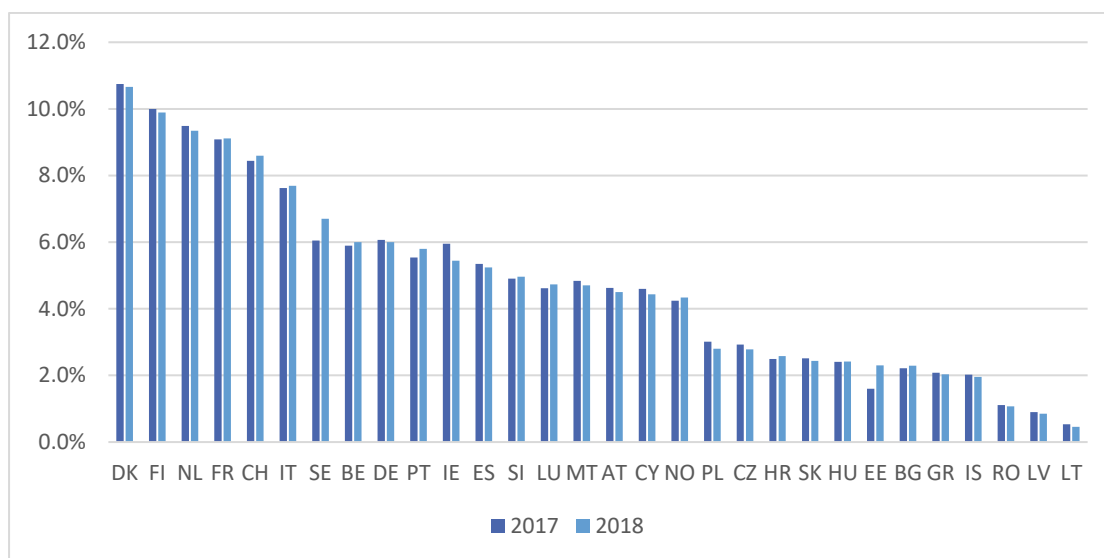


Illustration 9 Insurance premiums in the domestic market, % of GDP (source: Insurance Europe)

Also evaluating the volumes of the insurance market against GDP in comparison with other EU countries, the Latvian insurance market is relatively small. It is influenced both by the relatively small share of life insurance and, apparently, by the relatively inactive use of other types of insurance. Given that insurance can be an important tool both for building social security in old age and for hedging against possible losses as a result of various accidents, it is important to promote public awareness of the importance of insurance products in personal financial planning, as well as confidence and willingness to use those products more actively, thus strengthening the financial sustainability of households.

3.6. Household savings and investment

In recent years, the amount of household deposits with credit institutions has been gradually increasing, reaching 5.5 billion euros at the end of June 2020, according to the FCMC. At the same time, although total deposits are growing, the share of deposits in household assets is declining, with insurance and pension products also accounting for an increasing share.

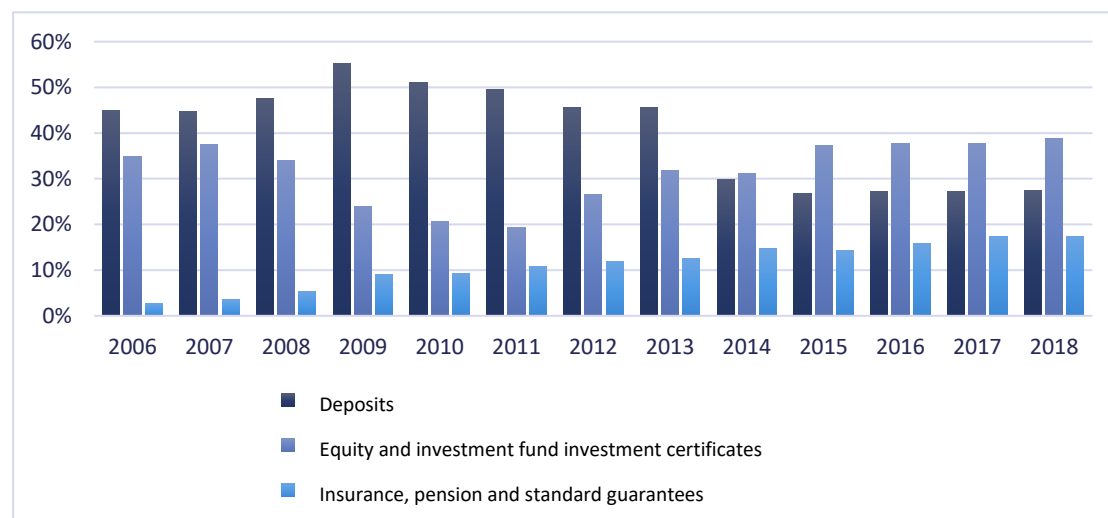


Illustration 11 Proportion of significant components in household financial assets, % (source: Bank of Latvia)

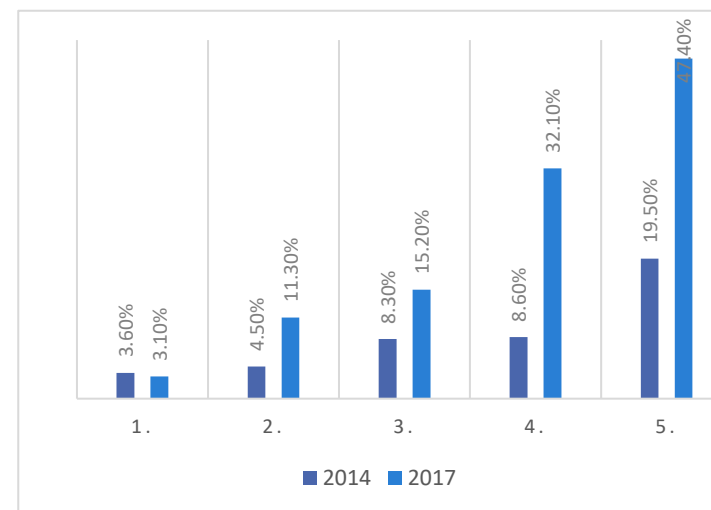


Illustration 10 Participation of households in 3rd tier pension funds, life insurance policies with accruals, by income, % (source: Bank of Latvia)

Also, according to the results of household finance and consumption surveys conducted by the Bank of Latvia, which are conducted every three years, it is observed that the share of households that make savings in the form of deposits, pension funds or savings insurance is gradually increasing. If in 2014 only 8.9% of households used 3rd pillar pension funds or savings insurance, then in 2017 it was already 21.8%. These instruments are much more actively used by higher-income households, but the creation of savings is also very important for low-income households. While it is understandable that in the case of higher incomes, there is also more free money to be put in savings, at the same time it is important to promote the financial literacy of the population by promoting skilled household budget planning and understanding of the importance of saving and investment opportunities.

3.7. JSC “Development Financial Institution Altum” support programmes

In order to promote access to finance for companies in areas where it is not available on the market and where market failures exist, ALTUM implements support and development programmes mainly in the form of financial instruments, additional grant programmes, implementing state policy in the national economy, as well as securing the fulfilment of other state delegated tasks determined in legislation. The focus of ALTUM's activities in recent years has been on guarantee products, creating several new guarantee products (for example, portfolio guarantees, housing guarantees for new specialists, promoting access to higher education - study and student loans for studies in Latvia) and significantly improving existing ones (e.g. farmers, businesses), as well as promoting guarantee instruments, given ALTUM's complementary role in the financial market. ALTUM guarantees for financial services of credit institutions are like additional collateral in situations when it is not sufficient, thus credit institutions can provide financing to a wider range of customers.

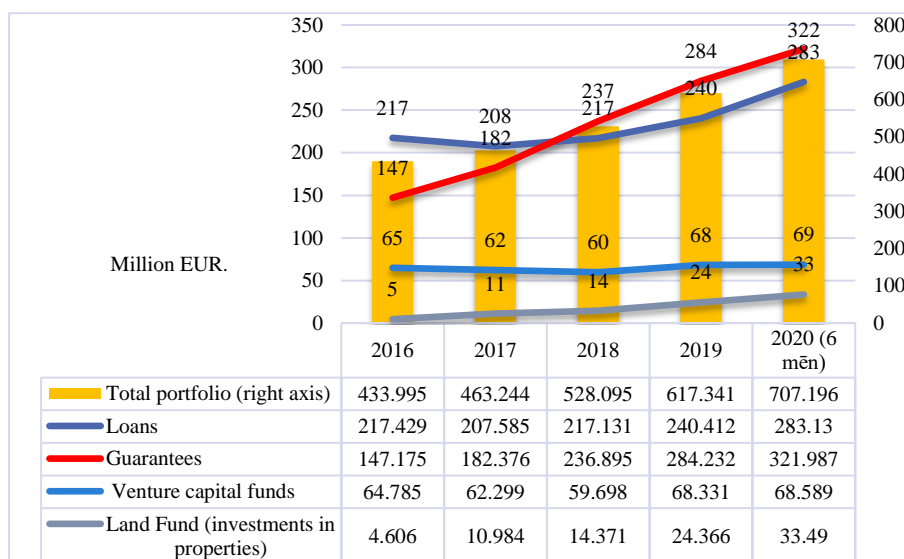


Illustration 12 Gross portfolio in 2016-2019 and 1st half of 2020, EUR, accumulated amounts (source: Altum)

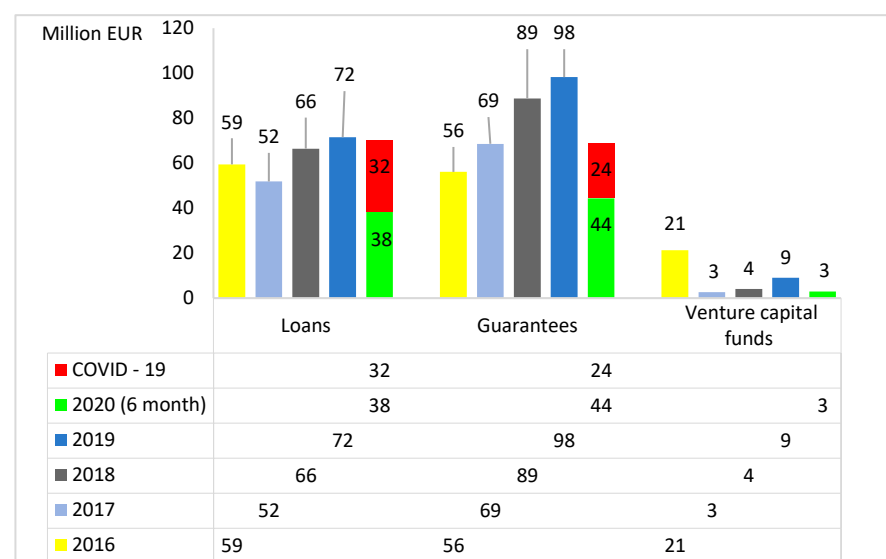


Illustration 13 New transactions in 2016-2019 and in the 1st half of 2020, EUR (source: Altum)

In 2018, the ALTUM guarantee portfolio exceeded the loan portfolio - this was one of ALTUM's strategic goals - a significant increase in the volume of guarantees, while maintaining the loan portfolio at approximately the same level by switching from direct lending to other financial institutions. The situation changed in early 2020, as a result of the Covid-19 crisis, when ALTUM direct loans increased significantly, considering the fact that companies required financing to maintain their liquidity and it was not possible to receive it from credit institutions, through the introduction of a number of new short-term support financial instruments. It should be noted that in 2020, Covid-19 support instruments account for a large share of new business - almost half of the total new loans issued are Covid-19 current assets loans, while about a third of the total new guarantees are issued under the Covid-19 guarantee programme.

In parallel with the implementation of short-term crisis support programmes, it is necessary to further develop financial instruments aimed at the development of strategically important projects, including projects of international significance, which would provide Latvian companies with opportunities to engage in value chains and strengthen their capacity for cross-border cooperation, also participating in public procurement in the EU and in third countries. Given the growing uncertainty in international markets in recent years, and in particular the caution caused by the Covid-19 crisis, which is a limiting factor for more active new investment, work continues on loan, guarantee, equity and quasi-equity financial instruments and raising corporate and financial market participants' awareness of the ALTUM medium and long-term export credit guarantee instrument, which can provide additional security and attract private investment, especially to the sectors characterised by the highest levels of technological development and innovation.

3.8. International Financial Institutions Financial Mechanisms

Latvia's participation in international financial institutions (IFIs) provides opportunities to attract financing for public and private sector investment needs in the form of various financial instruments. IFIs offer market-based financing in areas where there are market failures and lack of investment, while ensuring complementarity, thus investing in projects for the implementation of which private sector funding is not or only partially available. At the same time, IFIs also play an important role in providing support in crisis situations - Latvia has received support from several IFIs not only during the financial crisis in 2008, but also the Covid-19 crisis highlighted the need for additional funding from IFIs to mitigate the pandemic directly and through ALTUM financial instruments.

Despite the availability of IFI investments, their activity in Latvia has been relatively low in recent years - each IFI direct investment in Latvia averages only 0-3 new projects per year. IFIs also invest in regional projects, for example, purpose-built funds with IFI co-financing, the operation of which also envisages investments in Latvia, but information on the availability of such financing is limited. Therefore, one of the goals of the Plan is to promote IFI investments in Latvia. Currently, the Latvian public and private sector has access to funding from five IFIs - the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank, the World Bank Group International Finance Corporation and the Council of Europe Development Bank:

The main forms of financing from the European Investment Bank (EIB) are loans to the public and private sectors, equity investments, including venture capital and funds, guarantees and advisory services to strengthen the capacity of project promoters. The EIB also offers the blending of financing with EU structural and investment funds, as well as other EU financial instruments. At the same time, the EIB is a key partner in implementing financial programmes with an EU guarantee from the European Fund for Strategic Investments (EFSI) and the InvestEU programme, which aims to mobilise private investment in strategic projects across the EU and support companies in the recovery phase. The EIB's cooperation partner within the EFSI in Latvia is ALTUM, which has strategically chosen to attract EIB resources to support Latvian SMEs with the aim of reducing dependence on EU funds and diversifying the sources of financing available to support the Latvian economy. As a result, entrepreneurs have access to additional financing through financial instruments implemented by ALTUM on better terms. ALTUM uses EIB products as guarantees for *Private Finance for Energy Efficiency projects*, which are financed from the resources of green bonds issued by ALTUM. At the same time ALTUM, as the *EIB Advisory Hub* in Latvia, advises project promoters and entrepreneurs on the preparation and submission of projects within EFSI. At present, more than 30 projects in the fields of infrastructure, education, science, development and innovation, renewable energy and energy efficiency have been consulted through ALTUM within the framework of EFSI. Of these, two projects are currently being further negotiated with the EIB to raise funding of over 160 million euros in total. In addition, the European Investment Fund programs COSME, EaSI, Innovfine, which facilitate the availability of financing, are available and used. In total, EIB investments in Latvia amount to 2.8 billion euros.

The main forms of financing from the European Bank for Reconstruction and Development (EBRD) are loans for business expansion or modernisation, change of ownership, public-private partnerships, working capital, trade finance guarantees, and investments in corporate equity as a minority shareholder and anchor investor (up to 30%). At the same time, the Bank also provides support for the privatisation and commercialisation of state-owned companies, thus helping to strengthen their operational efficiency, which is particularly important for those companies that have received state support to mitigate the negative effects of the Covid-19 crisis. In addition, the EBRD provides support (advice) in the implementation of public sector structural reforms and policy-making to promote private sector development. Like credit institutions, the EBRD is a demand-driven institution and invests in companies that are stable and viable in the long run. However, the main difference from commercial lenders is that the EBRD's investments simultaneously implement the concept of additionality, firstly by investing in projects for

which funds of commercial lenders are not accessible, and secondly by simultaneously implementing structural reforms in the course of project implementation. Assessing the EBRD's activity in Latvia over the last three years, it has been relatively low, but with an increasing trend: In 2017, the EBRD's investments amounted to 3 million *euros*, in 2018 - 42 million euros, in 2019 - 85 million euros. On the one hand, the EBRD's low level of investment can be explained by the policy pursued to discontinue Latvia's status as a country of operation in the bank or to graduate on the basis of Latvia's level of development reached and lack of projects. At the same time, the EBRD has identified that support for energy efficiency and capital market development are key market failures that the Bank is committed to addressing. On the other hand, there is a lack of large-scale projects in the field of renewable energy in Latvia, as well as a limited amount of lending to SMEs. It is also possible to identify financial sectors and industrial projects, which have limited opportunities to attract financing elsewhere (or need support in project preparation). In the area of capital markets, the EBRD has participated in a number of structural reform projects funded by the EC Structural Reform Support Programme. During the Plan period, EBRD financing in Latvia is expected to be primarily available for at least the following purposes: (i) the transition to a green economy, including support for energy efficiency; (ii) support for financial institutions, in particular for setting up SME support instruments; (iii) development of the capital market, including the involvement of state and municipal capital companies in the capital markets; (iv) support for private-public partnerships as well as private sector infrastructure projects. In total, EBRD investments in Latvia amount to 777 billion euros. At the same time, Latvian companies and industry experts have the opportunity to participate in the implementation of EBRD-financed projects through the bank's procurement procedure. Since 2013, Latvian companies and industry experts have implemented 18 EBRD-financed projects *in the* amount of 1.3 million euros.

The main forms of financing of the Nordic Investment Bank (NIB) are loans to the public and private sectors, investments in green bonds, project and structured finance loans, including guarantees and financing of private public partnerships. The focus of the NIB's activities is on financing projects that improve productivity and benefit the environment in the Nordic-Baltic region. Before taking a loan decision, the NIB assesses how the financed projects contribute to productivity growth and provide environmental benefits in the bank's member countries. The NIB aims to support projects aimed at technical development and innovation, the improvement of infrastructure, the development of human capital and equal economic opportunities, as well as the improvement of market efficiency and the business environment. Environmental benefits are achieved by funding projects that contribute to reducing pollution, maintaining sustainable infrastructure, improving resource efficiency, developing clean technologies and mitigating climate change. In total, NIB investments in Latvia amount to 975 million euros.

The support of the International Finance Corporation (IFC) is available to those Latvian companies that have expanded their operations to developing countries, and to credit institutions that issue loans to such companies. IFC's focus is on private sector development and the mobilisation of private capital, providing support to developing countries where private capital flows are insufficient to address significant development challenges. IFC's main forms of financing are loans, equity investments (direct or through private equity funds), trade and commodity financing,

capital mobilisation, financing of derivative products interest rates, financing for the provision of currency or commodity prices, and blended finance. In turn, IFC offers credit institutions to participate in a syndicated loan programme and a trade financing programme, reducing the risks of promoting trade in new or complex markets. As Latvia is a donor country of the World Bank Group, IFC does not finance the implementation of projects in Latvia. At the same time, Latvian companies and industry experts have the opportunity to participate in the implementation of World Bank Group-financed projects through the bank's procurement procedure. In total Latvian companies and industry experts have implemented 155 World Bank Group-financed projects in the amount of 71.39 million US dollars.

The Council of Europe Development Bank (CEB) invests in social projects to promote social inclusion and improve the living conditions of the most vulnerable population in Europe. The Bank provides loans and guarantees to its member countries to finance projects that meet certain criteria. Potential borrowers are the state, local governments, as well as financial institutions. The Bank's priority is to provide loans for projects to the target group countries in Central, Eastern and South-Western European countries, incl. also to Latvia. The priorities for CEB lending are: (i) the integration of refugees, displaced persons and migrants, helping to address the challenges faced by European countries as a result of the flow of refugees, displaced persons and/or migrants; (ii) sustainable and inclusive growth with an emphasis on socially orientated components, in particular public infrastructure, the social profession, new job creation and retention, access to the labour market, access to housing and the integration of vulnerable groups of the population; (iii) developing climate mitigation and adaptation measures by integrating climate action measures into CEB projects. From 1998-2019, 10 projects for the total amount of 358 million euros were approved in Latvia.

Until now, IFI investments in Latvia have been relatively low, and in order to activate IFI operations, it would be necessary to assess and identify specific investment needs where IFI support can ensure complementarity and reduce market failures. In order to strengthen the capacity of state institutions in project planning and preparation by attracting IFI funding, the establishment of a single support centre - one-stop agency for providing centralised information on IFI investment attraction and project planning and preparation opportunities should be considered. At the same time, it is necessary to continue to provide the necessary information to public and private sector participants on opportunities to attract IFI investments and participate in IFI-funded projects - by organising informative and educational seminars and bilateral talks with IFI experts offering information about possibilities to attract IFI funding into the implementation of specific projects, as well as inform the range of potential clients on the availability of financing in IFI co-financed regional funds.

In view of this section, it is necessary to implement measures in the following directions:

- Promoting sustainable lending;
- Capital market development and creation of investment culture;
- Promoting the financial literacy of the population.

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
1. Availability of financing and investment potentialities						
1.1.Promoting sustainable lending						
1.1.1.	Carry out regular assessments of barriers for lending to businesses and individuals.	Identify necessary policy actions to improve the credit environment.	Report is provided to the Financial Sector Development Board.	MoF	FCCM, BoL, FLA, CRPC	Every year by 1 September for the previous calendar year.
1.1.2.	Simplify the registration of changes related to refinancing in the Land Register by reducing the mortgages processing fees if supporting documents are submitted electronically.	Legal and factual barriers to securing mortgages are reduced; The refinancing market has been promoted.	Necessary amendments to regulatory enactments have been developed and submitted to the Cabinet of Ministers for consideration.	MoJ	MoF	31.12.2021
1.1.3.	Improve the availability of information on the liabilities of individuals for credit risk assessment.	Extended availability of information on the liabilities of individuals.	An assessment of possible solutions has been prepared and submitted to the Financial Sector Development Council for consideration.	MoE	MoF, SRS, FLA, CRPC, NIB, DVI	31.12.2021
1.1.4.	Promote investment and	Improved public and private	Educational informative events	MoF	MoE, IDAL	2021

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	technical assistance from international financial institutions in areas where the availability of the financing is limited.	sector awareness and understanding of opportunities to attract investment and technical support from international financial institutions, including in areas such as green transition, digitalisation, innovation, capital markets, and PPPs.	<p>have been organised for public and private sector participants, providing an overview of investment opportunities and current projects of international financial institutions.</p> <p>Information has been distributed on direct and regional projects co-financed by international financial institutions, the activities of which are implemented in Latvia or in the implementation of which Latvian market participants may participate.</p> <p>An assessment has been prepared on the establishment of a support centre for the provision of centralised information on the possibilities of attracting investments from international financial institutions and project planning/preparation.</p>			2022 2023
1.1.5.	Further development of the medium and long-term export	The efficient operation of the medium and long-term export	The process and document base required for operationalisation	MoF	MoE, MoA, ALTUM	30.06.2022

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	guarantee system.	guarantee system is ensured by providing support to export-capable companies.	has been developed to ensure the implementation of the tool.			
1.1.6.	Improve financial instrument support programmes by assessing the possibilities for the further development of the mezzanine instrument.	Assessment is prepared and, if necessary, the amendments to the legal framework are prepared.	Support provided to companies.	MoE	LDDK, ALTUM, FNA, FM, LVCA	31.12.2021
1.1.7.	Further improvement of the higher education accessibility system.	The efficient operation of the study and student loan model for studies is ensured, providing support to university students.	The necessary possibilities for model improvement to ensure the sustainability of the model have been evaluated.	MoES	MoF, ALTUM	31.12.2021
1.1.8.	Facilitate the recovery of loans and debts of legal entities outside the recourse procedure or in written procedure, promoting the use of non-contentious solutions, reviewing restrictive regulations (existing limits, deadlines, notification procedures), as well as evaluating the efficiency of the use of commercial pledges.	Barriers to accelerated debt recovery have been reduced.	Necessary amendments to the legal framework have been prepared.	MoJ	MoF, FLA	31.12.2021

1.2.1. Capital market development and creation of investment culture

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
1.2.1.	Establish a Baltic Acceleration Fund (SME IPO Fund).	More active involvement of small and medium-sized enterprises in the capital market; Promoted capital market activation; Expanded opportunities for companies to attract financing.	Conceptual report submitted to the Cabinet of Ministers.	MoF	MoE	30.08.2021
			A draft regulatory framework has been developed and submitted to the Cabinet of Ministers.	MoF	MoE	30.12.2021
1.2.2.	A regular assessment has been made of the progress made in promoting the development of the capital market and investment culture, as well as the factors that still hinder it.	The necessary actions to improve the capital market and investment culture environment have been identified.	Report is provided to the Financial Sector Development Board.	MoF	FCMC, MoE	Every year by 31 December for the current calendar year.
1.2.3.	Continue the ongoing support programme for companies to enter the capital market.	More active involvement of small and medium-sized enterprises in the capital market; Promoted capital market activation; Expanded opportunities for companies to attract financing.	The proposals for the amendments to the legal framework have been submitted for consideration in the Cabinet of Ministers.	MoE	MoF, FCMC	30.06.2022

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
1.2.4.	Introduce a collateral agent institute for corporate bonds and credit institution syndicated loans.	The issue of corporate bonds has been promoted.	The proposals for the amendments to the legal framework have been developed and submitted for consideration in the Cabinet of Ministers.	MoF		31.12.2022
1.2.5.	Develop and explain to the public a clear strategy and plan for increasing the share of private owner's capital in state-owned assets, as well as for raising additional funding in the capital market through bond issue.	More active participation of state capital companies in the capital market.	A strategy has been developed and submitted to the Cabinet of Ministers for consideration.	PKC	MoF, MoE, FCMC	31.12.2021
1.2.6.	To create a development and support model, providing an opportunity for private companies, as well as state and municipal companies to evaluate participation in the capital market. To promote the implementation of the strategy approved by the Cabinet of Ministers, ensuring the participation of state owned	Participation of state capital companies in the model. Support has been provided in the process of preparation for participation in the capital markets for private companies, as well as state and municipal capital companies.	An offer has been prepared for the possible entry of state and municipal capital companies into the capital market, which at the same time complies with the investment framework of SFPS funds.	FCMC, PKC	MoF, MoE, MoT, Nasdaq	01.01.2022-31.12.2023

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	companies in the capital market.					
1.2.7.	To assess the necessary amendments to laws and regulations in order to ensure tax neutrality for the issue of securities and securitisation transactions, in compliance with tax anti-avoidance norms, as well as to assess the possibility of removing tax elements hindering securitisation transactions in Latvia in order to raise funds in capital markets.	Promoted capital market activation; Expanded opportunities for companies to attract financing.	Evaluation prepared for the necessary amendments to the legal framework.	MoF	FLA, FCMC	30.06.2021
1.2.8.	Evaluate the administrative and regulatory burden on issuers by reviewing the requirements of the Financial Instruments Market Law and other regulatory enactments binding on issuers.	Improvement of the regulatory framework has been promoted.	Proposals have been developed for amendments to the legal framework.	MoF	FCMC, MoJ	30.06.2022
1.2.9.	Continue to improve the regulation of state-funded pensions by promoting efficient asset management, awareness of pension plan participants and	Higher income substitutability within state funded pensions has been promoted; The active participation of participants in state-funded	The proposals for the amendments to the legal framework have been submitted for consideration in the Cabinet of Ministers.	MoF	FCMC, MoW, FLA, LVCA	31.12.2021

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	the choice of an age-appropriate pension plan.	pension fund plans in the selection of the plan has been promoted.				
1.2.10.	Evaluate the possibility of creating a higher-risk Life Pension product, which envisages investing capital in financial instruments.	The participation of persons in the investment market, development of investment culture has been promoted.	Evaluation is reared and, if necessary, Proposals are developed for amendments to the legal framework.	MoF	LAI	31.12.2022
1.2.11.	To improve the securitisation regulation, taking the specifics of the Latvian capital market into account.	The capital market has been activated, facilitating opportunities for securitisation transactions.	A draft regulatory framework has been submitted to the Cabinet of Ministers.	MoF	FCMC, ALTUM, MoE	31.12.2021
1.2.12.	Perform educational activities to explain the role and significance of venture capital investments.	The creation of small and medium-sized enterprises, the operation of which would correspond to venture capital financing, has been promoted.	Small and medium-sized enterprises are supported.	MoE	LVCA, ALTUM, LATBAN, FCMC, LVCA	Regularly every year.
1.2.13.	Further develop the Latvian venture capital market by creating the next generation of state co-financed venture capital funds.	Availability of financing for early-stage small and medium-sized enterprises, which find it difficult to use other financing, is hindered.	Proposals for the regulatory framework for the establishment of the next generation of state co-financed venture capital funds have been prepared and submitted to the Cabinet of Ministers.	MoE	LVCA, MoF, ALTUM, LATBAN	30.06.2022
1.2.14.	Continue the work started on the	Development of a plan for the	It has been assessed how it is	MoF	FCMC	31.12.2022

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	inclusion of the Baltic capital market in international financial indices.	future operation of the Baltic capital market for inclusion in the international financial index.	possible to eliminate the obstacles to the absence of the Baltic capital market in the international financial index and the possibilities to eliminate them.			
1.2.15.	Establish a corporate governance rating for issuers on the capital market and agree on a rating maintainer.	The rating methodology has been developed and the first evaluation has been performed.	Corporate governance rating published.	FCMC	BICG	31.12.2022
1.2.16.	Promote law enforcement institution awareness of market manipulation and insider dealing.	Awareness raising for law enforcement institutions.	A training plan has been prepared. A training course has been prepared.	FCMC	MoF, MoJ	30.06.2022
			Training provided to law enforcement institutions involved.	MoJ	MoF, FCMC	30.06.2023
1.2.17.	Develop proposals and mechanisms for investment service providers to be more active in attracting investors through digital opportunities for capital market participation.	More active involvement of investment service providers and investors in the capital market has been ensured.	Digital tools developed by investment service providers for investors.	FLA	ALTUM, FCMC	31.12.2022

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
1.2.18.	Develop proposals and support mechanisms for the more active involvement of investment banks in the capital market.	More active involvement of investment service providers in the organising of issuing in the capital markets.	Diversification of the range of services for investment service providers (provision of investment banking services), focusing more actively on supporting the participation of SMEs in the capital markets.	MoF, FLA	FCMC, MoF	31.12.2022
1.2.19.	Develop proposals to encourage passive investment.	A passive form alternative investment fund has been developed. Opportunities to make investments in a passive form.	A mutual investment fund has been developed.	MoE	ALTUM, FLA, FCMC	31.12.2022
1.3. Promoting the financial literacy of the population						
1.3.1.	To provide the population with more accessible data on the accrued pension savings and the expected amount of the pension .	Make information on the amount of funds and contributions accumulated in the 3rd pension tier more accessible. Aggregate all pension savings together. Inform about the expected amount of pensions depending on the contributions made.	Electronic access has been developed to information on the amount of funds and contributions accumulated at the 3rd pension tier, ensuring that data on the amount of funds and contributions accumulated at the 1st, 2nd and 3rd pension tiers are available together, evaluating the most efficient way of information transfer, which ensures less administrative	MEPRD	MoF, MoW	31.12.2023

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
			burden.			
1.3.2.	To promote and popularise the already developed content and methodology material on the wider use of financial literacy in existing curricula.	Financial literacy promoted.	The assessment prepared and submitted to the Cabinet of Ministers for consideration.	MoES	FCMC, BoL, MoF, CRPC	31.12.2021
1.3.3	Promote awareness of the need for investment, including in the capital market. To promote the development of a savings culture by providing opportunities for population of Latvia to invest in state-owned assets through public offerings.	Development of household investments has been promoted.	A state-of-the-art solution has been developed and implemented to provide clear information on the risks associated with different types of investments and to help private investors assess the suitability of certain types of investments for the investor's risk tolerance and level of financial literacy.	FCMC	Nasdaq	01.06.2022
1.3.4	Promote the provision of focused, targeted information on responsible borrowing.	Awareness of responsible borrowing has been promoted, the credit burden of households has been reduced.	Measures implemented within the framework of the FCMC financial literacy strategy, including regular informative events, publications.	FCMC, CRPC	FNA, BoL	Regularly
1.3.5.	Promote regular savings habits and awareness of their need.	The understanding of the need to create savings has been promoted and the share of the population that makes savings has increased.	Measures implemented within the framework of the FCMC financial literacy strategy, including regular informative	FCMC	FNA, LAI	Regularly

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
			events, publications. The proportion of the population who make savings is increasing (at least 30%, according to a financial literacy survey).			
1.3.6.	Promote the involvement of various institutions in the implementation of the financial literacy strategy of the Latvian population in order to increase the number of financial literacy activities and improve the overall level of financial literacy of the population.	Increased involvement of institutions in the implementation of the financial literacy strategy. The number of financial literacy activities has increased. Financial literacy is included in the institutions' annual plans and budgets. The financial literacy strategy 2021-2027 is being implemented. Institutions participate in the Financial Literacy Working Group.	The number of joint institutional projects and own initiatives in the field of financial literacy is increasing. In general, the number of projects to promote financial literacy has increased. The institutions have included financial literacy issues in their annual plans and budgets. The population's financial literacy index is rising.	FCMC	MoES, MoW, MoF, MoE, SRS, FIS, FLA, MoJ, BoL, FLA, CRPC, LAI	Regularly

4. Digitisation and accessibility to innovative services

Innovation through digital technologies is increasingly driving the development of new products, processes and business models. In this development, data, together with the IT infrastructure, becomes a key value and the economic benefits of accessing certain types of data are greater if it is available to as many people as possible in the overall process. At the same time, it must be emphasised that these developments pose new challenges for the protection and proper use of consumer data. It is therefore very important to assess the security considerations for the use of data, striking a reasonable balance between the interests of economic operators and the ability to ensure the necessary level of security.

Digitalisation is also transforming the financial system and the way financial services are provided to businesses and population. The ability to innovate and adopt the latest technologies is important in both the financial and non-financial sectors. Work is under way at both the national and EU level to seize the opportunities offered by technology and facilitate the digital transition of the financial system, while being aware of and controlling the risks associated with them and ensuring consumer rights, privacy and investor protection.

Taking the EU policy priorities, as well as the priorities set in the national policy planning documents into account, one of the priorities of this Plan is the digitisation and accessibility of innovative services. An innovative financial sector can not only provide innovative and convenient services to its customers, but can also serve as a catalyst for innovation in non-financial sector companies. At the same time, the necessity to promote cybersecurity and reduce digital security risks identified in policy planning documents must be taken into account. Cyber security is an element of a comprehensive national defence system. The vision of cyber security policy is a secure, open, free and reliable cyberspace in which the safe, reliable and uninterrupted receipt and provision of services essential to the state and society is guaranteed and the human rights of the individual are respected in both physical and virtual environments.

The Covid-19 pandemic has highlighted the need to accelerate the digital transition. This transition will be important for economic recovery in order to ensure technological independence, competitiveness, green transition, job creation and the improvement of people's living conditions. At the same time, this development must protect fundamental values and the rights and security of citizens. At the same time, investing in the development of fifth generation wireless networks (5G), high-performance networks, digital skills and the digitalisation of businesses and public administrations are essential to overcome the Covid-19 crisis and return to a stable and growing economy. It should be noted that the European Commission has developed recommendations for measures to be implemented by Member States to reduce cyber security risks in 5G networks.

4.1. EU policies to promote the digital transition and innovative financial services

In 2019, EC President Ursula von der Leyen identified as one of the EC's priorities “a Europe suitable for the digital age”. Digitalisation is essential for Europe's ability to deliver democratic governance, security, the social market model, sustainable development and long-term economic growth.

The 2015 Digital Single Market Strategy has been successfully implemented, with 32 of the 36 legislative proposals submitted. At the same time, there is still insufficient data exchange between the public and private sectors in Europe, a lack of digital sector professionals and skills, the growing role of large digital platforms in the economy creates challenges, cyber security challenges remain, as well as Europe has the lowest investment in fifth generation wireless network (5G) infrastructure and the development of artificial intelligence technologies compared to the United States and China. Priorities and areas for action include the digital single market, financial technologies, cybersecurity and stability, digital identity and EU-level regulation of digital assets.

With regard to the financial sector, on 8 March 2018, the EC presented a financial sector action plan for a more competitive and innovative European financial sector.¹⁷ With this plan, the EC set out to create a forward-looking regulatory framework that embraces digitalisation and creates an environment in which financial technology products and solutions can be deployed across the EU, reaping the benefits of the single market without compromising financial stability or the protection of consumers and investors. In that Communication, the EC notes that, based on the findings of the public consultations and in the light of the initiatives already proposed, the EC considers that the scope for large-scale legislative or regulatory action or reform at the EU level is limited at this stage of the process and it will take a number of targeted initiatives to cover the digitisation of the financial sector. The proposed initiatives included:

- the feasibility of innovative models operating across the EU with clear and consistent licensing requirements;
- Proposal for an EU regulation on the provision of collective investment and collective lending services and related requirements;
- increasing competition and cooperation between market participants by introducing common standards and interoperable solutions, etc.

Working on the various initiatives contained in the Action Plan Action plan for a more competitive and innovative financial sector, however, it can be concluded that there are still differing interpretations amongst the EU Member States applied to new entrants to the digital financial services market. To ensure greater harmonisation, the EC launched a public consultations on digital finance on 3 April 2020, to use the proposals and conclusions received during consultations to develop the EU's digital finance strategy, which was published by the EC in September 2020. In

¹⁷ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - FinTech Action plan: For a more competitive and innovative European financial sector https://eur-ex.europa.eu/resource.html?uri=cellar:6793c578-22e6-11e8-ac73-01aa75ed71a1.0005.02 / DOC_1&format=PDF

launching the consultation process, the EC identified the following key priorities:

- ensure that the EU financial services regulatory framework is corresponding for the digital generation, i.e. technology-neutral and innovation-friendly;
- overcome fragmentation and enable consumers and businesses to reap the benefits of the EU's digital single market for financial services;
- promote a data-driven financial sector;
- improve the resilience of digital financial services.

On 24 September 2020, the EC published the Digital finance package¹⁸, the strategic goal of which is to use digital finance for the benefit of consumers and businesses, and which consists of:

- Digital financing strategy;
- Retail payments strategy;
- legislative proposals for an EU legal framework for crypto assets;
- legislative proposal for an EU regulatory framework for digital operational resilience.

The EC aims to foster responsible innovation in the EU financial sector, in particular with regard to innovative digital start-ups, while reducing potential investor protection, anti-money laundering and cybercrime risks. The measures adopted will also play a key role in the EU's economic recovery in the context of the Covid-19 crisis.

The Digital financing strategy aims to make European financial services more understandable and accessible to consumers, and to stimulate responsible innovation and competition between financial service providers in the EU. This strategy will adapt EU rules on financial services to the digital age and technologies such as artificial intelligence and the blockchain. In line with the EC's broader data strategy, the measures adopted aim to promote data sharing and transparent financing, while maintaining EU privacy and data protection standards. The strategy aims to ensure a level playing field for financial service providers, both traditional credit institutions and technology companies.

The aim of the retail payment strategy is to provide European citizens and businesses with secure, fast and reliable payment services. It will make it easier for consumers to make payments in stores and make e-commerce transactions secure and convenient. The strategy aims to achieve a fully integrated retail payments system in the EU, including instant cross-border payment solutions. It will facilitate euro payments between the EU and

¹⁸ https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en

other jurisdictions.

Legislative proposals on crypto assets include a specific framework for crypto assets not covered by other EU legislation, regulation for crypto asset service providers and a pilot scheme for the market infrastructure service providers using blockchain technology. Under the pilot scheme, service providers will be able to claim time-limited exemptions from other EU regulations (Directive on markets in financial instruments, Regulation on improving securities settlement in the European Union, requirements for central securities depositories). The aim of the pilot scheme is to gain experience, support innovation, ensure predictable regulation, limit the risks of fraud and money laundering in crypto asset markets, ensure consumer protection and financial stability.

The legislative proposals on digital operational resilience aim to ensure that all actors in the financial system have adequate safeguards in place to mitigate cyber-attacks and other risks. The proposal includes a common approach to information and communication technology (ICT) risk management, incident reporting according to common principles, regular testing of ICT systems and tools to ensure business resilience and a monitoring system for ICT service providers (financial sector outsourcing).

In October 2020, the ECB published a Report on a digital euro¹⁹, which analyses aspects of the introduction of the digital euro and adapting the euro to the digital generation. The aim of the digital euro would be to introduce a secure form of digital currency for the settlement of various financial transactions, thus complementing the use of cash. Whereas the introduction of the digital euro poses a number of challenges: the impact on financial stability; impact on the banking sector and its funding base; impact on data protection, cyber security, consumer protection; the international role of the euro, careful research is needed to find the best solution to overcome them. The introduction of the digital euro is affected by the growing demand for electronic payments in the Eurozone, the declining use of cash, the emergence of global private payment solutions that pose risks to financial stability and consumer protection, and the widespread use of digital currencies issued by other central banks. The Eurosystem intends to decide on the launch of the digital euro project (research phase) in mid-2021. Being aware that the digital transformation of money affects every inhabitant of Latvia, it is important to promote the availability of information and public understanding of digital financial assets and other innovative financial services.

4.2. Financial sector innovation and digitalisation of financial services

¹⁹ https://www.ecb.europa.eu/pub/pdf/other/Report_on_a_digital_euro~4d7268b458.en.pdf

Digitisation in the Latvian financial sector is at a high level. Innovative services and a developed payment and capital market infrastructure are available to consumers and businesses. An integral part of digitalisation is also the development of financial technology companies, which improves competition and creates innovation in the financial sector. Given the prevalence of Covid-19, the remote availability of financial services is increasing. The revised Payment Services Directive (PSD2) has taken an important step in the use and sharing of customer information with third party service providers. Consequently, both *open banking* solutions and modern possibilities for making payments have been introduced, and it can be safely stated that there are good preconditions for the further development of the digitalisation direction.

According to the population survey conducted by the Bank of Latvia in cooperation with SIA “Latvijas Fakti” in February 2020, the population makes the majority of payments in non-cash. The total number of payments is also increasing. With the increase in non-cash payments, the average number of cash payments continues to decline. A repeat survey in August 2020 showed that Covid-19 exacerbated the above-mentioned trends in household payment habits, with 68% of payments of population settled in non-cash in August, compared with 64% in February.²⁰ Taking these development trends into account, it is important that BoL and non-cash service providers provide users with more attractive, convenient and secure payment services.

Technological developments provide an opportunity to develop new payment solutions, for example:

- in e-commerce, using application programming interface, API, solutions, integrate payments into the purchase confirmation or otherwise include them in the purchase process;
- making *peer-to-peer (P2P)* payments based on a telephone number or other identifier of the recipient;
- POS terminals use square code makers and near field communication (*NFC*) readers;
- create ever new forms of payment that reduce costs for the user while increasing the level of convenience.

The main justification for such changes seems to be the focus on the customer's preferences, i.e. such payment solutions are designed with the understanding that the customer wants to receive a product or service, rather than spend time to make a payment for it.²¹ Similar research is conducted on a regular basis, and the financial sector, as well as other ecosystem actors, are also contributing to a reduction in the use of cash in large-scale transactions. The role of the state in communication is also important, especially in communication on cyber security issues.

²⁰ Bank of Latvia “Payment Radar”, <https://www.bank.lv/darbibas-jomas/maksajumu-sistemas-uzdevumi/maksajumu-radars>

²¹ K. Ozoliņš, “Development of Payments in the Digital Age”, <https://www.bank.lv/par-mums/jaunumi/678-raksti/11853-maksajumu-attistiba-digitalaja-laikmeta>

Regarding Nasdaq capital market infrastructure, the Baltic market forms a single Nasdaq exchange in Tallinn, Riga and Vilnius, providing capital market infrastructure starting from listing, trading and quotation of securities to the settlement of payments and safe custody of securities. The introduced Baltic market model and the joint distribution of information makes the region more accessible and attractive to local and international investors, as well as companies wishing to list their shares on the stock exchange. With regard to sustainable financing, the Baltic stock exchanges have joined the ESG target reporting portal. An updated reporting system was introduced in May 2019, where information is provided by Swedish, Finnish, Danish, Icelandic and Baltic companies that have integrated ESG objectives into their business strategies. In total, 430 companies, including some from the Baltics, currently provide information on the ESG's objectives, which covers a wide range of information on environmental, social and governance aspects.

With regard to payments, the Bank of Latvia has set up a system that allows banks to offer instant payments to their customers²², ensuring the transfer of money from an account in one bank to an account in another bank within a few seconds 24 hours a day, incl. on weekends and holidays. Reachability throughout the Single Euro Payments Area (SEPA) is also ensured, so instant payments are possible to any account in the SEPA country, incl. also regardless of public holidays in other countries. Proxy Registry “Instant Links” provided by the Bank of Latvia offers an opportunity to make payments between accounts in various credit institutions, using the beneficiary's mobile phone number without the need to know the account number. Proxy Registry “Instant Links” of the BoL is currently actively used not only by the largest credit institutions in Latvia, but also by Estonia.

In September 2020, the Bank of Latvia announced the start of work in cooperation with banks and other players in the financial sector on the next significant innovation, which is the introduction of Request-to-Pay at the interbank level, incl. using the possibilities provided by the Proxy Registry “Instant Links”. This innovation will make it easier and faster for both businesses and consumers to make payments. With the introduction of Request-to-Pay, the Bank of Latvia will have provided a comprehensive set for the development and widespread use of innovative interbank payments for more convenient interpersonal payments, e-commerce, commerce, bill payment, face-to-face payments (e.g. for government services) and virtually any other area. It is important that credit institutions join instant payments, instant links, and introduce Request-to-Pay faster, as well as demonstrate their readiness to develop products based on these services for companies. The Bank of Latvia, credit institutions and public administration institutions should inform companies in a timely and coordinated manner about the benefits and specifics of new solutions, as well as promote professional discussions and public awareness on these issues.

²²Instant payments or quick payments are money transfers 24 hours a day, 7 days a week, 365 days a year, including public holidays, making payments to bank customers within a few seconds and allowing the money received to be immediately used further.

The development of Request-to-Pay is one of the first directions of activity in the innovative cooperation and experimentation platform created by the Bank of Latvia - Zib-payment laboratory ZibLab ++. Its goal is to promote and coordinate the development of innovative interbank payment solutions based on instant payments and instant links technology in the Baltic states.²³ Instant payments in Latvia are the next leap in the development of innovative payment instruments after the introduction of the Euro and integration into SEPA.

It is important for the development of innovative payments not only to ensure modern, efficient and secure payment systems, but also to promote the development of convenient and cheap payment services based on them and their availability to consumers.

First, Latvian payment service providers need to comply with Regulation (EU) No. 260/2012 of the European Parliament and of the Council (14 March 2012), establishing technical and business requirements for credit transfers and direct debits in euros, the requirements on which the European Payments Council (EPC) recommendation and the EC Retail Payments strategy vision is based that SEPA direct participants should be reachable via instant payments (SCT Inst) by the end of 2020.²⁴ EU Retail payments strategy²⁵ makes the full and comprehensive implementation of instant payments one of its priorities. Second, payment service providers could develop payment solutions for their customers with much higher added value if they are integrated into the Proxy Registry "Instant Links" and Request-to-Pay infrastructure. It is essential to use such solutions based on open interbank payment standards, replacing closed interbank solutions and thus stimulating the development of new and widely available innovative payment solutions. Thirdly, it is important that state administration institutions, without lagging behind the private sector, provide population of Latvia with the opportunity to use innovative, instant payment solutions when settling accounts with state administration institutions, including tax payments. It should be noted that the planned Request-to-Pay infrastructure and related solutions for payments in the internet environment and physical points of sale have great potential to effectively serve as the backbone of the state e-invoicing and e-receipt ecosystem.

²³H. Ozols, Bank of Latvia "Payment Radar", September 2020, <https://www.bank.lv/darbibas-jomas/maksajumu-sistemas-uzdevumi/maksajumu-radars>

²⁴ In order to comply with requirements of the Regulation of the European Parliament and Council (EU) No. 260/2012 in regard to the SEPA SCT Inst scheme set up by the EPC (Instant Payment Scheme) that its members represent a majority of payment service providers in most Member States and constitute a majority of payment service providers in the Union (this requirement will not be met by the current deadline of November 2020) and without jeopardising the continued existence of the Instant Payment Scheme, the European Commission intends to propose a regulation to extend this deadline by one year and to make it mandatory to participate in the SCT Inst scheme.

²⁵ https://ec.europa.eu/info/consultations/finance-2020-retail-payments-strategy_en

Payment development policy should be shaped by the following priorities:

- **it is necessary to further develop the modern interbank payment infrastructure and promote the use of its assets;**
- **continue to develop payment solutions that offer increased levels of convenience and usability while respecting security requirements.**

4.3. Non-bank financial sector

Historically, the banking sector has been one of the areas most resilient to change. In addition, consumer inertia in financial services is high. Consumers are reluctant to change financial service providers and payment habits. However, significant changes have taken place in recent years. The number of financial technology (fintech) start-ups is growing rapidly in almost all financial services segments. Most of these companies are in the field of retail payments. It should be noted that the probability of failure for fintech businesses is quite high. However, the minority that will be able to set up a sustainable business is likely to fundamentally change certain areas of financial services.²⁶ The development of the latest technologies, accompanied by a change in consumer habits, is forcing financial technology or fintech players to change the status quo by offering faster and cheaper services than traditional financial players, as well as providing a better user experience, incl. offering innovative solutions significantly faster.²⁷

In recent years, the development of financial technologies has become a significant trend in the development of the financial sector, creating competition and new innovations, thus improving customers' daily lives and habits. However, Latvian fintech companies are still relatively small and in the initial stage of development, but at the same time they are growing rapidly and with great potential to become very profitable, and already contribute to the growth of the country's economy. In the future, fintech companies could become a valuable partner for commercial banks and promote the development of the financial system in Latvia.²⁸

As there are relatively high barriers to entry in the financial services sector, the support of supervisors is also crucial in fostering innovation and the entry of new players into the market. Support for innovative financial technologies is one of the FCMC's strategic activities. Within this

²⁶ McKinsey&Company. FinTechnicolor: The New Picture in Finance, 2016

²⁷ Deloitte. FinTech in the Nordics, 2017

²⁸ Inna Romānova, Ramona Rupeika-Apoga. FinTech Study Latvia, 2020

direction, the financial market supervisor has established two support programmes, Innovation Centre and Innovation Sandbox, where the FCMC provides free consultations and support to potential market participants on licensing issues, including issues related to the FCMC's opinion on the use and application of various fintech solutions in Latvia, and in the second of these support programmes, the FCMC offers the opportunity to test new financial products in the Innovation Sandbox.²⁹ At the same time, the FCMC continues to work on the improvement and development of various SupTech solutions.

In 2019, the Bank for International Settlements (BIS) established the BIS Innovation Centre³⁰ to identify and develop in-depth observations of critical trends in financial technologies and their relationship with central banks, to explore the potential of public goods to contribute to the functioning of the global financial system, and to serve as a focal point for a network of central bank innovation experts. Among the projects that are currently being actively worked on is the regulatory and supervisory technological approach (so-called RegTech and SupTech) development, global stack, tokenisation, trade digitisation process, etc. On 30 June 2020, the BIS announced plans to establish four new BIS Innovation Centres - in Toronto, London, the Northern European Centre in London and the Eurosystem Centres in Frankfurt and Paris. The Bank of Latvia, actively involved in the preparation of the Eurosystem's application, observed that the BIS as one of the main requirements for a potential location sets a developed innovative financial service ecosystem consisting of several basic blocks, shown schematically below. Latvia could use this methodology to assess the Latvian fintech ecosystem and define areas where active action is currently needed to improve the situation.

²⁹ <https://www.fktk.lv/licencesana/inovacijas-un-fintech/>

³⁰ <https://www.bis.org/topic/fintech/hub.htm>

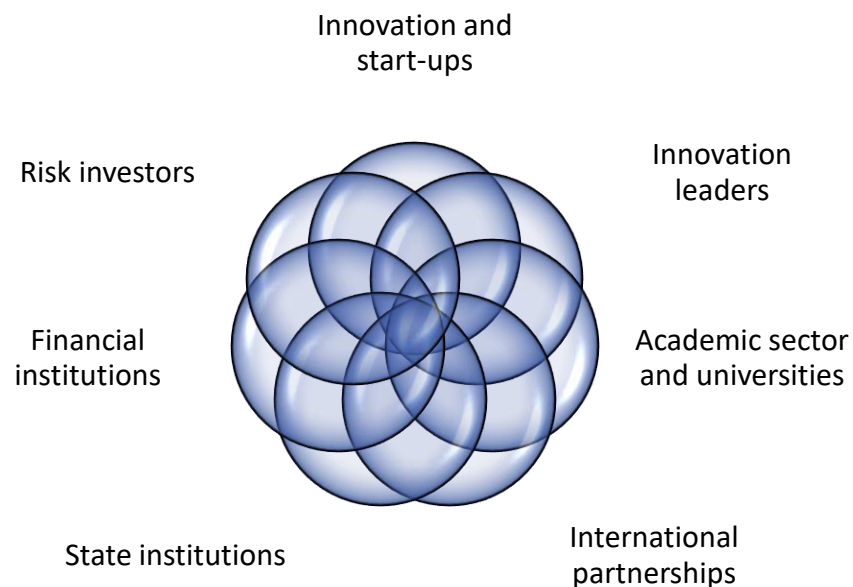


Illustration 14 Elements of the financial innovation ecosystem

There are about 70-90 fintech companies operating in various fields of financial services in Latvia. The number of these companies has increased overall over the last three years. Most companies are active in the provision of loans and various elements related to the provision of payment services, but there are also areas of activity such as online investment and P2P, financial software, blockchain technology-based services, crypto assets, analytics and others. The founders mention the expansion into international markets, attracting appropriate employees and others as the biggest challenges in the near future.³¹

³¹ https://businessnetwork.lv/ievads/finanses/start-up-petijums-53037?utm_source=db&utm_medium=widget&utm_content=start-up-petijums-53037

One of the most advanced areas of financial technology globally is payment services. Thus, in Lithuania, since the establishment of the national fintech strategy in 2017, the number of licences issued in the field of payments (electronic money institution or payment institution licence) has doubled, reaching 118 licensed institutions at the 2nd quarter of this year (57 institutions in the 2nd quarter of 2017).³² In Latvia, on the other hand, this indicator has not increased in 3 years and there are currently 8 electronic money institutions and 6 payment institutions operating in Latvia.³³ However, neither in Latvia nor in Lithuania would all licensed market participants in the field of payments automatically be considered as fintech companies.

It would be important to emphasise that since the introduction of the revised Second Payment Services Directive (PSD2) on 18 July 2018, Latvia has changed the requirements for the commencement of operations, as a result of which the registration regime only provides for an exemption from licensing for limited operations in Latvia. These changes were made in order to comply with the original purpose of the option proposed by the Directive, which would be to clarify operating restrictions, namely a ban on cross-border activities. It was determined that the activities of a registered payment institution and an electronic money institution may only be in the territory of Latvia, as well as customers may be only those located in Latvia or closely related to Latvia. As a result of these changes, the number of registered institutions decreased. In order to continue their activities on a larger scale, all registered institutions were invited to receive licenses, as well as the importance of the activities of licensed institutions was increased, concentrating their sustainable activities not only in Latvia, but also in the EU.

In the global Findexable FinTech index, which was published at the end of 2019, Lithuania took a high 4th place, Estonia - 10th place, and Latvia - 49th place. On the list of fintech cities, Vilnius took 29th place (6th place in the European region), Tallinn 45th place (14th place in the European region), while Riga only 96th place (34th place in the European region)³⁴

The above indicates that there are significant problems in the development of fintech in Latvia and that action would be needed to stimulate the development of the fintech ecosystem in Latvia.

In the area of fintech corporate regulation, there is only special regulation for the reductions in the licensing and supervision fees of institutions

³² <https://www.lb.lt/en/news/electronic-money-and-payment-institutions-managed-to-withstand-the-shock-of-covid-19>

³³ <https://www.fktk.lv/tirgus-dalibnieki/maksajumu-pakalpojumu-sniedzeji/>

³⁴ <https://gfi.findexable.com/fintechs/>

provided for in the Law on Payment Services and Electronic Money. On the one hand, additional regulation would be considered a burden, however, in the case of Latvia it would be necessary to develop a nationwide fintech development policy, which would determine the priorities of fintech development directions at the state level, which could directly stimulate fintech development in Latvia. *Fintech* companies in Latvia offer services that complement both banking services and those traditionally performed by banks, thus the development of fintech promotes competition in the financial services market.³⁵

Barriers to the development of fintech in Latvia at present include: the need for a bank account; restrictions on remote customer registration and account opening, lack of a national support programme.

Fintech is an innovation, i.e. high-risk business, in which, as the experience of Lithuania and the United Kingdom shows, it is important to promote the development of *fintech's* business culture in order to create and develop more ideas. The more fintech companies are created, the more likely they are to be able to create efficient and sustainable business models and contribute to the country's development and public welfare. When creating a framework for the development of fintech, the risks of a specific business model must be taken into account and appropriate supervision must be ensured.

Fintech development policy should be shaped by the following priorities:

- **identify and reduce barriers to fintech development;**
- **assess the state of the Latvian financial technology ecosystem and identify directions in which additional activities would be needed to improve the situation;**
- **create a national strategy and programme for stimulating the fintech ecosystem, incl. to identify priority areas of specialisation in which, taking into account the achievements of other countries in this field, it would be possible to achieve higher goals (for example, artificial intelligence, big data, more extensive use of technologies, etc.);**
- **develop FCMC fintech support tools (sandbox, innovation centre) and strengthen their use;**
- **promote the involvement and contribution of fintech companies in the digital transformation of public administration institutions;**
- **evaluate the practice of the application of regulatory enactments in other EU countries.**

4.4. Data openness and digitisation in Latvia

The European Data Strategy envisages the creation of a single data market that will ensure its free movement within the EU, creating greater access

³⁵ Inna Romānova, Ramona Rupeika-Apoga. FinTech Study Latvia, 2020

to public and private data for the benefit of citizens, businesses and the general public. As part of this strategy, the EC intends to create a common financial data space.

The availability of data is important for research and development activities. Available data and information from public registers promote a level playing field between market participants. The availability of data is important both in business and when evaluating potential investments. According to the Open-useful-Reusable Government data index (OECD, 2019), Latvia's score in this area is 0.54 out of 1, the OECD average is 0.6. Korea, France, Ireland and Japan showed the highest index.³⁶

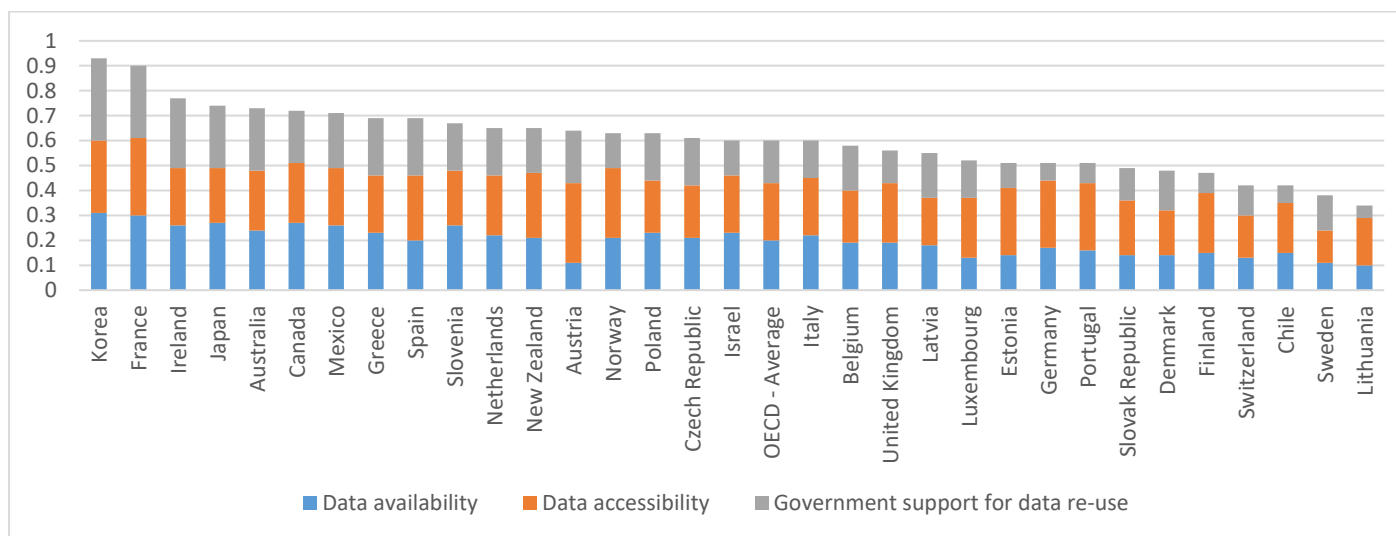


Illustration 15 Open-useful-reusable government data index (source: OECD)

The Cabinet of Ministers has approved the informative report “Latvia's Open Data Strategy”, which outlines further directions for action to promote data openness in Latvia.³⁷

³⁶ <http://www.oecd.org/gov/digital-government/policy-paper-ourdata-index-2019.htm>

³⁷ <http://tap.mk.gov.lv/lv/mk/tap/?pid=40472319>

Although digital technologies help companies to become more competitive, to improve services and products, and to enter new markets, an analysis of the digital transformation shows that this is not the case in all sectors of the economy, in all business segments, or in all countries. According to a number of studies by the European Investment Bank and other institutions, many companies, especially in the SME group, are not realising their digital potential. In Europe, less than 20% of SMEs are highly digitised, compared to 50% in the group of large companies. The level of digitisation is particularly low in Eastern Europe (including Latvia) and the South, often below the EU average. This is most evident in traditional sectors of the economy, such as construction and certain manufacturing sectors. There is a risk that this gap will widen if the main drivers of digital change continue to evolve, while others are increasingly lagging behind, at the risk of losing competitiveness. These companies need to invest in new technologies and digital solutions. This issue must be addressed at both a local and European level, otherwise growth, economic recovery and convergence will suffer. Digital technologies in this case mean robotics, the Internet of Things, artificial intelligence, platforms and other new technologies. In terms of certain technologies and sectors, Latvian companies have better results than the EU average, but in a large number of sectors, Latvia shows one of the lowest results in Europe in the application of digital technologies. In general, digital technologies are used more by large companies. The use of digital technologies has a direct relationship with the amount of added value. Employee productivity and pay are also higher in more digitalised companies.

The level of digitisation of SMEs varies according to geographical location (between different EU regions) and sector, and digitalisation requires limited additional financial investment. EIB Investment Review³⁸ The Digital Transformation Enablers Index is based on the analysis of factors that promote the take-up of digital technologies by companies, such as digital infrastructure, investment and access to finance, demand for digital skills, etc. The results are presented by dividing the EU countries into three groups. Latvia ranks in the third group, or among the economies that are least conducive to the adoption of digital technologies. As barriers to investment in digital technologies, companies most often cite staff shortages, business regulation and taxation, and labour market regulation.³⁹

To track progress towards the digital economy and society, the EC has set up an online tool called the Digital Economy and Society Index (DESI). The index covers a set of five indicators that show the current state of Europe's digital policy at both the EU and national level. Since 2014, the EC has been collecting information on Member States' progress in the digital field through reports based on the DESI index. According to the latest (2020) DESI results, the Latvian DESI index (50.7) is below the EU average (52.6). Although Latvia's index has risen over the past two years, positions vis-à-vis other EU countries have deteriorated - from 15th place in 2019 to 18th place in 2020.⁴⁰

³⁸ <https://www.eib.org/en/publications/financing-the-digitalisation-of-smes-report>

³⁹ https://www.eib.org/attachments/efs/eibis_2019_report_on_digitalisation_en.pdf

⁴⁰ <https://ec.europa.eu/digital-single-market/en/scoreboard/latvia>

In the thematic section on digital integration, Ireland, Finland, Belgium, the Netherlands, Denmark and Sweden report the highest results, while Bulgaria, Romania, Hungary, Poland, Greece and Latvia are well below the EU average.⁴¹

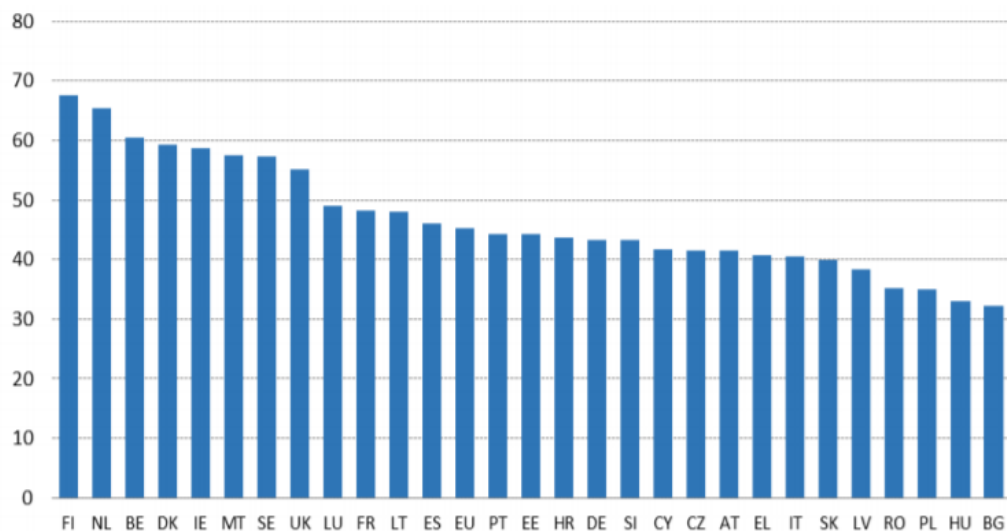


Illustration 13 Digital technology integration (source: DESI 2020, EC)

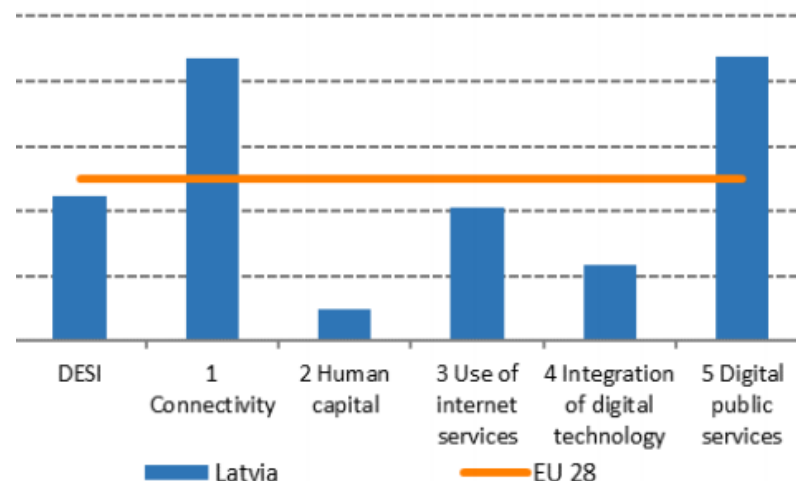


Illustration 14 DESI-2020 relative performance in each area (source: EC)

Latvia has good results in the field of digital public services, fifth generation wireless communication network (5G) and very high performance networks (VHCN). Indicators related to the digital skills of the population and the integration of digital technologies in companies are less good. Judging by digital integration, Latvia ranks 23rd in the EU, also lagging behind the EU average (28.3 and 41.4).

Although the Financial Sector Development Plan does not directly address issues related to digitisation outside the financial sector, at the same time it is important that the financial sector be able to support the digital transformation of the Latvian economy by ensuring the availability of innovative financial services. Data availability and digital solutions in the public sector are also essential for the further digital development of

⁴¹ <https://ec.europa.eu/digital-single-market/en/integration-digital-technology>

both the financial sector and the economy as a whole.

In the light of this chapter, the following actions are proposed in the area of digitisation and innovative services in three directions:

- **creating an ecosystem that supports innovation;**
- **availability of innovation support infrastructure;**
- **educating the public about the opportunities and risks of financial technologies.**

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
2. Digitisation and accessibility to innovative services						
2.1. Creating an ecosystem that supports innovation						
2.1.1.	Establishment of an inter-institutional cooperation framework to support and develop financial innovation.	Effective and coordinated cooperation of state institutions with companies in the field of fintech.	A concept for the creation of an information exchange and cooperation platform has been developed.	MoF	FCCM, BoL, SRS, CRPC, LIDA, FIS	30.08.2021
			A permanent cooperation platform (working groups) has been established.	MoF	FCCM, BoL, SRS, CRPC, LIDA, FIS	31.09.2021

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
2.1.2.	Development of national fintech strategy.	Promoted competition in the financial sector; Development of innovative business; Awareness of the financial technology ecosystem has been promoted.	Establishment of a working group or committee;	MoF	MoF, MoE, BoL, LIPAA, LMENA, STARTIN, FLA, CRPC, FCMC	28.02.2021
			An assessment of the state of the Latvian fintech ecosystem has been prepared, existing barriers to fintech development have been identified and proposals for necessary action have been developed;	FCMC	MoF, MoE, BoL, LIPAA, LMENA, STARTIN, FLA, CRPC	31.06.2021
			Strategy development	MoF	MoF, MoE, BoL, LIPAA, LMENA, STARTIN, FLA, CRPC, FCMC	31.10.2021
2.1.3.	Develop fintech support tools (digital sandbox, innovation centre).	Competition in the financial sector and the development of innovative entrepreneurship have been promoted.	An evaluation and action plan have been prepared in cooperation with the fintech sector.	FCMC	MoF, MoE, LMENA, STARTIN, BoL	31.08.2021
2.1.4.	Establishment of a one-stop agency for start-ups in the field	Competition in the financial sector and the development of	A concept for the establishment and operation of a one-stop agency has	MoE, IDAL	MoF, FCMC, BoL, SRS, ER	31.12.2021

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	of fintech.	innovative entrepreneurship have been promoted.	been developed; Website created or improvement of an existing for the operation of a one-stop agency.			
2.1.5.	Financial innovation monitoring.	Access the most up-to-date information on financial innovations in Latvia.	The financial market has been monitored and a summary of the solutions has been prepared.	FCCMC	SRS, LIDA, MoF, MoE, FLA, BoL	Every year by 31 March for the previous calendar year.
			Financial innovations outside the regulated financial sector have been monitored and a list of fintech companies has been prepared.	IDAL	SRS, LIDA, MoF, MoE, LFNA, BoL	Every year by 31 March for the previous calendar year.
2.1.6.	Promoting cooperation with universities on financial innovation issues.	Cooperation with universities on financial innovation issues has been promoted.	Proposals for further cooperation have been developed.	MoF	MoES, FCCMC, MoE, LIDA, BoL	30.08.2021
2.2. Availability of innovation support infrastructure						
2.2.1.	To assess and remove obstacles and restrictions that restrict the possibility for payment and electronic money institutions to open a current account for the fulfilment of the requirements of Section 38 of the Law on Payment Services and Electronic Money.	Promoted competition and development in the financial sector.	The assessment prepared and reviewed in the FSAP.	MoF	BoL, FCCMC, FLA, LMENA	31.08.2021

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
2.2.2.	Promote the joining of Latvian credit institutions to the European instant payment scheme SCT Inst.	Improved availability of innovative payment services.	70% of Latvian credit institutions have joined the European Payments Council (EPC) SEPA Instant Credit transfer scheme.	FLA	BoL, MoF	30.11.2021
2.2.3.	Promote the participation of Latvian credit institutions in the LB Proxy Registry “Instant Links” and Request-to-Pay Service.	Improved availability of innovative payment services.	70% of Latvian credit institutions use the Proxy Registry “Instant Links” and Request-to-Pay Service.	FLA	BoL, MoF	30.11.2021
2.2.4.	Join the instant payments and related service infrastructure maintained by the Bank of Latvia to provide tax and non-taxpayers ability to make settlements to budget quickly and up-to-date.	The Treasury has joined the LB's instant payment and related service infrastructure and provides access to innovative payment services.	Instant payments allow you to make payments to the budget in a few seconds, 24/7/365 mode.	The Treasury	MoF, BoL	31.12.2021
2.2.5.	Promote the development of the national e-invoicing and e-receipt infrastructure and its alignment with payment solutions, incl. Request-to-Pay.	Improved availability of innovative services.	A notarised exchange place for structured financial documents has been created and the necessary regulatory framework has been developed.	MoF	MEPRD, MoE, BoL, SRS, LFNA	31.12.2023
2.2.6.	Promote the wider implementation of the structured reference approach for payments to large service	Wider use of structured reference solutions.	Common structured reference principles have been developed.	FLA	BoL	31.12.2021

No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
	providers (alternative to personal identification number).					
Educating the public about the opportunities and risks of financial technologies						
2.3.1.	Raise citizens' awareness of digital security (awareness of cybercrime, fraud), reduce exposure to fraud (especially in the Internet environment), by involving national law enforcement authorities.	Promote digital security.	Information measures performed.	FCMC	SP, LFNA, CRPC, CERT.LV	Constantly
2.3.2	Promote the cyber risk management culture of FinTech companies.	Promote digital security.	Information measures performed.	FCMC	FLA, AFSAL, CERT, MoF	Constantly
2.3.3.	Promote the understanding of the population and the financial market about innovative financial services, fintech culture and development.	Promote awareness of innovative financial services.	Informative measures performed.	FCMC	LIDA, MoE, MoF, FLA, CRPC, BoL	Quarterly

5. Sustainable finances

The aim of the UN Framework Convention on Climate Change Paris Agreement⁴² is to strengthen global action to combat climate change, reduce greenhouse gas emissions and keep global warming well below 2 °C in comparison to pre-industrial levels, and seek to limit temperature rises to 1.5 °C, as this will significantly reduce climate change. risks and impacts. The Paris Agreement aims to encourage a shift in investment in line with low-carbon and climate-sustainable development, and achieving this goal will require a reduction in carbon capacity in the economies of the EU and Paris Agreement countries, which will mean a gradual restructuring of economies.

The Cabinet of Ministers has approved Latvia's strategy for achieving climate neutrality by 2050 and the National Energy and Climate Plan⁴³, which sets out the fulfilment of greenhouse gas emission reduction commitments under the Paris Agreement. The EC estimates that the EU will need up to 470 billion euros in additional investment each year to meet the agreement's targets.⁴⁴ Although a successful transition to a climate-neutral economy will require a significant amount of public investment, the transition will be successful if the private sector is involved in channelling of financial resources towards sustainable investment and the financial sector can play a key role in financing the economy.

Sustainable financing requires a direct link between the funds raised and the ability to assess the sustainability impact of the investments made. And a number of shortcomings are to be identified currently in this process.

The transition to a climate-neutral economy involves both opportunities and risks. For the financial sector, the following risks can be identified:

- **physical risks** - due to climate change, economic activity and the value of assets are affected (more frequent extreme weather events - floods, fires or due to environmental degradation - coastal erosion, loss of biodiversity, etc.);
- **transition risks** - when the requirements of regulatory enactments, technological innovations, consumer sentiment, change of market sentiment in the financial sector can cause structural changes and significant changes in the value of assets.

⁴²**The first general legally binding global scale climate agreement** with the aim to strengthen global action on climate change and keep global warming well below 2 °C in comparison to pre-industrial levels and seek to limit it to 1.5 °C. The Paris Agreement was adopted in December 2015 by the Conference of the Parties to the United Nations Framework Convention on Climate Change.

⁴³ <http://likumi.lv/ta/id/312423-par-latvijas-nacionalo-energetikas-un-klimata-planu-20212030-gadam>

⁴⁴ European Commission, “Identifying Europe’s recovery needs”, Staff working document, Brussels, 27 May 2020

It should be noted that in the current context and taking into account the scope of EU regulatory initiatives in sustainable financial sector, in particular, an important role will be played by the transition risks and liability risks⁴⁵. In addition, this impact will be felt not only by credit institutions, but also by the non-banking sector, insurance companies, pension funds, investment funds, the real economy and the population. Although the Bank of Latvia's financial stability report concludes that Latvia will suffer less from physical risks in terms of climate, the FCMC, as a supervisor, will have to focus on transition and liability risks and their impact on the financial sector.

5.1. EU initiatives on climate change and sustainable finance

The EU has long been a world leader in mitigating the effects of climate change. The main policies for the financial sector are set out in the EC Communication “Action Plan: Financing Sustainable Growth” published in 2018, which has three main objectives:

- reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth;
- manage financial risks related to climate change, environmental degradation and social issues;
- promote the transparency and sustainability of financial and economic activities.

Sustainable financing refers to all types of financial services that integrate environmental, social and governance criteria into business or investment decisions in order to provide long-term benefits to customers and society through sustainable development⁴⁶. Sustainable finance usually refers to the process by which environmental and social considerations are taken into account in investment decisions, thus increasing investment and sustainable performance in the long run. In particular, environmental considerations relate to climate change mitigation and adaptation to it, as well as to the protection of the wider environment, such as air and water pollution, depletion of natural resources and biodiversity loss, and related risks (such as natural disasters). Social considerations can address issues such as inequality, inclusion, employment, investment in human capital and communities. Environmental and social considerations are often interlinked, as it is climate change that can exacerbate inequalities in existing systems. As a result, sustainable finances are geared to the long-term goals of society and contribute to more sustainable economic, social and

⁴⁵ Liability risks arise from people or companies seeking compensation for losses they may have suffered from the physical or transitional risks of climate change described above.

⁴⁶ **The concept of sustainable development** is defined in the report of the United Nations World Commission on Environment and Development “Our Common Future” (also known as the Brundtland Commission report, 1987) and has been widely used internationally since the 1992 UN Conference on Environment and Development in Rio de Janeiro. Sustainable development is explained as “development that meets the needs of today without compromising the needs of future generations”. Sustainable development is characterised by three interrelated dimensions: environmental, economic, social. This means that strict environmental and climate resilience requirements and high economic performance do not contradict the fact that economic growth must not degrade the environment while ensuring a high quality of life.

environmental development, including raising awareness and transparency about sustainability risks that may affect the stability of the financial system. EC defines sustainable finance as the process by which decisions on investments in the financial sector are properly taking Environmental, Social and Governance, or ESG considerations into account, resulting in increased long-term investments in sustainable economic activities and projects.

On 11 December 2019, the EC presented the “EU Green Deal”, announcing an ambitious set of measures aimed at all sectors and industries for a fair and inclusive transition to climate neutrality by 2050. To achieve this, it is necessary to reduce CO₂ emissions by 50-55% compared to 1990 levels by 2030, as well as to review all regulatory enactments from the point of view of climate risk. At the EU level, sustainable financing aims to support the goals of the European Green Deal by channelling private investment into the transition to a climate-neutral, climate-resilient, resource-efficient and equitable economy, in addition to public funding.

There is still no common international definition of low-carbon, green or sustainable finance and no single international standard that may or should not be considered a “green” investment. This situation can lead to a loss of confidence in the concept of sustainable investment among those involved in the economic system, and rather serves as an obstacle to increasing sustainable funding. Therefore, in May 2018, the EC announced a package of measures to implement a number of the notified actions in its action plan. The package included proposals aimed at:

- the establishment of a common EU classification system, or sustainable financial taxonomy, for what can be considered as environmentally sustainable economic activity;
- improve disclosure requirements for the integration of environmental, social and governance factors of institutional investors and asset managers into risk management processes;
- create a new category of benchmarks containing low-carbon and positive-carbon benchmarks that will provide investors with better information on the degree of carbon impact of their investments.

The EC has made significant progress on the proposals under the Action Plan, and these three key initiatives are currently being implemented. The final text of the Taxonomy Regulation was published in June 2020 and the EC is currently working on the development of technical criteria for the examination of economic performance, based on the recommendations of the final report of technical experts, to be implemented through delegated acts (some of which will be adopted by the end of 2020, but some by the end of 2021). The Taxonomy Regulation is the most important proposal under the EU Action Plan, which provides a general framework for the development of an EU-wide classification of environmentally friendly economic activities. The Taxonomy Regulation defines six environmental objectives in order to determine the environmental sustainability of a given economic activity, which further includes the economic and social dimension:

- climate change mitigation;

- adaptation to climate change;
- sustainable use and protection of water and marine resources;
- transition to a circular economy;
- pollution prevention and control;
- protection and restoration of biodiversity and ecosystems.

Another very important initiative that will have a significant impact on the financial sector from next year is the changes to the EU Disclosures Regulation, which introduces additional disclosure requirements for asset managers and institutional investors to improve transparency for final investors regarding sustainable finance. This Regulation entered into force in December 2019 and will apply from March 2021. The European Supervisory Authorities shall develop detailed technical standards to support the application of this Regulation. Most of them will be adopted by delegated acts by 30 December 2020.

The EC is currently working on a Renewed Sustainable Finance Strategy, which aims to develop policy instruments to ensure that the financial system genuinely supports companies' transition to sustainability in the context of the impact of the economic recovery from the Covid-19 outbreak. The strategy will build on the 2018 Action Plan, and it is intended that this will include the integration of ESG factors in corporate governance and Ecolabel establishment for retail financial products (retail products). The EC plans to publish the renewed strategy by the end of 2020.

As already mentioned, the Green Deal emphasised the need for long-term signals to divert financial and capital flows to green investment. In this context, green bonds are playing an increasingly important role in financing the assets needed for the transition to a low-carbon economy. However, the EU does not have a single standard for green bonds, so the EC is working on an EU standard for green bonds in the EU. The EC is considering a legislative initiative on an EU Green Bond Standard, and based on the results of the public consultation (on the above-mentioned renewed strategy as well as the targeted consultation on the establishment of an EU Green Bond Standard) and the ongoing bilateral stakeholder dialogues, the EC, in Q4 of 2020, will make a decision on how to further develop the green bond standard. At the same time, it should be noted that the EC letter of intent of 16 September 2020 “On the state of the Union in 2020” marks the establishment of an EU green bond standard among the key new initiatives for 2021. The EC also announced its intention to set a target to provide 30% of the funding with green bonds from the European Recovery Facility funding, in a total of 750 billion euros.

The European Supervisory Authorities (ESAs) are working to develop regulatory technical standards on how environmental, social and governance factors and climate change and environmental risks can be integrated into a financial institution's strategy and risk management, disclosure and

scenario analysis and stress testing.

In May 2020, the ECB published the ECB guidance draft on climate change and environmental risks for public consultation. The guidance sets out the ECB's understanding of sound and prudent management of climate change and environmental risks in accordance with the existing prudential framework and describes what the ECB, as the supervisor of financial institutions, expects from supervised institutions regarding climate change and environmental risk assessment in formulating and implementing its strategy and risk management, ensuring greater transparency regarding exposure to such risks by improving the disclosure of information on climate change and environmental risks, etc.

5.2. Green bonds in Latvia

There is a growing global interest in sustainable financial instruments and a growing number of green, social and dual-use bond issues. So far in Latvia, only two companies (Latvenergo AS and ALTUM) have issued green bonds, which on the one hand is a positive signal, and on the other hand - taking into account the growing interest in sustainable investment opportunities, as well as the need for financing to promote sustainable development, a significant further development in this area is important. Also, no government green bonds have been issued in Latvia so far, therefore it should be assessed whether at present, taking into account the need for investments in this field, as well as market interest, it would be useful to consider issuing such bonds.

In June 2015, Latvenergo AS issued green bonds in the amount of 75 million *euros*, closing the programme in 2016 with another issue in the amount of 25 million *euros*. In April 2020, Latvenergo AS announced a new issue of up to 200 million *euros* for which an issue prospectus has already been approved. In accordance with the strategic goals of the Latvenergo Group, the funds raised will be invested in the implementation of environmentally friendly investment projects. The independent research centre CICERO Shades of Green has assessed the updated green bond framework of Latvenergo AS with the mark Dark Green, which is the highest possible rating on the CICERO rating scale. In April 2020, ALTUM issued bonds for the total amount of 20 million *euros*, which is the second issue under the 70 million *euro* bond issuance programme. These bonds were issued in addition to the bonds issued in 2018 in the amount of 10 million *euros* and to bonds issued in 2019 in the amount of 15 million *euros*.

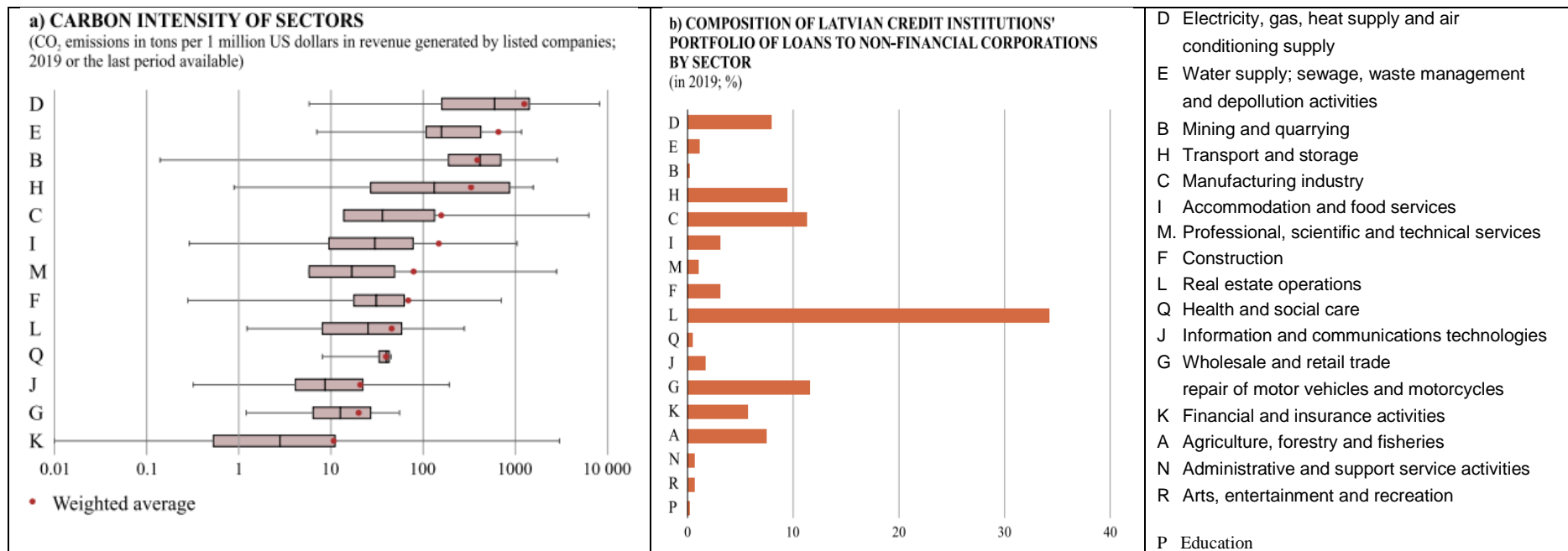
Both Latvenergo AS and ALTUM green bonds are included in the Nasdaq Baltic Regulated Market. In total, the list of Nasdaq corporate debt securities currently includes bonds of four companies, in addition to the bonds of these two companies; the list also includes bonds issued by the Lithuanian company AUGA group, AB and Ignitis Group. In the field of government debt securities, only Lithuania has issued green bonds so far from the Baltic states.

5.3. Impact of climate change on the Latvian financial sector

According to the Bank of Latvia's assessment, climate change will affect the Latvian economy and, accordingly, its financial system less than other EU member states. Climate risks are not significant systemic risks for the Latvian financial sector, taking into account the carbon capacity of the Latvian economy and the structure of the credit portfolio of credit institutions. At the same time, however, it should be noted that further research and monitoring of this issue is needed.⁴⁷

It is important to take into account the fact that there will be a significant impact on the financial sector and the Latvian economy in general from the EU regulatory framework (including changes in the EU Disclosures Regulation and changes in the NFRD). It will affect all actors in the financial sector: banks, insurance companies, investment management companies, large companies - directly and small companies - indirectly, as well as citizens and investors. It is therefore necessary to ensure that the financial sector and the economy as a whole are ready for these changes from the beginning of 2021. In addition, it should be noted that although the Taxonomy was originally largely focused on the private sector, the EC is currently working to adapt and actively use the Taxonomy in the public sector (e.g. through procurement or budgeting, etc.).

⁴⁷ Bank of Latvia, Financial Stability Report 2020, <https://www.bank.lv/lb-publikacijas/finansu-stabilitates-parskats>



Data source: LB Financial Stability Report 2020

Sustainable finances are increasingly becoming part of the financial system, helping to achieve sustainable economic development. Thus, within the framework of the plan, ensuring the achievable goals in the next three years, measures will be included that meet the following priorities:

- Establish an institutional framework for achieving sustainable financial goals;
- Promote the availability of data for sustainability assessment;
- Promote public awareness of sustainable finances.

3. Sustainable finances						
3.1. Establish an institutional framework for achieving sustainable financial goals						
No.	Task/measure	Activity outcome	Outcome indicator	Responsible authority	Co-responsible authorities	Term for implementation
3.1.1.	Establishment of an inter-institutional working group/committee and preparation of a Sustainable Finance Strategy, which will include a concrete action plan and a roadmap for the financial sector towards sustainable financial implementation in the country.	A clearer definition of policy objectives and a roadmap for achieving sustainability goals in specific sectors of the economy has been promoted.	A working group or committee has been set up.	MoF	PKC, MoE, MoA, MEPRD, MoT, FLA, LAA, LVCA, FCMC, BoL	31.03.2021
			A sustainable financial strategy has been prepared.	MoF	PKC, MoE, MoA, MEPRD, MoT, FLA, LTAB, LAA, LVCA, FCMC, BoL	31.12.2021
3.1.2.	The legal framework and the necessary infrastructure for the issuance of “green” or sustainable government debt securities have been prepared. Issuance is ensured in the case of availability of appropriate projects.	An issue of “green” or sustainable government debt securities has been made, based on eligible projects.	An issue of “green” or sustainable government debt securities has taken place.	The Treasury	The Treasury	31.12.2021
3.2. Promote the availability of data for sustainability assessment						

3.2.1.	Improving the availability of ESG data.	Classification of financial assets and liabilities according to ESG criteria, measurement of climate impact has been promoted.	An assessment of the availability of ESG data has been prepared.	MoF	MoE, MoA, MEPRD, MoT, FCMC, FLA, LAA, LVCA, NASDQ Riga	31.12.2021
			Proposals for the improvement of regulation have been developed and submitted to the Cabinet of Ministers.	MoF	MoE, MoA, MEPRD, MoT, FCMC, FLA, LAA, LVCA, Nasdaq	31.12.2021
3.2.2.	Establishment of Ecolabel for retail products.	Improved private investor confidence in “green” products; reduced risk of green labelling of retail financial products without justification.	The authority responsible for awarding the label has been identified.	MoF	MoE, MoA, MEPRD, MoT, FCMC, FLA, LAA, LVCA, Nasdaq	31.12.2021
			Responsible institution has been identified to monitor the adequacy of ESG data.	MoF	MoE, MoA, MEPRD, MoT, FCMC, FLA, LAA, LVCA, NASDQ Riga	31.12.2022
			Legislation on eco-labelling of financial products in accordance with EU requirements has been developed and submitted to the Cabinet of Ministers.	MoF	MoE, MoA, MEPRD, MoT, FCMC, FLA, LAA, LVCA, Nasdaq	31.12.2023
3.3. Promote public awareness of sustainable finances						
3.3.1.	Educating financial sector institutions, public	The public and the financial sector will be better informed	A section of the FM website has been created, which will be	MoF	FCMC, BoL	30.06.2021

	administration and citizens and raising awareness about sustainable finances.	about sustainable financial activities.	dedicated to current issues of sustainable finance.			
				Improved understanding of sustainable finance among financial sector actors.	FCMC	

6. Assessment of the impact on the State and local government budget

The plan has no impact on the state and local government budgets.

Task	Measure	Code and name of the budget programme (sub-programme)	Funding planned in the Medium Term Budget Framework Law			Necessary additional funding					Year of implementation of the measure (if the implementation of the measure is time-limited)
			n year	n + 1	n +2	n + 1	n +2	n + 3	in the subsequent period until the end of the measure (if the implementation of the measure is time-limited)	thereafter annually (if the implementation of the measure is open-ended)	
Total funding for implementation of the plan			0	0	0	0	0	0	0	0	0

Minister for Finance

J. Reirs