FINANŠU UN KAPITĀLA TIRGUS KOMISIJA

OVERVIEW OF FINANCIAL AND CAPITAL MARKET

Quarter 4 2020

CONTENTS

BANKS

Key performance indicators

	2019	2020	Changes
Number of market participants (banks and branches of foreign banks)	14+5	13+3	↓
Assets (billion euro)	22.5	24.3	↑
Non-bank deposits (billion euro)	17.5	18.8	↑
Non-bank gross loan portfolio (billion euro)	13.6	13.1	↓
Share of non-performing loans (NPL) in non-bank loan portfolio[1;2] (NPL), %	5.2	4.7	↓
Share of loans past due more than 90 days in non-bank loan portfolio[1], %	3.2	2.3	↓
Share of provisions to non-bank NPL[1;2], %	31.1	27.8	↓
Share of domestic loans to deposits (household and non-financial corporations)	87.2	75.7	↓
Return on Equity[1], % (ROE)	9.5	5.4	↓
Cost-to-income ratio[1], % (CIR)	61.6	67.8	↑
Common Equity Tier 1 capital ratio[1], % (CET1)	22.1	24.6	↑
Total Capital Ratio[1], % (TCR)	23.4	25.7	↑
Liquidity Coverage Ratio[1], % (LCR)	310.9	370.7	↑

- **In the first quarter of the year, the winding-up process of several credit institutions in Latvia was completed**. Implementing groups' strategic decisions on the termination of businesses in Latvia, in the first quarter of the year the activities of branches of "Danske Bank" and "Svenska Handelsbanken AB" groups were suspended in Latvia. On 18 February 2020, the European Central Bank (ECB) decided to withdraw authorisation of "AS PNB Banka", which had actually been suspended since 15 August 2019, when the ECB, as the direct supervisor of "AS PNB Banka", declared "AS PNB Banka" as failing or likely to fail, and the European Single Resolution Board decided not to take resolution actions in respect to the Bank (i.e. not to take measures to stabilize the Bank's activities). On 12 September 2019, Riga City Vidzeme District Court declared it insolvent, and the FCMC proposed that the ECB take a decision on the withdrawal of authorisation.
- **The total assets of the Latvian banking sector increased significantly**. The total assets of the Latvian banking sector grew by EUR 1.9 billion or 8.4% during the year, but excluding the impact of the termination of credit institutions, the increase in assets reached 10.9%. A relatively rapid increase in the amount of assets in the reporting year was driven by two factors. Firstly, the participation of a number of credit institutions in the auctions of the European Central Bank's targeted longer-term refinancing operations (TLTRO III) with a total of almost EUR 1.2 billion. Secondly, the growing uncertainty about the economic development prospects and the decrease in consumption contributed to a rapid increase in deposits of domestic non-financial corporations and households, resulting in an increase in total deposits of EUR 1.4 billion or 7.6%. As lending activity remained weak, the amount of funds placed in the central bank increased significantly (by EUR 506.6 million or 13.1%) as well as investments in securities (by 1.6 billion or 82.3%).
- **The amount of deposits held by non-bank customers in the banking sector as a whole increased significantly during the year (by EUR 1.3 billion or 7.6%).** Domestic deposits increased considerably, i.e. by EUR 1.4 billion or 10.1% (including non-financial corporations by EUR 827 million or 17.4%, households – by EUR 966 million or 12.8%, other financial institutions – by EUR 78 million or 10.3%, while general government deposits declined by EUR 461 million or 52.6%). At the same time, deposits of foreign customers continued to fall (by 2.1% or EUR 73 million), mainly households and non-financial corporations' deposits, while financial institutions' deposits increased substantially. The geographical

[1] Ratios calculated according to The EBA methodological guide (www.eba.europa.eu), including only credit institutions active at the end of 2020 (Ratios *ROE, CET1, TCR* and *LCR* – only for banks active at the end of 2020)
[2] Excluding claims on the central bank and other credit institutions

structure of deposits continued to change in favour of domestic deposits, reaching a share of 81.7%, while the share of non-EEA customer deposits in total deposits continued to shrink (from 6.7% to 5.7%).

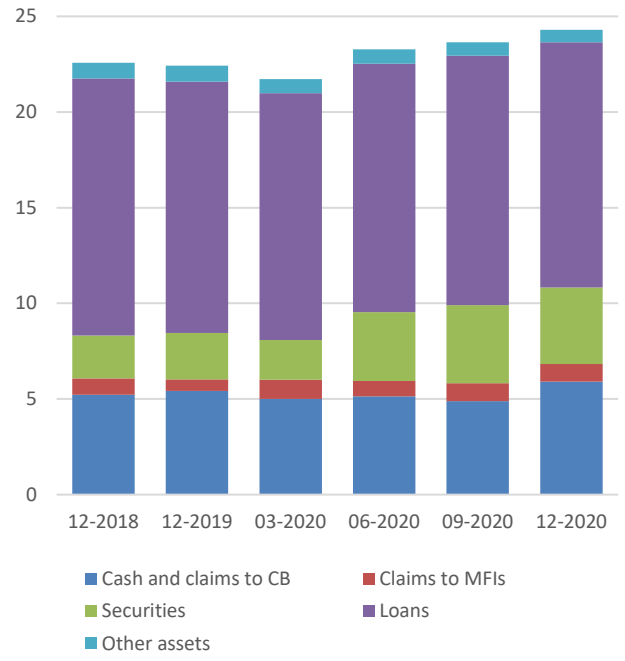
- **Liquidity indicators continued to improve during the reporting year.** The average EU harmonised liquidity coverage ratio (LCR) increased in the reporting quarter, reaching 371%, which was 56 percentage points higher than at the end of the previous year. For individual banks, the ratio ranged from 137% to 590%, well above the minimum requirement of 100%. The improvement in the liquidity situation of the banking sector was mainly driven by the rapid increase in deposits, with banks substantially increasing their balances in the central bank.
- **The total amount of loans granted to non-bank customers in Latvia's banking sector diminished by 3.9% during the year,** including 3.0% for domestic customers. The overall decrease in the amount of loans to non-bank customers was largely due to structural changes in the Latvian banking sector: the withdrawal of authorisation of one credit institution and termination of the activities of two branches of foreign banks.
- **Excluding the effects of the above-mentioned structural changes, the size of the non-bank customer loan portfolio decreased by 1.0%** in the reporting year, mainly due to a reduction in the domestic loans (by 1.1%). Loans of domestic non-financial corporations declined (by 2.0%), while the domestic households' loans increased slightly (by 0.8%). However, lending developments in the reporting year were broadly characterised by significant differences between market participants: if the amount of loans granted to domestic customers in certain credit institutions did not change significantly or even decreased, some banks experienced a relatively rapid increase in lending to domestic customers, including the banks that continued implementation of reviewed business models. In these banks the portfolio of loans to domestic customers increased by 17.8% or EUR 112 million during the year, confirming their involvement in the domestic lending market in line with the settings of business strategies. Nevertheless, the impact of those banks on the overall changes in the sector's credit portfolio was not so significant given their relatively small market share in domestic lending (~6%). During the reporting year, the loans of foreign customers continued to decrease, including loans to non-EU customers declined by 12% overall. At the same time, loans to EU customers even slightly climbed (3.9%).
- **The quality of loans to non-bank customers continued to improve, with the share of non-performing loans (NPL) shrinking to 4.7% at the end of December.** During the reporting year there were changes in the structure of the NPL, particularly in the last quarter of the year when individual banks made write-offs of long-outstanding and irrecoverable loans. The proportion of loans past due more than 90 days decreased in the NPL structure, reaching 2.3% at the end of December (compared to 3.2% at the end of the previous year). In general, these processes had a positive impact on the quality of the loan portfolio, and in the last quarter of the year the share of NPL decreased significantly in both domestic non-financial corporations and foreign loans, reaching 4.2% and 12.8% at the end of December, respectively. The quality of domestic households' loans also continued to show a sustainable positive trend throughout the year, with the share of NPL falling to 3.1% at the end of December, due to an improvement in the quality of the housing loan portfolio of 3.0%, while consumer loans showed a slight deterioration of 2.4%.
- **In the banking sector as a whole, the share of provisions to NPL shrank to 27.8% at the end of December,** including a steeper reduction in the last quarter of the reporting year (from 30.2% to 27.8%), when several credit institutions realised write-offs of long-outstanding and irrecoverable loans. The coverage of such loans with provisions has traditionally been significantly higher, so their write-off reduced the average ratio of provisions of the sector to the NPL ratio.
- **In the last quarter of the year, the rate of profit decline in the sector continued to improve.** In the first half of the year, the profit of banking sector was by 70% lower than in the corresponding period of the previous year, while at the end of the year, it was by 36% less, reaching a total of EUR 154 million over the year. The fall in profits was driven by both higher expenditures for provisions (EUR 21 million or 46%) and lower operating income (EUR 57 million or -7.4%). A sharp increase in expenditures related to the provisions occurred in the first half of the year, when credit institutions, assessing the potential negative impact of the COVID-19 pandemic on economic development prospects and the potential deterioration in credit quality, significantly increased their expenditures related to provisions, while some credit institutions experienced a more rapid increase in these expenditures in the last quarter of the year due to long outstanding and unrecoverable loans' write-offs . Accordingly, the rate of return on capital (ROE) decreased to 5.4% in the reporting year, thus significantly lagging behind the 2019 figure (9.5%) and

showing that overall the impact of the COVID-19 pandemic on banks' profitability had been significant. Four credit institutions closed the year with losses and their ROE ranged from -47.4% to -3.7%.

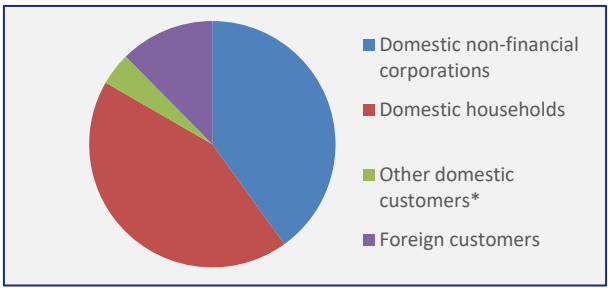
- **Operating income was significantly affected by a substantial decrease in profit from financial instruments and exchange rate fluctuations** (-47% compared to 2019). This was mainly due to asset price adjustments in financial markets during the first half of the year, when the fall in profits on transactions in financial instruments and exchange rate fluctuations reached 88%, but in the second half of the year its effects gradually decreased, thereby reducing the overall rate of the fall in operating income (from 11% to 7%). Although to a lesser extent, operating income had also been affected by the uncertainty created by the COVID-19 pandemic and its impact on the economy as a whole. Net interest income (-1.7 %) and commissions income (-5.3%) also decreased. It should be noted that the opposite trends in net interest income were observed in banks implementing the change in business model. Their net interest income grew 7.9% in the reporting year, reflecting a relatively rapid pace of domestic credit portfolio growth at these banks. Though with the decreasing rate of decline in operating income, the ratio of cost to income in the last quarter of the year improved from 69.6% to 67.8%, it remained significantly behind the 2019 figure (61.6%). A more rapid deterioration in the CIR rate was hampered by a reduction in administrative costs of credit institutions of EUR 13.4 million or 3.1%.
- **Banks' capital ratios improved significantly in the reporting year, providing sufficient capital buffers to cover potential losses during the economic downturn.** At the beginning of the reporting year, in line with the ECB and the FCMC's call to refrain from paying dividends with a view to continue lending, as well as ensuring the absorption of potential losses in the future, a number of banks decided on the inclusion of retained earnings of previous years in capital, significantly improving the overall capital ratios of the banking sector. The last quarter of the year also saw a relatively rapid improvement in capital ratios. This was determined by both capital gains (by a decision already taken by individual banks on retained earnings of the reporting year and inclusion in CET1 capital) and a reduction in risk-weighted assets. The CET1 capital increased by EUR 44.7 million or 2.1% during the quarter, while the amount of risk-weighted assets decreased by EUR 208.8 million or 2.4%, including credit risk (by EUR 135.0 million or 1.8%) and operational risk (by EUR 82.8 million or 7.7%). The decrease in the amount of credit exposures was mainly due to the decrease in total credit portfolio. On the other hand, the decline in the operational risk requirement in the last quarter of the year could be explained by its calculation on the basis of the sum of the net income of the last three years and thus, in the last quarter of the year, the calculation included the results of 2020, in which overall net income had decreased. As a result of those factors, the average CET1 rate of the banking sector improved in the last quarter of the year from 23.5% to 24.6%, while the total capital ratio from 24.6% to 25.7%, i.e. exceeding both the ratio at the end of year 2019 (22.1% and 23.4%, respectively) and the EU average ratio (14.6% and 18.9%).

Balance sheet structure

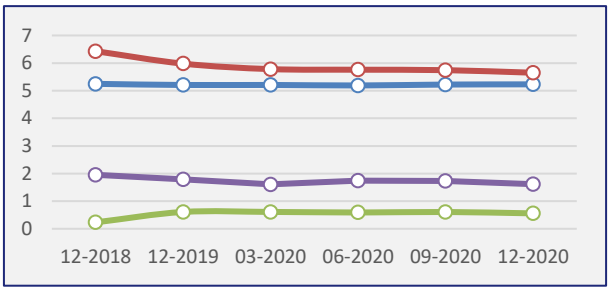
Asset structure, billion euro



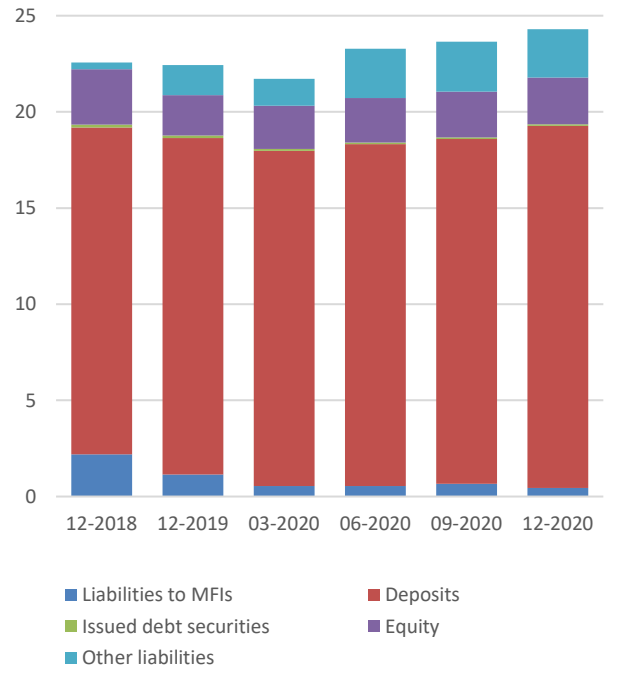
Structure of non-bank gross loan portfolio at the end of reporting period (%)



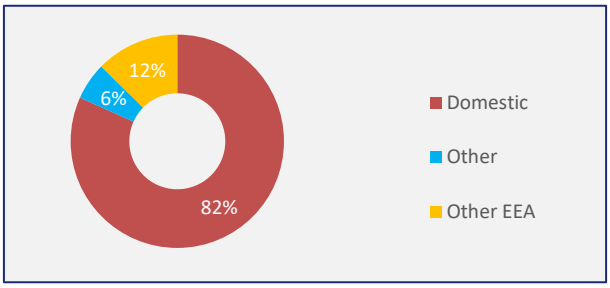
Non-bank gross loan portfolio, billion euro



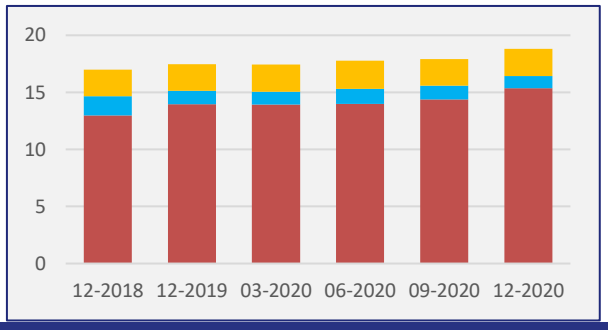
Liabilities structure, billion euro



Structure of non-bank deposits at the end of reporting period (%)



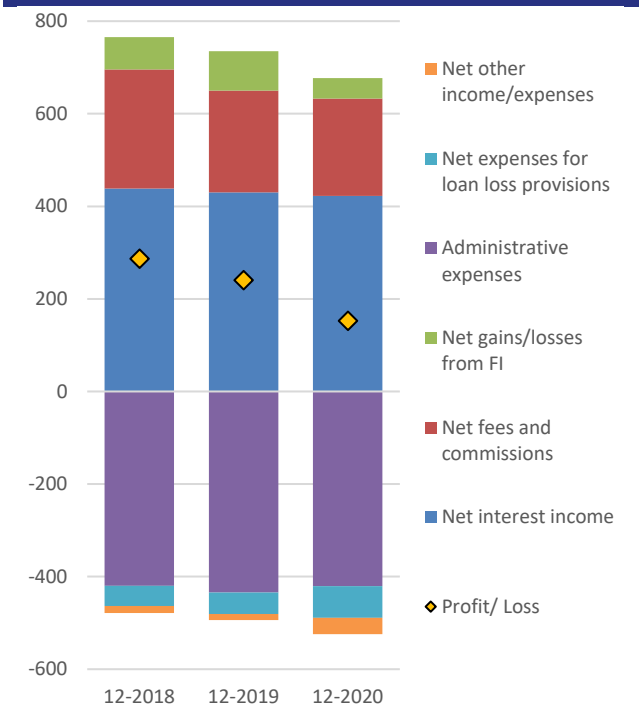
Non-bank deposits, billion euro



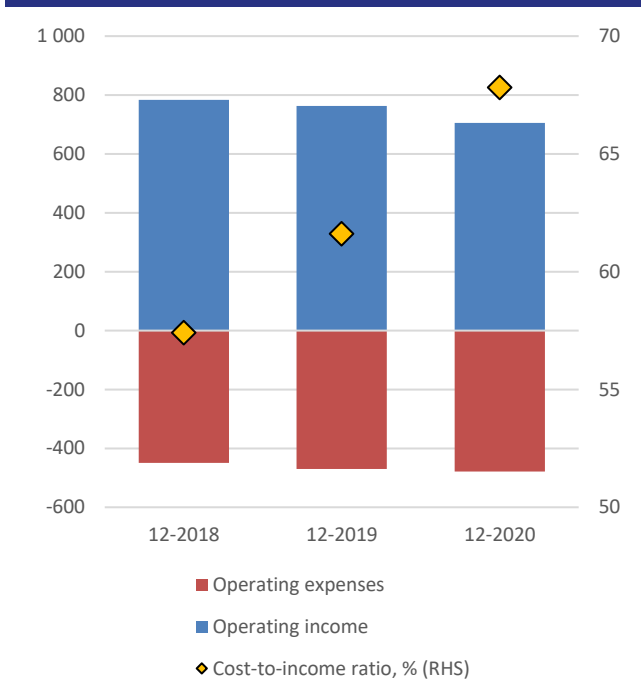
** Central government and financial corporations*

Profitability

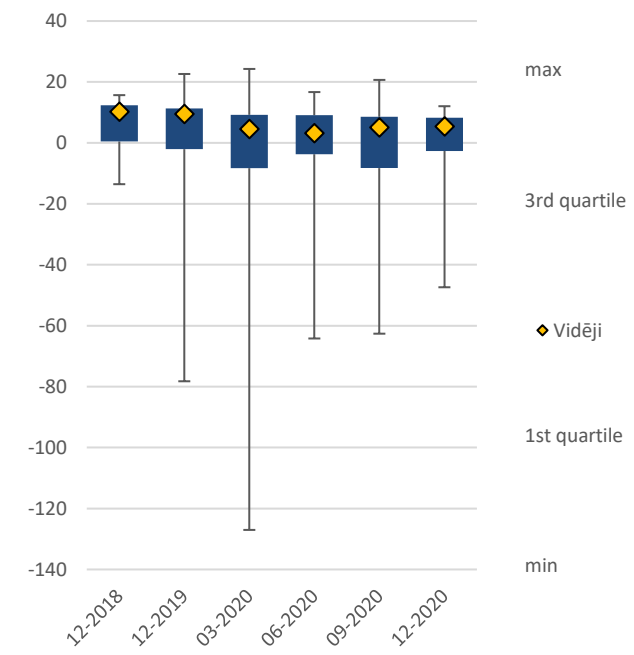
Profit structure, million euro



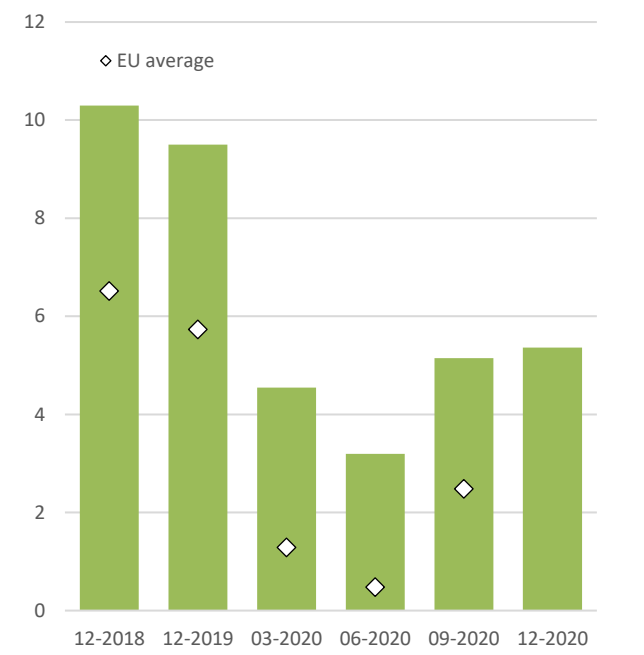
Cost-to-income ratio (CIR),%



ROE dispersion, %



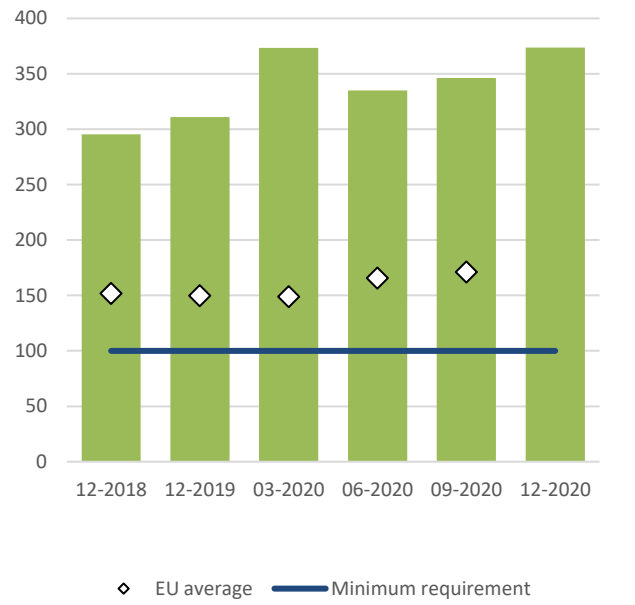
Return on Equity (ROE), %



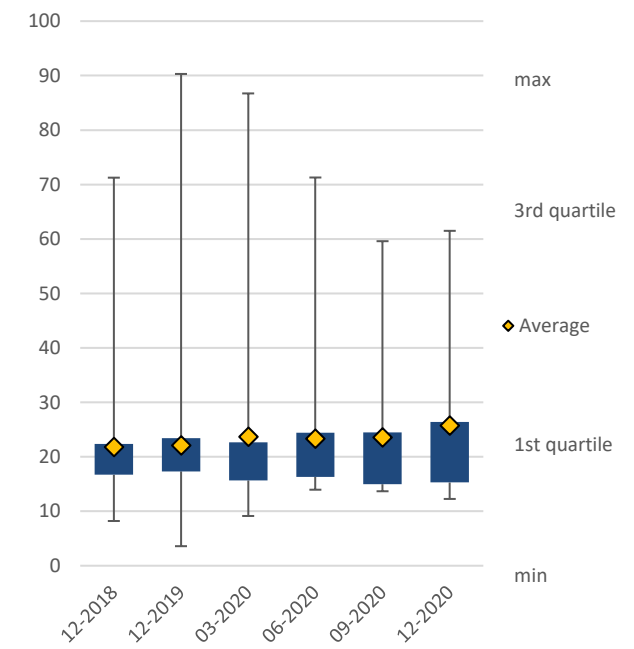
Capital adequacy and liquidity

Capital ratios, %

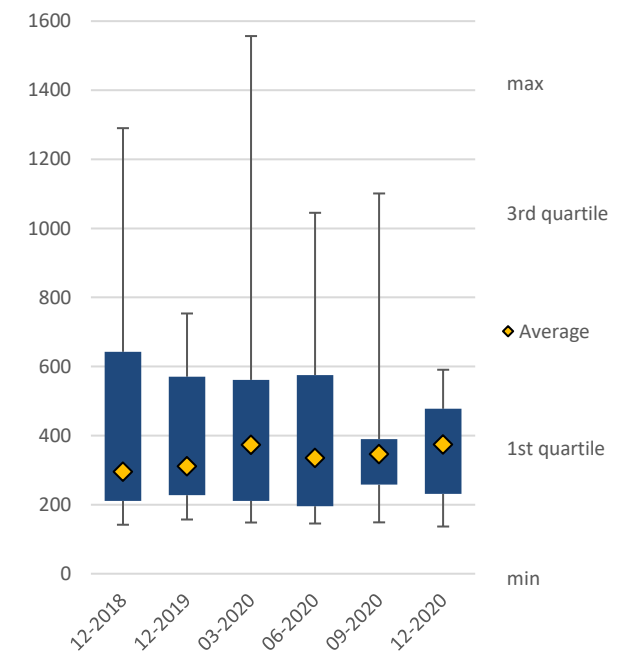
Liquidity Coverage Ratio (LCR),%



CET1 ratio dispersion, %

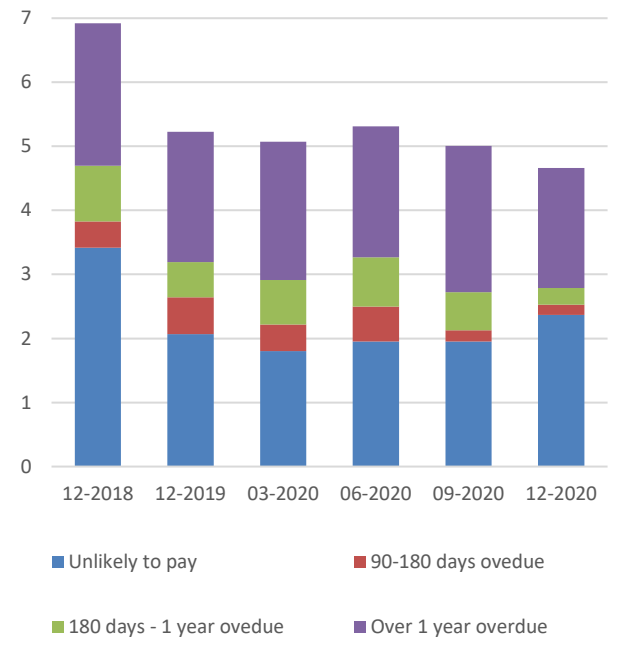


LCR dispersion, %

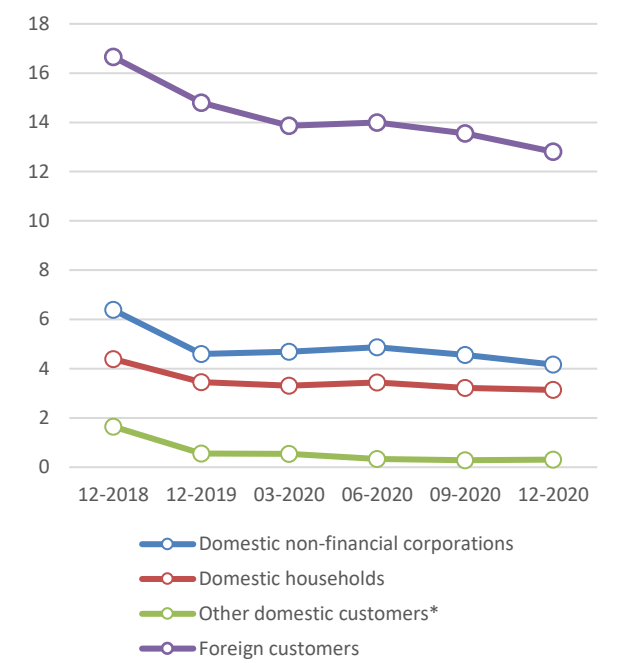


Non-bank loan portfolio quality

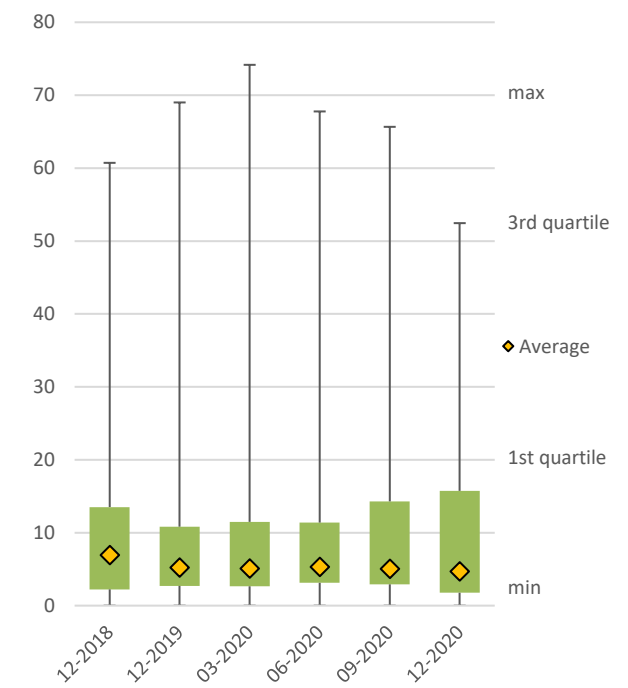
NPL structure, %



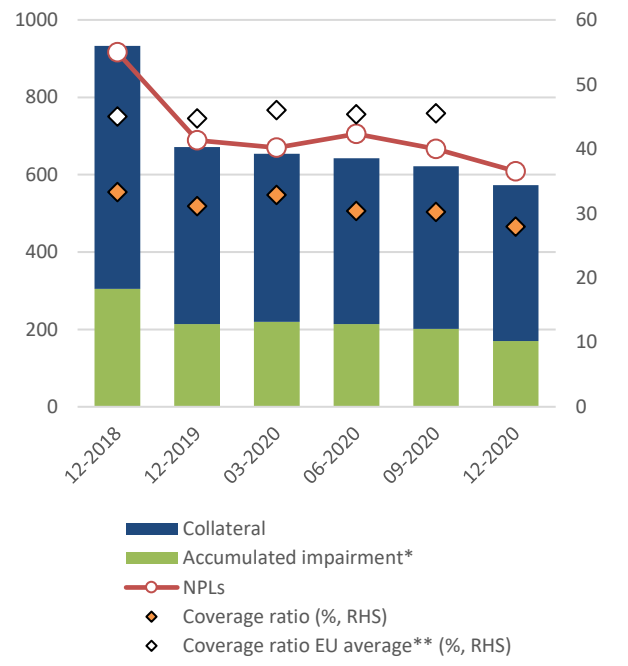
NPL, by respective segment %



Dispersion of NPL, %



NPL, collateral and provisions for NPL, million euro



** Provisions for non-performing loans*
*** Calculated for the entire portfolio in accordance with The EBA methodological guide, including claims on central bank and credit institutions*

COOPERATIVE CREDIT UNIONS

Key performance indicators

	2019	2020	Changes
Number of market participants	35	34	↓
Market concentration[3], %	83.6	82.6	↓
Assets (million euro)	33.2	31.3	↓
Deposits (million euro)	24.2	22.2	↓
Loans (million euro)	25.1	24.2	↓
Share of non-performing loans (NPL)[4], %	14.5	16.9	↑
Provisions to loan portfolio, %	6.8	7.2	↑
Return on Equity (ROE), %	4.7	3.9	↓
Capital Adequacy Ratio (%)	20.4	22.2	↑
Profit or (-) loss for the year (thousand euro)	320	269	↓

- **During the reporting year, the number of credit unions decreased**, with the decision of the Board of the FCMC of 14 July 2020 the licence of the credit union LABA *Kooperatīvā Krājaizdevu sabiedrība* was withdrawn. The credit union did not comply with the requirements for the activities laid down in the Credit Union Law (including the capital adequacy requirements), nor did it comply with other requirements set out in the FCMC's regulatory enactments, including in the field of the prevention of money laundering and terrorism and proliferation financing.
- **Deposits from members decreased during the reporting year** (by 8.3%), which also resulted in a reduction in the assets of the credit union sector. Due to the limits imposed by the COVID-19 pandemic, household income decreased accordingly as unemployment increased[5] and the funds previously accumulated were used to cover the needs. Deposits of credit union members were almost the only source raised by credit unions (~ 100%), and most of them (89%) were household deposits.
- **During the reporting year, the amount of loans repayed and written off exceeded the amount of loans newly issued and the credit portfolio of credit unions decreased overall** (by 3.6%). As uncertainty about the prospects for economic development due to the COVID-19 pandemic increased, the borrowers also became more prudent and, in assessing their priorities, the amount of loans for consumption decreased overall (by 9.5%), while the amount of loans for purchasing housing increased slightly (by 3.0%). The share of these types of loans in the total credit portfolio was 38.1% and 52.0%, respectively. Loans to households (99%) dominated the credit portfolio of the credit unions.
- **The quality of the credit portfolio did not show any positive trends.** The percentage of standard loans remained unchanged during the year, but this was backed by newly issued loans. On the other hand, part of the category of close-watch loans migrated to lower-quality credit categories (mainly the impact of one credit union), thus the share of NPL in the sector's total loans increased from 14.5% to 16.9%. The amount of provisions for loans also increased slightly and its share in total loans reached 7.2% at the end of December, but the share of the NPL provisions to NPL declined slightly.
- **The overall profitability of the credit union sector decreased, with the return on equity (ROE) decreasing to 3.9% at the end of December.** Net operating income decreased, including interest income by 5.3%, fee and commission income by 33.1% and profit from financial activity by 82.6%, with annual profit lower by 16.0% than in the previous year, reaching EUR 269 thousand. Although the decline in profit was partially suspended by lower net expenditure on provisions and a reduction in administrative costs, by 89.0% and 8.6%, respectively, it did not improve performance indicators overall and the cost-to-income ratio (CIR) deteriorated, rising to 77.4% at the end of the year. In 2020, in total, more than half of credit unions posted profits – 20 out of 34 (their total market share – 98.5%), earning a total of EUR 280.3 thousand.

[3] Three largest cooperative credit unions in terms of assets.

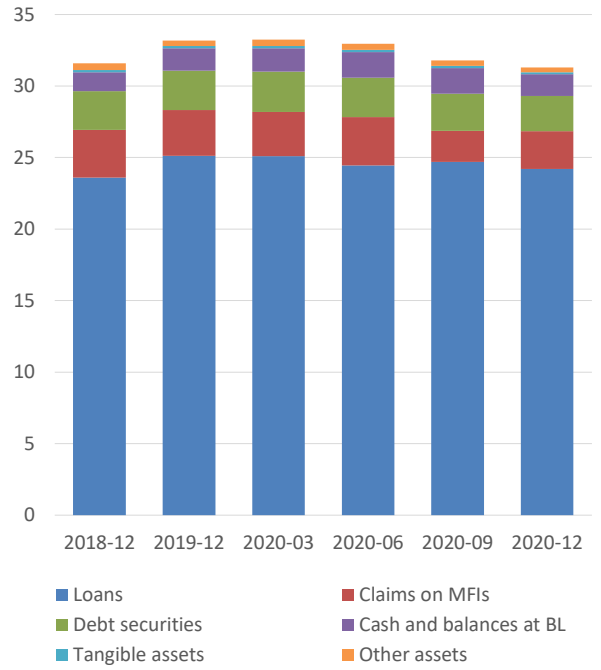
[4] Total substandard, doubtful and lost credits.

[5] According to the State Employment Agency, the official unemployment rate in Latvia was 7.7% at the end of 2020 (6.2% at the end of 2019).

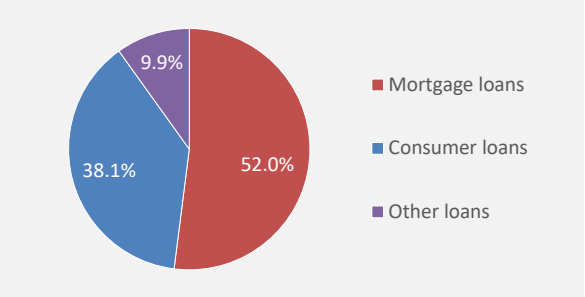
- **In the reporting year, all credit unions presented a sufficiently high capital adequacy**, their own funds ratio to the total assets and off-balance sheet items, i.e. capital adequacy ratio, at the end of December was 22.2% (i.e. the highest rate since 2018). For all credit unions, the capital adequacy ratio exceeded 13.5% (minimum requirement of 10%). The relatively high capital adequacy ratios were driven by both the profit made and asset reductions.

Balance sheet structure

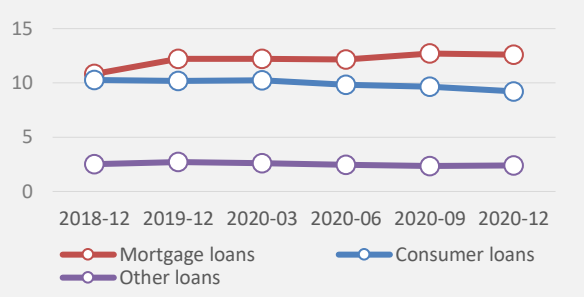
Asset structure, million euro



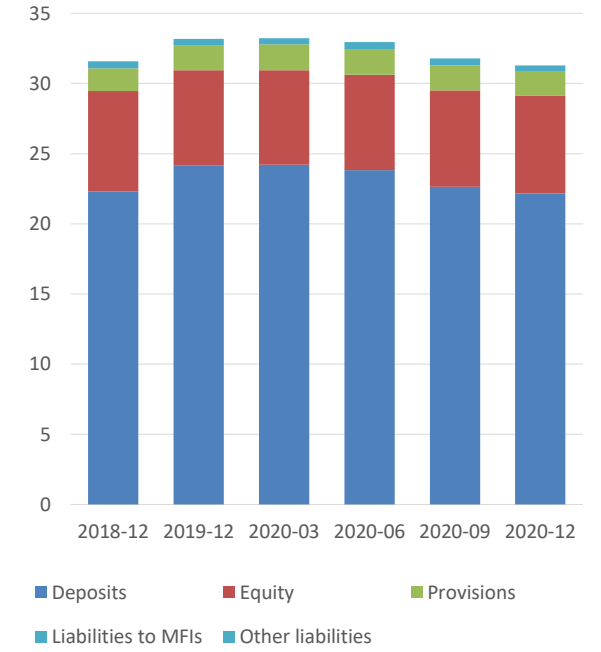
Structure of loan portfolio at the end of reporting period, %



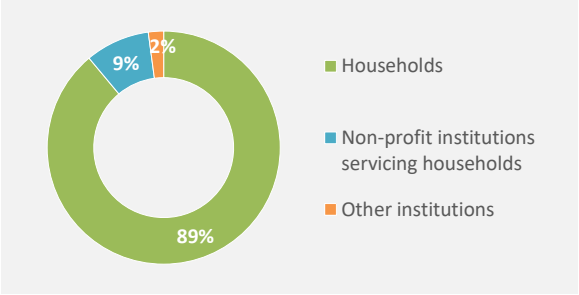
Loan portfolio, million euro



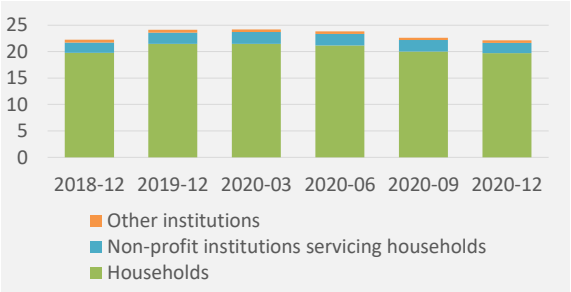
Liabilities structure, million euro



Deposit structure at the end of the period, %

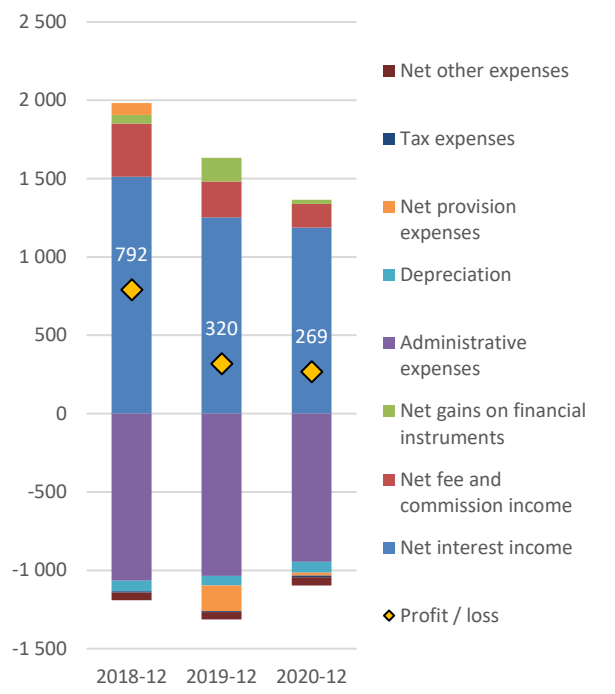


Deposits, million euro

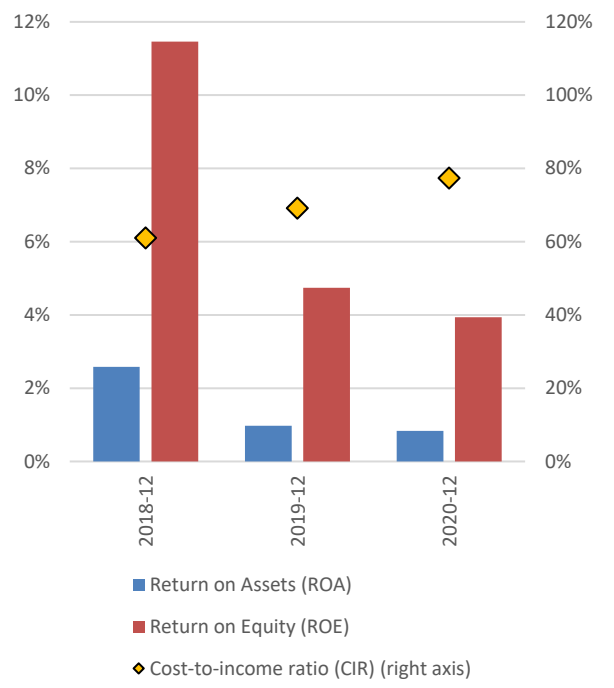


Profitability

Profit structure, thousand euro

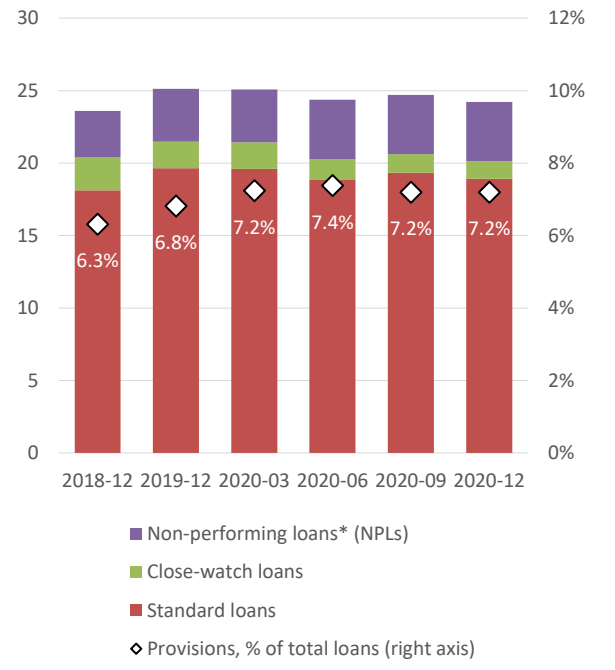


Profitability ratios, %

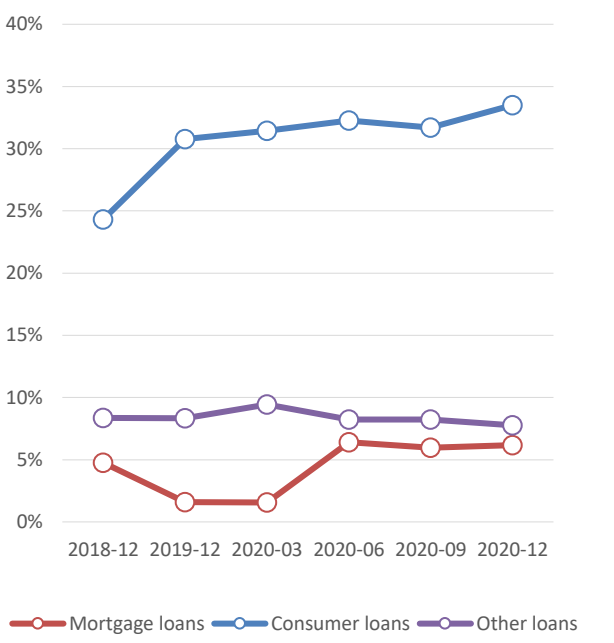


Loan portfolio quality

Loan quality structure, million euro



Share of loans past due more than 90 days in the respective segment,** %



* Total substandard, doubtful and lost loans.

***Data source: Credit Register of the Bank of Latvia.*

INSURERS

Key performance indicators

	2019	2020	Changes
Number of market participants (companies and branches)	6+12	6+11	↓
Gross premiums written since the beginning of the year (million euro)	856.7	797.5 (809.1) [6]	↓
Gross claims paid since the beginning of the year (million euro)	549.4	501.3 (507.7) [6]	↓
Profit/loss of the reporting year (million euro)	30.9	53.4	↑
Loss ratio, %	66.9	62.8	↓
Expense ratio, %	26.6	26.9	↑
Combined ratio, %	96.2	92.3	↓
Return on investment, %	5.6	7.0	↑
Solvency ratio, %	162	173	↑

- **During the reporting year, structural changes were observed in the insurers sector.** As a result, the Latvian branch of the Estonian insurance company Seesam Insurance AS was merged with the ADB Latvian branch of Compensa Vienna Insurance Group.
- **Total gross premiums written decreased by 7% during 2020,** reaching EUR 797.5 million. Excluding the impact of structural changes in the insurance sector (i.e. including data of branch of a foreign insurance company which had ceased its activity as from Q3 2020, the total gross premiums written amounted to EUR 809.1 million). In the non-life insurance segment, with ever-declining business volumes affected by the COVID-19 pandemic, the amount of premiums written decreased by 11% compared to the corresponding period of the previous year, including mainly transport insurance (by 14%), property insurance (by 8%) and assistance insurance (by 47%). On the other hand, the decrease in premiums written in life endowment insurance was offset by a higher increase in annuity insurance, with a total increase in gross premiums written in the life insurance segment of 5%. The decline was observed for insurers' activities in the European Economic Area (EEA) countries, where the amount of premiums written decreased by 13%, while the decrease in premiums written in Latvia was more than 2%, reaching 67% of total written premiums at the end of December, or EUR 537.4 million (EUR 548.9 million, excluding the effects of structural changes). Per capita premiums written in Latvia amounted to EUR 282 (EUR 288 excluding the effects of structural changes), only slightly less than in 2019 (EUR 291), while on average in Europe it was EUR 2 085[7].
- **In the overall portfolio of premiums written, the majority (40%) was still generated by premiums for transport vehicle insurance[8]** amounting to EUR 319.4 million. In Latvia, the most important classes of insurance were life insurance (25%), land transport insurance (16%), health insurance (18%), and OCTAA (16%).
- **The profitability of insurance companies improved**: in the reporting year they earned a total of EUR 53.4 million, a 73% increase compared to the previous year, mainly affected by a 117% increase in profits of non-life insurance companies (EUR 50.1 million in 2020, compared to EUR 23.1 million in 2019) and by successful investment results of insurance companies.
- **With the COVID-19 impact reducing the economic activity of the population and reducing transport use during the lockdown, the amount of claims incurred by insurers decreased more rapidly during the reporting year than the amount of premiums earned and the combined ratio[9] improved by reaching the lowest level in the last few years, i.e. 92.3% at the end of December**, in addition to all non-life

[6] Excluding structural changes
[7] Insurance Europe "European Insurance key facts 2019" infographic
[8] Land vehicle insurance, compulsory civil liability insurance of owners of motor vehicles and motor third party liability insurance (OCTAA)
[9] A combined ratio above 100% indicates losses from the non-life insurance activities (excluding investment income)

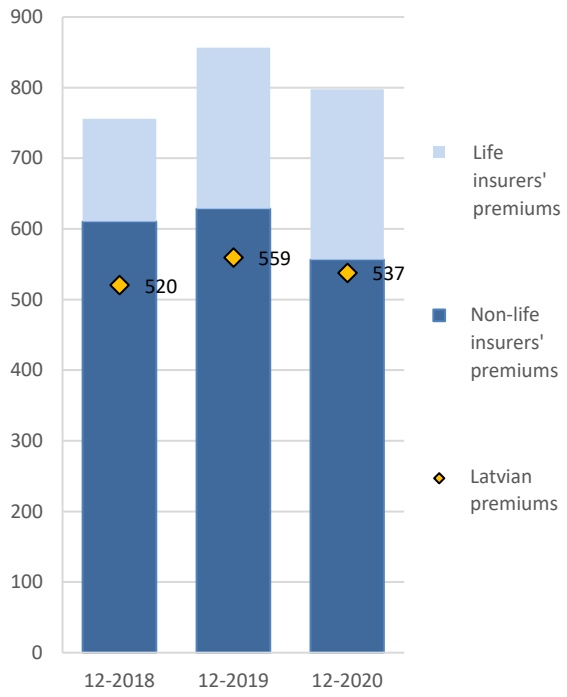
insurance companies it was below 100% (excluding one company with a rate of 102%, operating in other EEA member states).

- **The increased volatility in financial markets resulted not only in challenges, but also opportunities that contributed to a significant improvement in investment yields, with the average return on investment of insurance companies reaching 7%** (i.e. individual companies ranging from 0.3% to 20.7%[10]). In 2020, major changes in the asset structure of insurance companies were: investments in investment funds increased by 12% (EUR 59.3 million) and deposits increased by 26% (EUR 28.8 million).

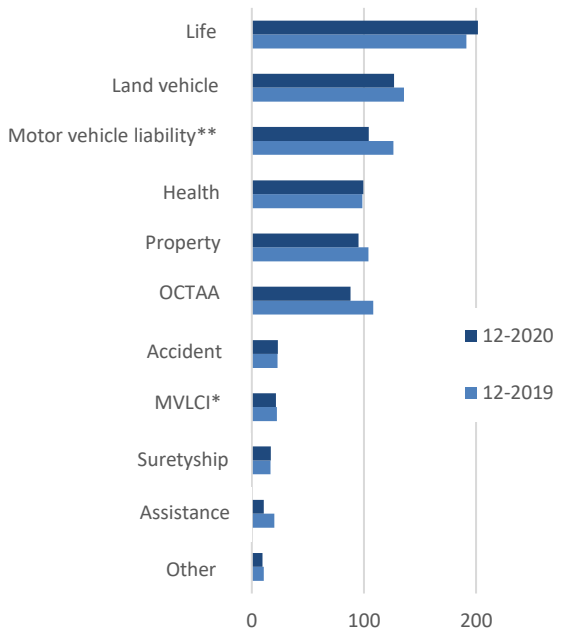
- **The solvency ratio of insurance companies[11] remained stable above the minimum requirements and reached 173% at the end of December** (the lowest permitted limit is 100%), including 228% for life insurance companies and 145% for non-life insurance companies, indicating a low probability of risks affecting the stability of the financial market.

Premiums written

Gross premiums written by insurers, million euro



Gross premiums written by insurers by the class of insurance, million euro



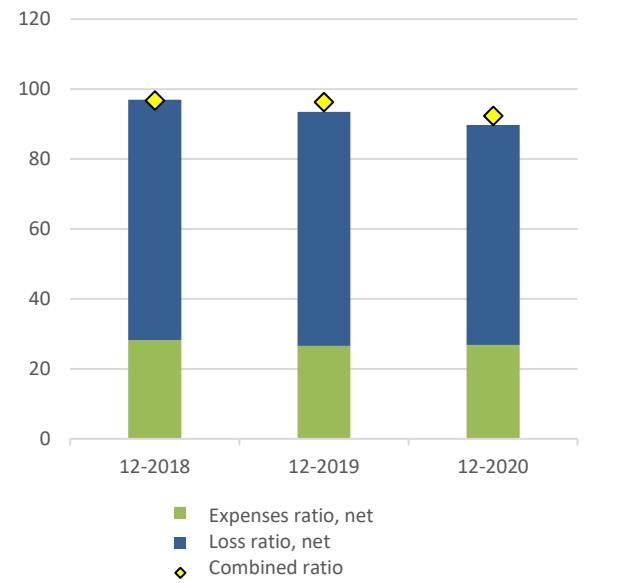
** Civil liability insurance ** Motor vehicle third party liability compulsory insurance*

[10] The rate of return on investment is significantly increased by the result of one single investment realised transaction

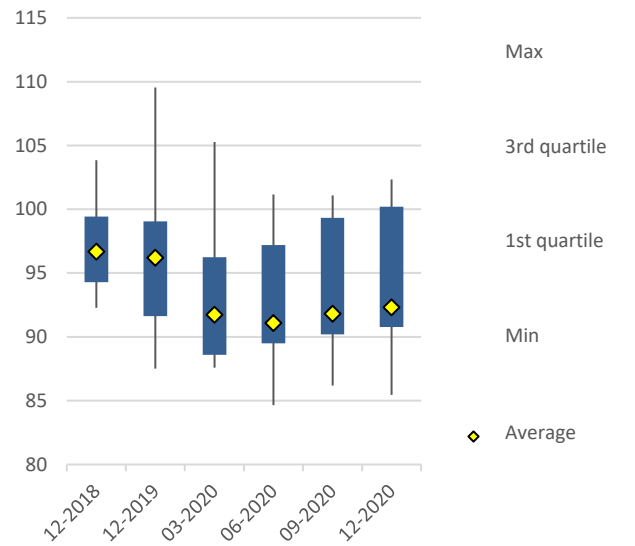
[11] Characterizes the eligibility of own funds to the risk-assessment-based Solvency Capital Requirement

Profitability and solvency

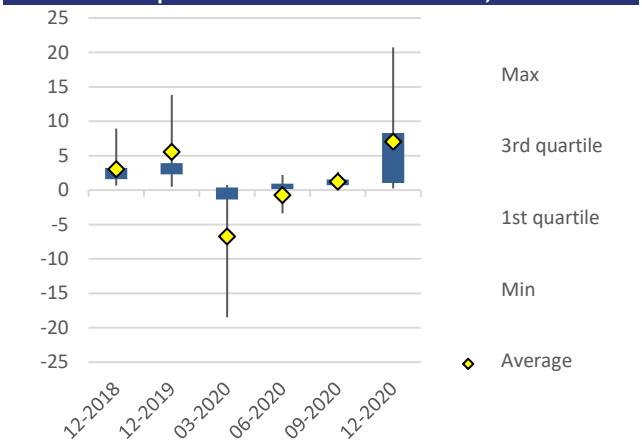
Combined ratio of non-life insurance companies, %



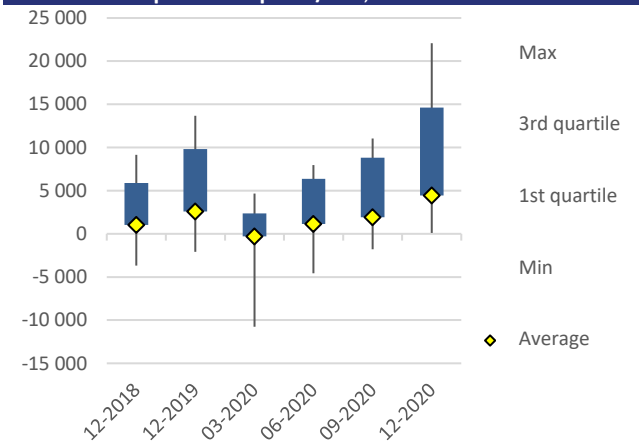
Dispersion of combined ratio of non-life insurance companies, %



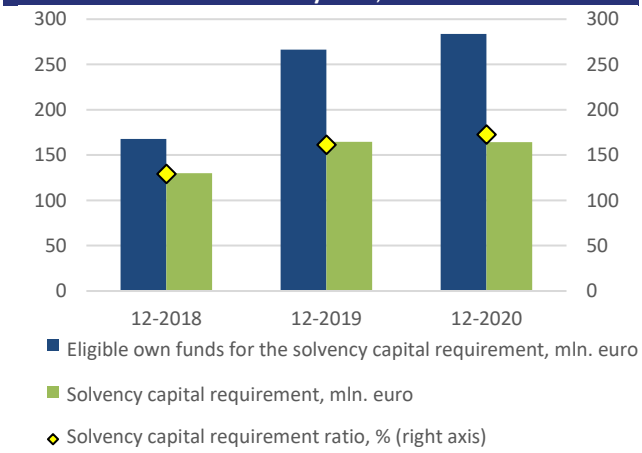
Insurance companies: Dispersion of return on investments, %



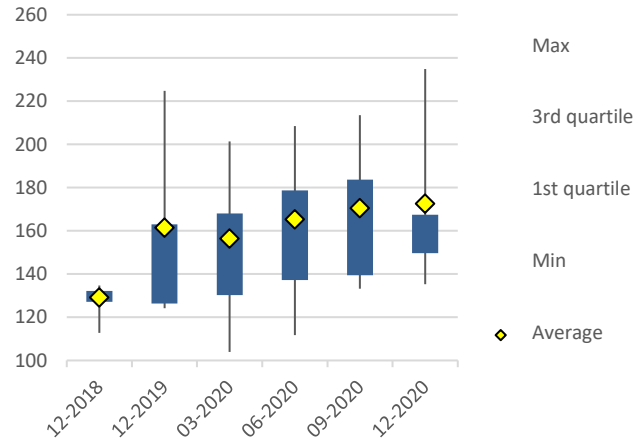
Insurance companies: Dispersion of profit/loss, thousand euro



Insurance companies: Solvency ratio, %



Dispersion of solvency ratio of insurance companies, %



PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

Key performance indicators

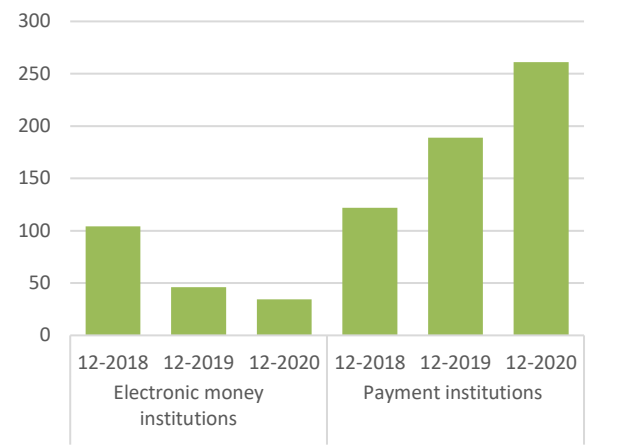
	2019	2020	Changes
Number of market participants:			
Payment institutions	10	7	↓
Electronic money institutions	8	8	-
Amount of payments made by, million euro:			
Payment institutions	189	261	↑
Electronic money institutions	46	34	↓
Amount of electronic money repurchased, million euro	22.7	17.2	↓
Income from the provision of services, million euro			
Maksājumu iestādēs	5.2	7.0	↑
Elektroniskās naudas iestādēs	5.3	3.3	↓

- **The payment institutions (PI) and electronic money institutions' (EMI) sector continued to narrow during the reporting year.** Changes to the regulatory framework introduced in previous periods[12] strengthened the regulatory framework for PI, EMI and payment service providers and the number of institutions representing these market segments continued to decrease. Seven payment institutions (including three registered and four licensed) and eight electronic money institutions (including six registered and two licensed) complied with enhanced compliance requirements and continued operations in Latvia at the end of the reporting year. As a result of the supervisory activities, one market participant carried out a customer base audit, while the licences for Hermes Financial Services, Express-Europe and Monetizator were cancelled.
- **The provision of payment and electronic money services in the reporting year resulted in total gross revenue of EUR 10.3 million** for payment institutions and electronic money institutions (i.e. 1% less than last year), including revenue of 68% generated by the PI (compared to 2019, when the majority (51%) was composed of revenue generated by electronic money institutions), with annual revenue increasing by 35%, while EMI's gross revenue decreased by 37%.
- **The conditions created by the COVID-19 pandemic during the reporting year also significantly affected the total amount of electronic money repurchased** (i.e. the exchange of electronic money issued to the cash), which shrank by 24% during the year, reaching EUR 17.2 million at the end of December.
- **The total amount of payments made by the PI and EMI in the reporting year increased by 26% and reached EUR 295 million.** Although the number of payment institutions decreased, the amount of payments made by them increased significantly, affected by both the redistribution of the existing market and the successful operation of individual market participants.
- **Liquid assets increased,** reaching EUR 57.3 million at the end of December 2020 (including claims against banks for the provision of payment services – EUR 52.1 million), and ensured that customers' claims were covered (EUR 56.4 million), including commitments to users of payment services (EUR 52.3 million). According to the requirements of the law, liquid assets fully covered the liabilities of market participants.

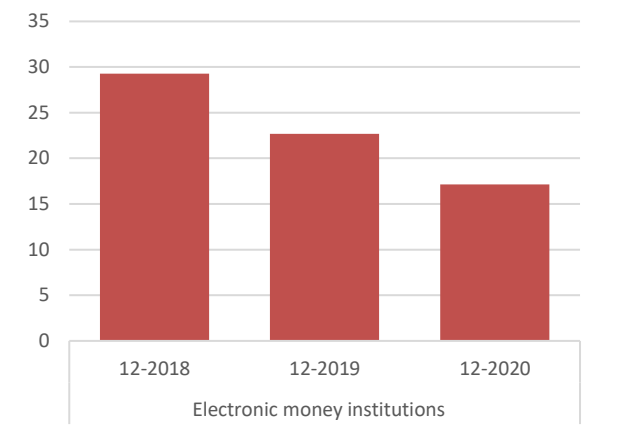
[12] In 2018, transactions monitoring standards were enhanced, as well as amendments made to the Law on Payment Institutions and Electronic Money (in accordance with the European Parliament and of the Council's Directive on payment services in the internal market); on 31 March 2020, amendments to the "Regulations on payment service providers' due diligence and transactions monitoring", amendments to "Regulations regarding Provision of Information Technology for Money Laundering and Terrorist and Proliferation Financing Risk Management" amendments to "Recommendations for credit institutions and financial institutions for the identifying, examination and supervision of politically exposed persons, their family members and closely associated persons".

PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

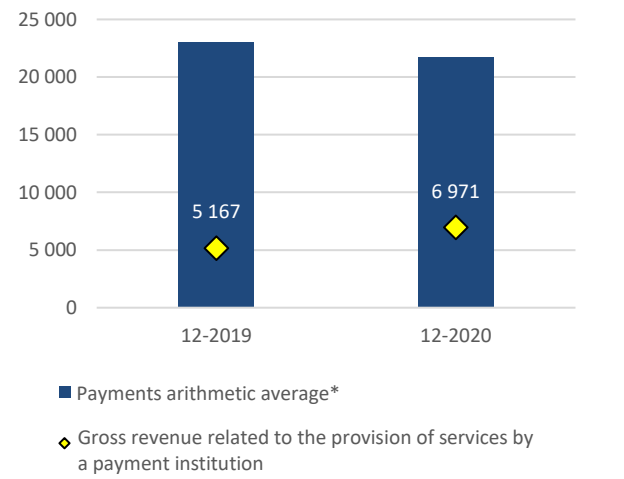
Amount of payments, million euro



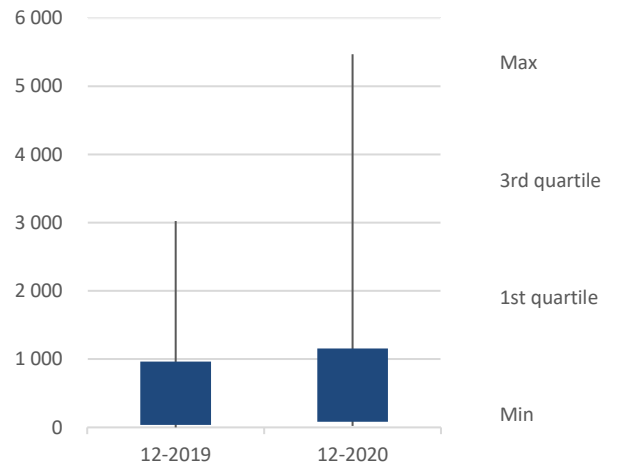
Amount of electronic money repurchased, million euro



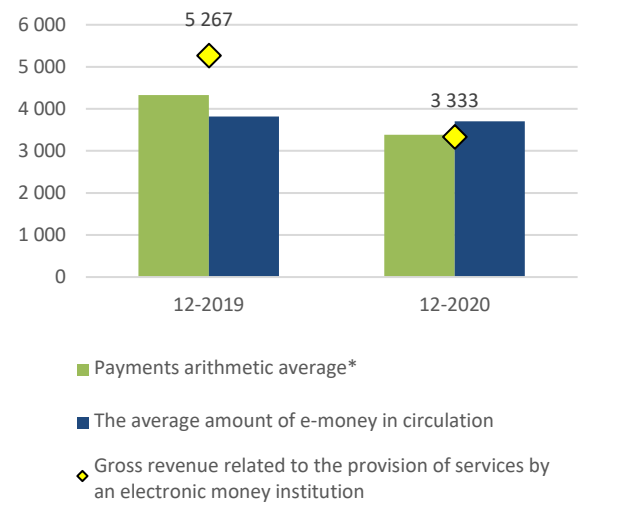
Provision of payment institution services, thousand euro



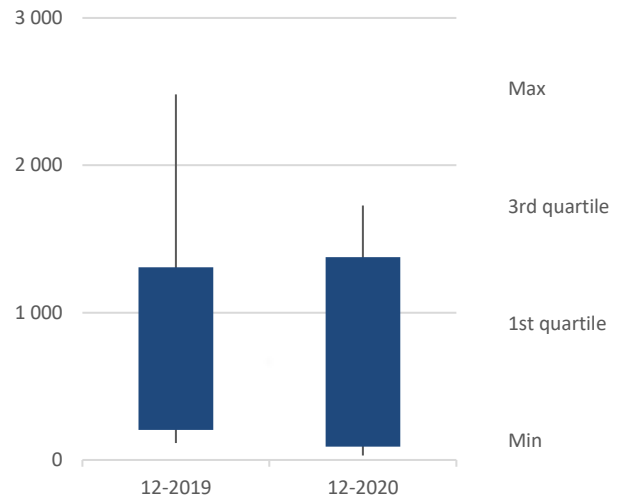
Dispersion of gross revenue of payment institutions, thousand euro



Provision of electronic money institution services, thousand euro



Dispersion of gross revenue of electronic money institutions, thousand euro



** the value calculated by summing up the value of monthly payments made by market participants during the previous 12 calendar month devided by 12*

STATE FUNDED PENSION SCHEME FUNDS

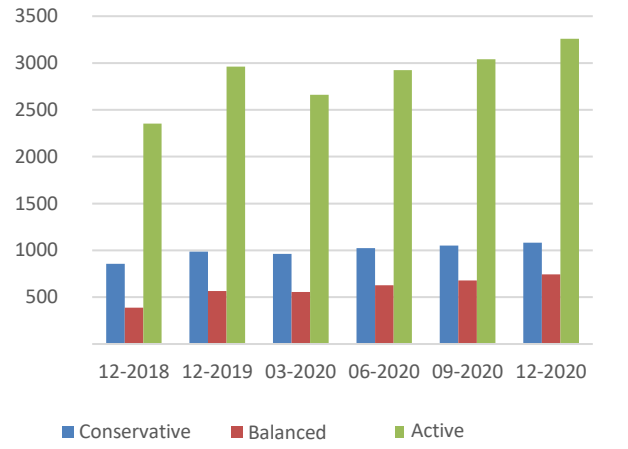
Key performance indicators

	2019	2020	Changes
Number of asset managers	8	7	↓
Number of investment plans	31	31	-
Number of participants	1 300 135	1 295 745	↓
Net assets (billion euro)	4.51	5.09	↑
Returns since the beginning of the year, %	10.8	2.1	↓
Management expenses, %	0.5	0.5	-

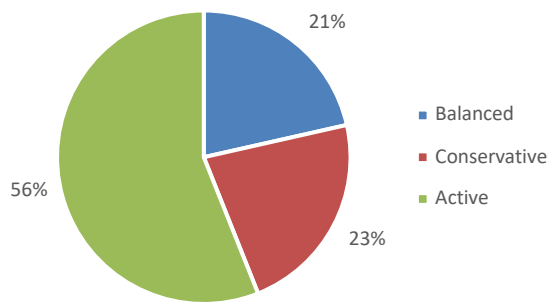
- **In the fourth quarter of the reporting year, following the liquidation of PNB Bank, the process of taking over pension plans from PNB Asset Management was initiated.** Three pension second level investment plans — PNB's Conservative Investment Plan "Daugava", PNB's Balanced Investment Plan "Venta" and PNB Active Investment Plan "Gauja" managed by "PNB Asset Management" were taken over by bank's Citadele subsidiary "CBL Asset Management".
- **The increasing trend in accumulated pension capital continued** and pension capital accumulated in investment plans increased by 13% or EUR 574.2 million during the year, reaching EUR 5.1 billion at the end of December. More than half, i.e. 56% of the contributions made were invested in active plans, 22% in balanced plans and 21% in conservative plans. Despite a slight decrease in the number of participants, total net assets increased by 13%, driven by an increase in the value of investments.
- **Most of the investment plans operated with positive returns in the reporting year**, including the return on conservative plans ranged from -4% to 4% (seven out of 10 plans with positive returns), balanced plans ranging from -11% to 4% (six out of seven positive-return plans), however, active assets ranged from -17% to 9% (15 out of 16 plans with positive returns). The market volatility caused by the COVID-19 pandemic broadly created not only risks but also opportunities, given that equity stock markets generally showed better outcomes than bond markets, in general all active investment plans showed higher yields, thereby contributing to the growth of net assets in the sector as a whole.
- **Investment plan management expenditure remained unchanged** and for all types of investment plans the ratio of investment management expenditure to net assets at the end of the reporting year was 0.5%, indicating the stability of management practices implemented by market participants and the sustainability of administrative expenditure.
- **Investment policy of investment plans generally remained cautious, but the dynamics in share prices during the reporting year contributed to an increase in the share of financial instruments with higher potential yields in the investment portfolio.** In the total investment plans portfolio, the share of debt securities decreased during the year (from 36% to 29%), while the share of investment funds' shares increased (from 54% to 61%). Most of the debt securities (63%) were securities issued or guaranteed by the State and their share in the total debt securities' structure tended to decline, while the share of debt securities issued by commercial companies increased.
- **The amount of investments made in Latvia and their share in total investments decreased during the reporting year.** At the end of the year, the amount of funds invested in Latvia amounted to EUR 658.3 million or 12.9% of total investment (including EUR 91.6 million was invested in securities issued or guaranteed by the State (a 66% decrease compared to 2019, when EUR 271.3 million was invested), EUR 92 million in corporate debt securities (EUR 90 million in 2019), EUR 4.1 million in shares (EUR 3.5 million in 2019), EUR 81.7 million in investment funds (EUR 52.9 million in 2019), EUR 17.4 million – in the Latvian venture capital market (EUR 18.5 million in 2019), while EUR 399.9 million was placed in credit institutions (EUR 291.6 million in 2019)). The observed trend indicated that the pension fund managers applied risk diversification techniques and the optimisation of risk management based on the current market trends, balancing them by generating profits in a high market volatility environment.

Management of State funded pension scheme assets

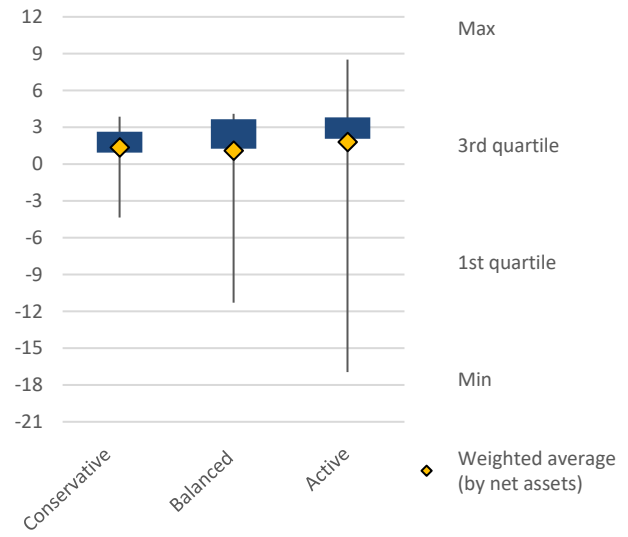
Net assets, million euro



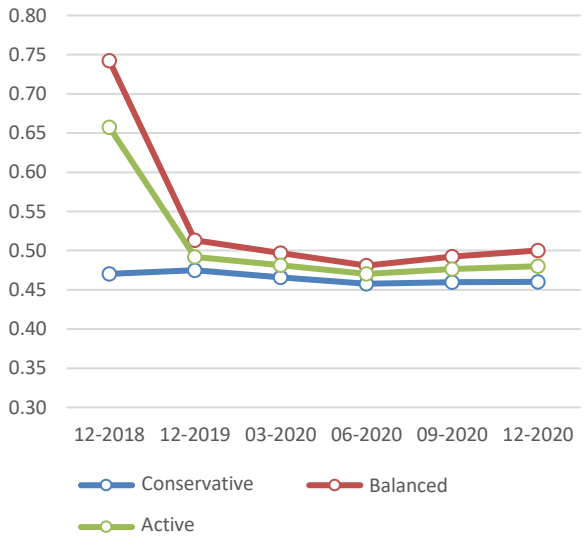
Contributions to investment plans in 2020, million euro



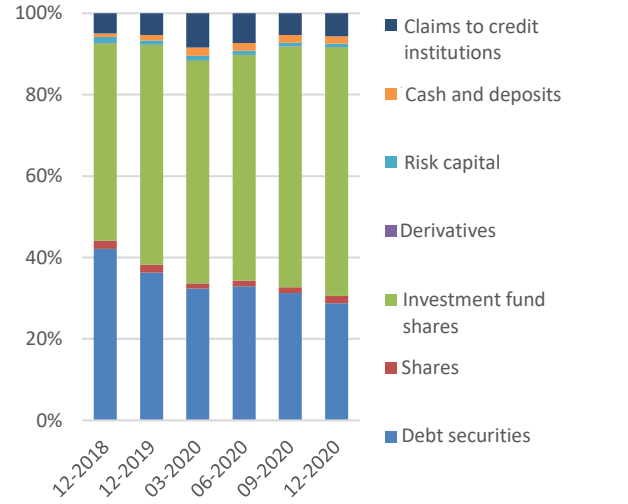
Returns of investment plans in 2020, %

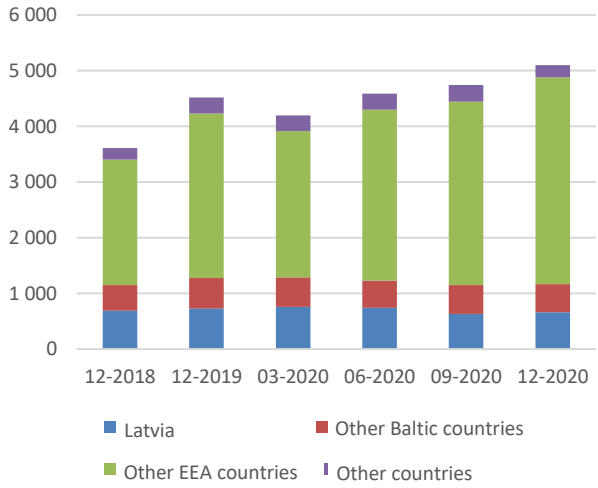


Management expenses (annualized,% of net assets)



Structure of investment portfolio by financial instruments and groups of countries*, %





** by the country of issuer's registration*

PRIVATE PENSION FUNDS

Key performance indicators

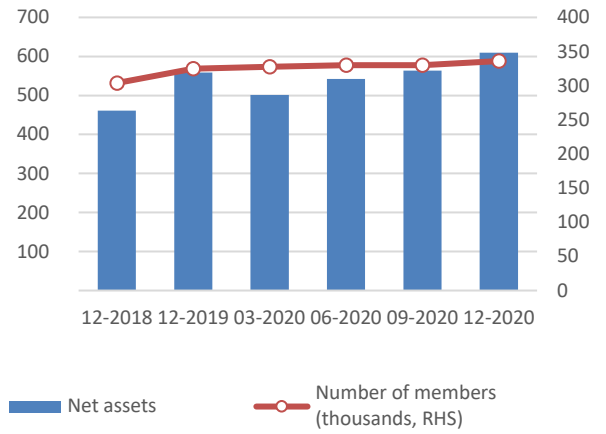
	2019	2020	Changes
Number of pension funds	6	6	-
Number of pension plans	16	16	-
Number of participants	324 829	336 036	↑
Net assets (million euro)	559.0	609.6	↑
Returns since the beginning of the year, %	10	2	↓
Administrative and management expenses, %	1.2	1.0	↓

- **The operation of private pension funds in the reporting year was characterised by a number of positive trends:** both the number of participants in the pension 3rd pillar pension plans and the amount of contributions to pension plans increased. The total return on pension plans remained positive (2%), including individual plans ranging from -4% to 7%. Despite the increase in market risks and the decline in profitability (by 8.1 percentage points), private pension funds were able to adapt to the uncertainty caused by the COVID-19 pandemic, while maintaining overall positive yields.
- **The number of individual participants increased by 11.8 thousand during the year, the number of participants whose contributions were made by employers decreased by 612.** The number of individual participants reached 285 702 at the end of the year, while employers made contributions for 50 334 participants to the 3rd pension pillar. The number of foreign customers gradually increased, reaching 689 or 0.2% of all pension plan participants at the end of December. At the end of the year, the number of participants in private pension plans reached 35% of Latvia's economically active population[13], indicating a gradual enhancement of financial literacy of Latvian residents.
- **The amount of contributions to the pension plans increased from both individual residents and employers.** In the reporting year, overall EUR 88.4 million were contributed to the pension plans, or by 9% more than in 2019. Participants' contributions increased by 6%, while employers' contributions - by 21%, which may indicate the ability of the economically active population to adapt to current labour market trends also in times of uncertainty created by COVID-19 pandemic.
- **The level of private pension plans' management expenses continued to decrease** – the ratio of administrative expenses and investment management expenses to net assets at the end of the reporting year reached 1.0% (decreasing by 0.2 percentage points), indicating the optimisation of expenses for Latvian private pension funds, while ensuring the management according to the financial and capital market trends.
- **The investment structure of private pension plans did not change significantly during the reporting year**: at the end of December, the share of debt securities reached 30%, while the share of investment fund shares represented 57%.
- **Although the amount of funds invested in securities issued by Latvia's issuers increased during the year, their share by groups of countries continued to decline.** At the end of the reporting year, EUR 96 million was invested in Latvia, and the share of these investments in the total portfolio was 15.8% (17.3% at the end of the previous year), while investments in the other Baltic States represented 11.9%, while in other EEA member states 69.7% of all investments. As pension funds diversified their investments, the share of investments in non-EEA countries decreased slightly, reaching 2.6% of total investments at the end of December.

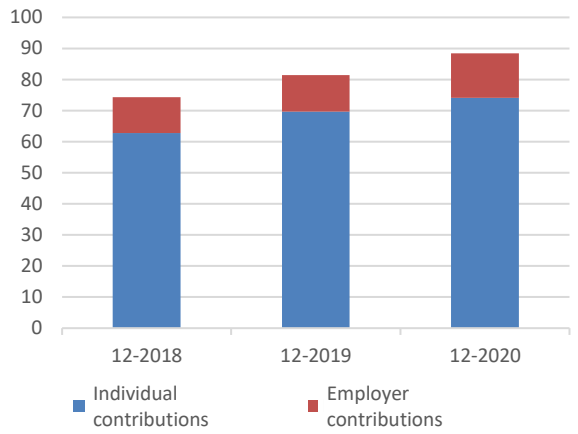
[13] CSB Data: Statistics for economically active population for Q4 2020.

Private pension funds

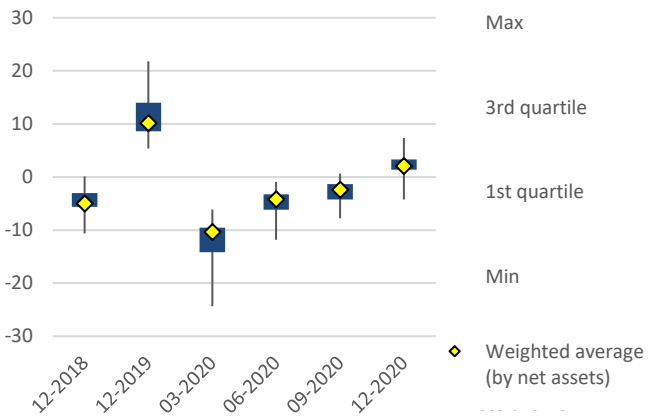
Number of participants and net assets, million euro



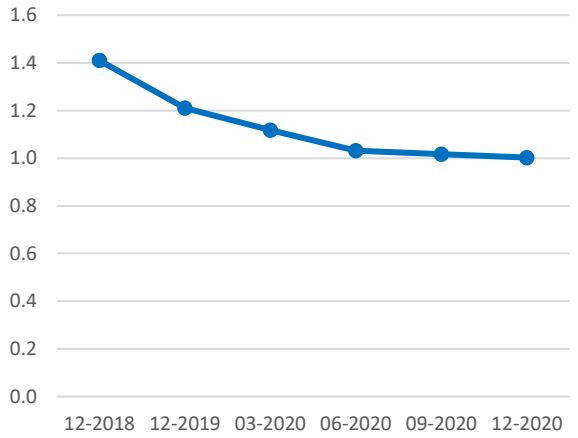
Contributions to pension plans, million euro



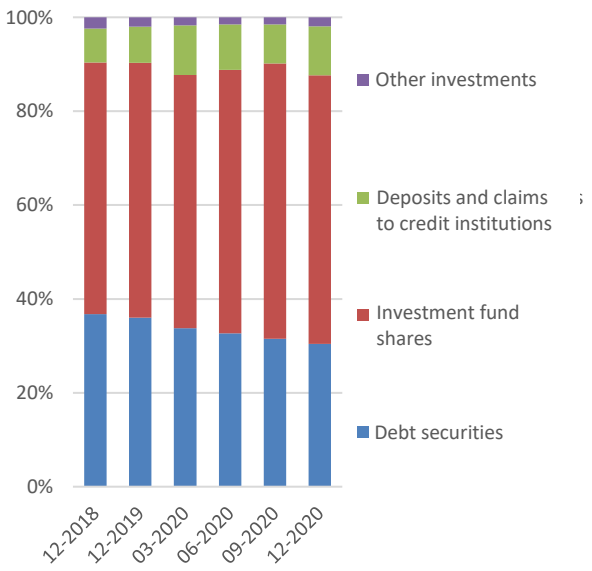
Returns on pension plans in 2020, %

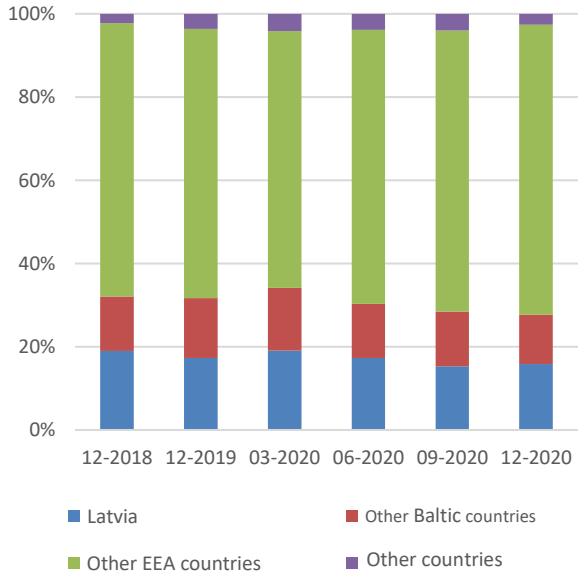


Administration and management expenses (annualized, % of net assets)



Structure of investment portfolio by financial instruments and groups of countries* (%)





** by the country of issuer's registration*

INVESTMENT FUNDS

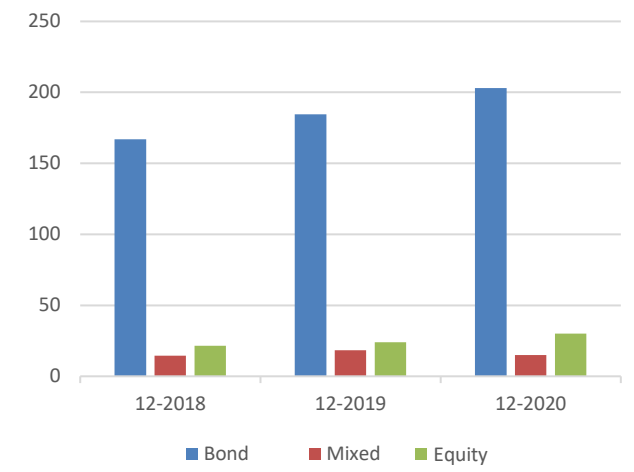
Key performance indicators

	2019	2020	Changes
Number of investment management companies	11	11	-
Number of investment funds	24	23	↓
Investment fund assets (million euro)	226.9	248.1	↑
Returns since the beginning of the year, %			
Bond funds	12.7	-2.85	↓
Mixed funds	14.7	1.48	↓
Equity funds	24.8	4.51	↓
Management expenses, %			
Bond funds	1.3	1.2	↓
Mixed funds	1.4	1.3	↓
Equity funds	1.9	1.7	↓

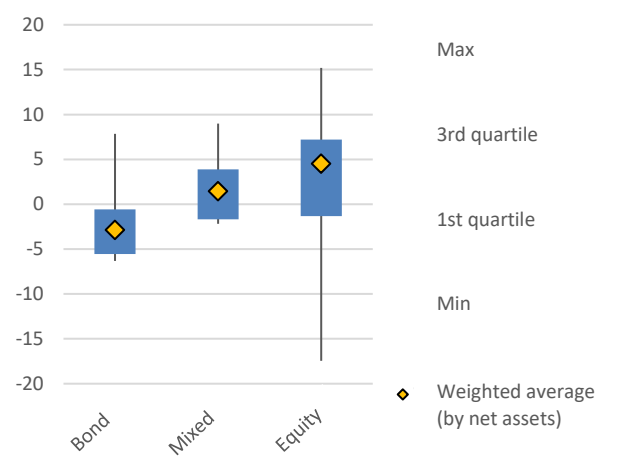
- **During the reporting year, the total number of managers remained unchanged**, although the structure of investment management companies changed slightly, since the investment management company Signet Asset Management Latvia IPAS with the Signet Bond Fund started operating, while PNB Asset Management investment manager with the PNB EM High Yield Bond Fund and the PNB Total Return Bond Fund ceased its activities.
- **During the reproting year, financial and capital markets experienced the biggest turbulence and unprecedented volatility of the last decade, which had a significant impact on both the return of investment funds and their overall performance.** Previous investment strategies had to be reviewed: successful investment funds became dependent on the ability to align investors' risk appetite with volatile market realities.
- **The return of investment funds was determined by the level of diversification of the investment portfolio.** The annual yield of bond funds ranged from -6% to 8% (two of the 11 funds with a positive yield), mixed funds ranged from -2% to 9% (one of the three funds with a positive yield), while equity funds ranged from -17% to 15% (four of the six funds with a positive yield). A worse performance was reported by funds with a base currency for investments in US dollars, as its value against the euro declined during the year. With stock markets broadly showing better results than bond markets, investment funds whose portfolios had a smaller proportion of shares experienced a bigger drop in yields. Meanwhile, mixed and equity funds showed better financial results despite the high market volatility. At the same time, the funds that applied a more cautious approach to choosing a risk-mitigation-based portfolio structure, although generating lower yields, tolerated less losses and, above all, remained within the positive returns.
- **During the reporting year, investment fund assets increased by 9% overall**, reaching EUR 248.1 million at the end of December. The rate of asset growth reached 10% for bond funds, -18% for mixed funds and 25% for equity funds, respectively. The trends in question reflected attempts by market participants to stay within the margin of positive yield, using a variety of risk management techniques, including the sale of falling-value assets. The decline in the capitalisation of mixed investment funds was related to the length of the repayment period of invested funds, while investment funds with a more or less uniform asset portfolio structure were able to seize the opportunity to acquire assets corresponding to their profile in the context of the price downturn trend, which explained the rapid expansion of the stock-based asset base and the increase in the capitalisation of the high-grade bonds.
- **There were no major changes to the geographical allocation of the portfolio of investment funds in the reporting year.** The share of investments in EEA countries and CIS countries increased slightly, reaching 47% and 10% of total investments at the end of December, respectively, while the share of investments in other countries decreased slightly, reaching 42%, partly due to higher EEA markets' volatility in other regions.

Investment funds

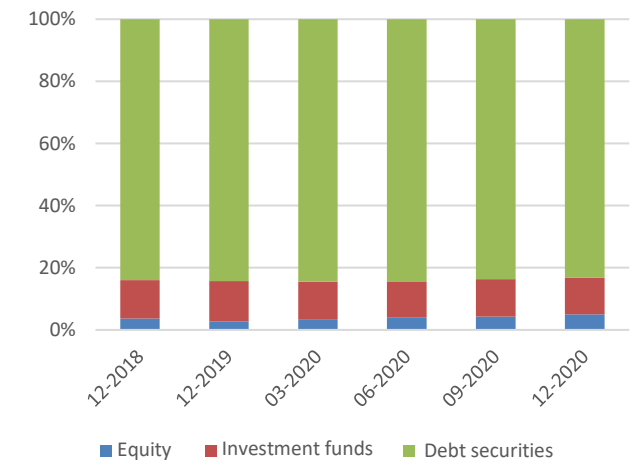
Asset dynamics, million euro

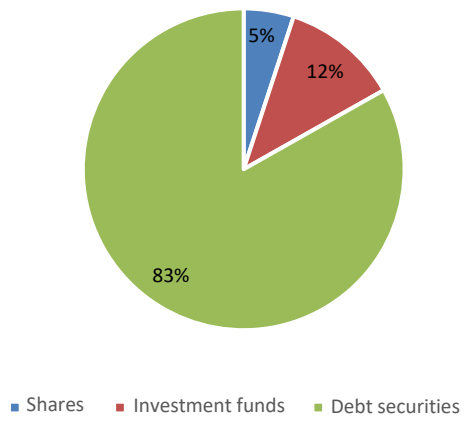


Returns by type of fund in 2020, %

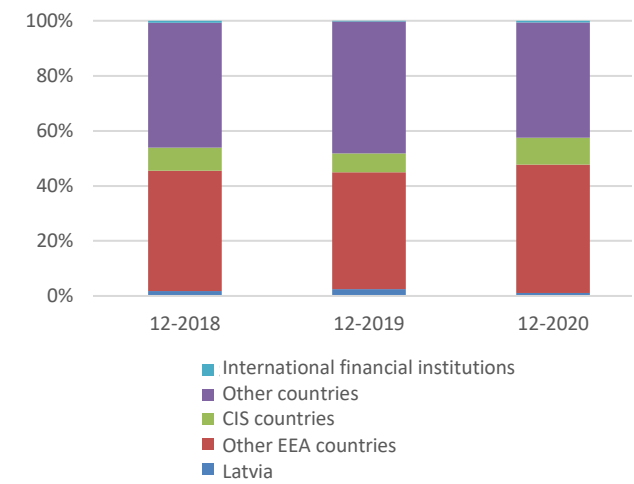


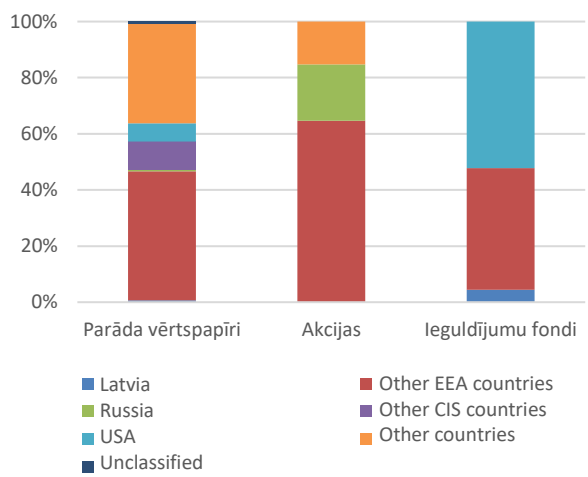
Structure of investment portfolio by financial instruments, %





Structure of investment portfolio by groups of countries*, %





**by the country of issuer's registration*