



COUNTRY PROFILE, LATVIA

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Introduction and Country Background

30% of Latvian inhabitants are of Russian origin

Key Facts

Capital - Major Cities	Riga - Daugavpils, Liepaja
Area	64,589 km ²
Population	2.264 million (10-2008 estimate)
Languages	Latvian
Currency	LVL (Latvian Lat)
Telephone Code	+371
National/ Bank Holidays	2008 — 18 Nov; 25-26, 31 Dec 2009 — 1 Jan; 10, 13 Apr; 1, 4 May; 23-24 Jun; 18 Nov; 25-26, 31 Dec
Bank Hours	9.00 - 19.00 Mon-Fri
Business Hours	8:30 - 17:30 Mon-Fri
Stock Exchange	Riga Stock Exchange (NASDAQ OMX Group)
Overall Share Index	OMXR (replaced DJ RSE)

GDP volume growth in recent years has been among the highest in the EU

Economic Performance

	2004	2005	2006	2007
Exchange Rate - LVL/EUR ¹	0.671	0.7028	0.7028	0.702804
Exchange Rate - LVL/USD ¹	0.540	0.565	0.560	0.51410
Money Market Rate (%) ¹	4.07	2.95	3.88	7.21
Consumer Inflation (%) ²	6.2	6.7	6.6	6.3
Unemployment Rate (%) ³	8.5	7.5	6.8	5.9
GDP (LVL billions)	7.4	8.9	10.8	12.6
GDP (USD billions) ⁴	13.6	15.7	19.2	23.0
GDP Volume Growth (%) ²	8.5	10.2	11.0	9.0
GDP Per Capita (USD)	5,936	6,851	8,349	10,074
Current Account (% of GDP)	-12.9	-12.4	-14.0	-13.7

Sources: International Monetary Fund, Central Statistical Bureau of Latvia

¹ Period average

² Year on year

³ Per annum (seasons adjusted)

⁴ Per average exchange rate

Latvia's first Prime Minister since independence became Prime Minister once again in December 2007

Government

Latvia claimed de facto independence in August 1991 as the Republic of Latvia (from Soviet Union).

Legislature Regime

According to the Constitution (Satversme), Latvia is a parliamentary republic, divided in 26 counties and 7 municipalities, in which the sovereign power belongs to the people, who are represented by a unicameral parliament (Saeima), with 100 members elected in general, equal, direct, secret and proportional elections for a four-year period. Only parties that obtain at least 5% of the votes in the elections are admitted in the Saeima (currently 6 political parties). Elections are held once every 4 years, on the first Saturday of October.

Head of State

Valdis Zatlers (no party affiliation), President since July 2007.

Political Leader

Ivars Godmanis. One of the Chairman of the LPP/LC (liberal). Nominated Prime Minister by President Zatlers on December 14, 2007 and approved by the parliament on December 20, 2007. His first term as Prime Minister was immediately following Latvia's independence from the Soviet Union, in which he oversaw the transition from communism to capitalism from 1990 to 1993

European Union

Latvia has been a member of the EU since May 2004. A referendum was held in September 2003, with a 69% majority in favour of membership. For an open economy like Latvia, which is rapidly catching up to the standard of living in the euro area, a slightly higher inflation rate compared to the euro area is natural and does not pose a threat to price stability. However, the low inflation rate prescribed by the current interpretation of the requirements for the adoption of the euro will not be an easy target for the country. According to the official sources, Latvia's ambition of introducing the euro will be delayed to no sooner than 2012 or 2013.

Banking Environment

The Bank of Latvia has stated that consolidation is needed to increase the competitiveness of Latvian banks

Overview

Introduction

Nearly all banks operating in Latvia are commercial banks and provide a wide variety of products and banking services. Some banks provide supplementary services like devices exchange, commercial promotions, and privatizations. Latvia experienced a banking crisis in the mid 1990's, culminating in 1995 with the largest commercial banks declaring bankruptcy. The banks had depositories of important Russian funds and of more than 500,000 accounts. Compared to approximately 60 banks in the early 1990's, only 33 banks survived to 1996.

The banking market in Latvia is concentrated in three players - Swedbank, SEB bank and Parex Banka - accounting for over half of the total banking assets in the country. Furthermore, foreign ownership of the sector is high (over three-fourths of paid-in share capital) mainly represented by Scandinavian financial groups.

Sector Figures

There are 26 banks as at end-June 2008, of which 5 are branches of foreign banks. The overall number of domestic banks in Latvia has remained nearly constant since 1999, with an increase seen in branches of foreign banks in 2006 and 2007. The Bank of Latvia has stated that consolidation is needed to increase the competitiveness of Latvian banks. According to the Financial and Capital Market Commission data, foreign shareholders owned 78.2% of the total paid-up share capital in Latvian banks at the end of 2007 (68.8% in 2006). They held over 50% of paid-up share capital in nine banks.

Recent Years

In general, the banking sector has seen significant growth recently, with year-on-year asset growth of nearly 30% in 2005, 45% in 2006, and 30% in 2007. Cash deposits, shares and especially loans were the largest contributors to this growth. In 2006, banks' profit reached 266.9 million lats (an increase of 73.9 million lats or 38.3% year-on-year).

In 2007, the banking sector as a whole saw its profit reach 371 million lats, an increase of nearly 40% from the previous year. Nonetheless growth in 2008 has slowed and the sector's profitability shall most likely be less than was the case in 2007.

Overall, the weaknesses of the banking system in Latvia is becoming evident. Major and well-capitalised foreign banks are far less dominant in Latvia than they are in the rest of Central and Eastern Europe. Thus the Latvian banks will be substantially dependent on funding from banks outside the country if they are going to increase lending in absolute terms by anything like the amounts seen in previous years. This is at a time when the macro-economic imbalances are alarming and that some kind of hard landing appears inevitable.

Sector Wide Agreements

In 2005, the EU reached political agreement on the proposed directive for new capital-adequacy rules, known as Basel II. These rules have been implemented in Latvia.

The Central Bank's principle objective is to maintain price stability

Central Bank

Background

The Central Bank is the Bank of Latvia, which is one of the key public institutions and carries out economic functions as prescribed in the Republic of Latvia Law "On the Bank of Latvia". The principal objective of the Bank of Latvia is to regulate currency in circulation by implementing monetary policy to maintain price stability in Latvia. The Central Bank legislation was revised in late 1998 to meet EU requirements.

The Bank of Latvia represents the Republic of Latvia in foreign central banks and international currency institutions. The Bank of Latvia also consults the Parliament and the Cabinet of Ministers on monetary policy issues. It is not, however, subject to decisions and instructions by the Government or other institutions. The Bank of Latvia is independent in setting and implementing policy under its legal mandate. Supervision of the Bank of Latvia is vested with the Parliament.

Currency

The Bank of Latvia on December 30, 2004, fixed the peg rate of the lats and the euro at 1 EUR = 0.702804 LVL, which took effect on January 1, 2005 in line with the government approved plan for Latvia's preparation for full-fledged membership in the Economic and Monetary Union (EMU).

Responsibilities

Among the most important objectives of the national central bank are the following:

- To establish and implement monetary policy in order to ensure price stability in the country
- To issue the national currency
- To organize and ensure the functioning of the payment and settlement systems in Latvia
- To collect, record and aggregate the financial information and the data of the national payment balance, as well as to publish the processed statistical information
- To manage foreign assets
- To act as financial agent for the Government
- To issue permits (licences) to legal persons listed in the Republic of Latvia Register of Enterprises, except credit institutions, for the purchase and sale of foreign currency as a business activity

Financial Authorities

The FCMC regulates the financial and capital markets

Financial and Capital Market Commission (FCMC)

The FCMC (FKTK in Latvian) began operating in July 2001 following the merger of the Credit Institutions Supervision Department of the Bank of Latvia, the Securities Market Commission and the Insurance Supervision Inspectorate. Pursuant to the Law on the Financial and Capital Market Commission the FCMC's strategic goals entail promotion of:

- stability in financial and capital markets,
- development and stability in the financial and capital markets, and
- interests of investors, depositors and the insured, and the promotion of.

Participants include issuers, investors, credit institutions, insurers, private pension funds, insurance intermediaries, credit unions, the RSE, the LCD, investment firms, brokers, investment companies and investment consultants.

FCMC also grants licences to provide financial services, including custody services and other intermediary activities in the Latvian financial and capital market.

The Association of Latvian Commercial Banks represents 23 entities

Association of Latvian Commercial Banks

The Association of Latvian Commercial Banks (abbreviated LKA in Latvian) represents the interests of the Latvian banking sector. The LKA was created in 1992 as a public organisation aimed at enhancing the development of a modern and reliable banking sector in Latvia. The LKA represents commercial banks in Latvia as well as branches of foreign banks. As of September 2008 there are 23 members, of which 2 are foreign bank branches. It plays an active role in setting standards for payment instruments in the banking sector.

Further, the LKA also assists in drafting laws and regulations governing the activities of banks and is represented on the Consultative Council of the FCMC.

Legal & Regulatory Issues

The market for financial transactions as such is deregulated

Introduction

The market for financial transactions as such is deregulated. However, due to Central Bank reporting requirements still existing for transactions between residents and non-residents, Latvia is not the ideal place for maintaining cash concentration pooling solutions involving non-resident companies.

Under the European Single Market's objective of free movement of capital Latvian Law has undergone strong harmonisation toward the rest of the EU, e.g. within Money Laundering, where the law fully conforms to the EU directives.

Residency is determined by registration and operation in Latvia

Resident and Non-Resident Status

Residents

All institutions, including foreign ones, registered and operating in the territory of the Republic of Latvia, as well as private persons whose households are located in Latvia and who do not leave Latvia for a period exceeding one year

Non-residents

All institutions registered abroad and private persons whose households are located outside Latvia or who are staying in Latvia for a period of time less than one year

Account ownership is independent of residency

Account Ownership

Any type of account can be owned by a resident as well as a non-resident company.

Banks are not allowed to offset own balances in a notional cash pooling solution

Cash Pooling Regulations

- Cash concentration and notional pooling are allowed as well domestically as cross-border
- Banks are not allowed to offset own balances in a notional cash pooling solution
- Cash pooling across legal entities within the same group is allowed
- Resident and non-resident companies can participate in the same cash pool in Latvia, but Central Bank reporting requirements must be adhered to and withholding tax regulations must also be observed
- Latvian legislation allows for multicurrency cash pooling. Nonetheless it is not widely offered by the banks

Current accounts can be held in all exchangeable currencies

Account Types and Charges

Current accounts can be held in all exchangeable currencies and are offered

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with or without overdraft limits. LVL accounts are convertible into foreign currency. Interest rates can be either fixed using a basic rate of the bank or based on a market rate (e.g. RIGIBID / RIGIBOR) less a spread. Account maintenance fees will normally apply but are small and negotiable

Payment Fees

A flat fee is charged for domestic payments - a per mille charge is typically charged for foreign payments (with a minimum and maximum price). Following the EU regulations on cross-border transfers in EUR, from 1 July 2003 the charge for a cross-border transfer of up to 12,500 EUR must be equivalent to the charge for a domestic payment in EUR. The increase to a maximum of €50,000 took effect on 1 January 2006. The payer must provide the receiver's International Bank Account number (IBAN) and the receiving bank's Bank Identifier Code (BIC, the SWIFT code). If such information is not provided - or the information is wrong - an additional charge will be levied.

The lat is pegged to the euro

FX Controls

The Bank of Latvia re-pegged the lat (LVL) from an SDR¹ basket of currencies to the euro in the beginning of 2005 as part of Latvia's entrance into ERM2². The Bank of Latvia set the peg rate of LVL to euro on December 30, 2004. It is the Bank of Latvia's task to issue foreign exchange regulations, although ultimately the Parliament (Saeima) is responsible. The Bank of Latvia quotes 50 exchange rates for foreign convertible currencies and gold.

Central Bank reporting is still mandatory

Central Bank Reporting Requirements

Central Bank reporting is still mandatory in Latvia as follows:

- Transactions above LVL 1,000 between residents and non-residents
- All payments made from accounts abroad
- Reporting periods are 1st, 7th, 8th, 15th, 16th, 23rd, 24th and the last day of the month
- Reports must be submitted no later than 3 business days after the end of the reporting period in which the transaction has occurred

Regulations are in place to prevent money laundering

Money Laundering

On 18 May 2006 Regulation No.93 on Establishment of Inside Control System for Prevention of Money Laundering and Terrorism Financing (the "Regulations") issued by the Finance and Capital Market Commission ("FCMC") entered into

¹ The SDR basket of currencies is a unit of account created by the International Monetary Fund (IMF) in 1969 to supplement the foreign reserve asset accrual instruments for the IMF member countries. SDR exists only in bank accounts, though not in the form of cash (banknotes and coins), and serves as a unit of account for the IMF and other international organisations.

² ERM2, Exchange Rate Mechanism 2, is an agreement between a number of EU countries and the European Central Bank (ECB) to keep the rate of the national currency within a fluctuation span of + / - 15% vis-à-vis an agreed central rate.

force. The EC Money Laundering Directive (Council Directive 91/308/EEC of 10 June 1991 as amended by directive 2001/97/EC of 4 December 2001) has been implemented in Latvia.

The “Third Directive” replaces existing EU legislation and incorporates into EU law the June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF). The Third Directive was implemented through the new law “On the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing” in August 2008. It builds on existing EU legislation and incorporates into EU law the June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF), the international standard setter in the fight against money laundering and terrorist financing. The Directive is applicable to the financial sector as well as lawyers, notaries, accountants, real estate agents, casinos, trust and company service providers. Its scope also encompasses all providers of goods, when payments are made in cash in excess of 15.000 EUR.

Electronic signature
legislation is in place

Regulations Applicable for Electronic Transactions

Latvia has implemented Directive 1999/93/EC of the European Parliament and of the Council on a Community framework for electronic signatures (enacted on January 2003). Role out of digital signatures began in March 2006. The Latvian government facilitated the introduction of various e-services, while VAS Latvijas Pasts served as the leading partner and Certified Service Provider.

Market Dominant Banks

The top 5 banks hold a combined market share of nearly 70%

Introduction

The top 5 banks market share measured by total assets at August 2008 are Swedbank (formerly Hansabanka) (22.4%), Parex Banka (13.8%), SEB Banka (13.2%), Nordea Bank Finland's Latvia branch (9.9%) and DnB NORD Banka (8.5%)—holding a combined market share of nearly 70% (note market share figures are rounded). Swedbank is also the dominant market leader in Estonia and second largest in Latvia measured by total assets.

Latvian Market Dominant Banks per 31 Dec. 2007

Bank	Assets (USDm)
Swedbank	237,843
Parex Banka ¹	6,521
SEB Banka ²	346,778
Nordea	533,243
DnB NORD Banka	*7,066

¹ Part of the Parex Bank Group

² Part of the SEB Group

* 31 Dec. 2006

Note: Figures are total group consolidated assets in millions USD.

Source: Banks' annual reports.

The largest bank in the Baltic

Swedbank

Hansapank was established in 1991 in Estonia. In 1996 it expanded to Latvia and then in 1999 to Lithuania. In 1998 Swedish Swedbank purchased 50% of Hansabank shares, and steadily increased its ownership stake overtime, eventually owning 100% of the bank in 2005. Hansabank expanded to Russia in 2005, with the acquired bank later being renamed Swedbank. Following a decision taken by the Swedbank group on 15 September 2008, Hansabank has been rebranded under the Swedbank name.

Swedbank's vision is to be the leading financial institution in the markets where present. With more than 22,000 employees Swedbank serves a total of around 9 million private customers and 500,000 corporate customers in Sweden, Estonia, Latvia and Lithuania. They also have a growing presence in Russia and the Ukraine. In the Baltic region, the bank serves 5.1 million private customers and 228,000 corporate customers, of which some 2.6 a internet banking customers, through 284 branches and 1,287 ATMs.

SEB is the second largest Baltic bank

SEB Banka

SEB banka emerged in September 1993, following a fundamental restructuring of

the Bank of Latvia. The Bank's retail arm, consisting of 21 distinctive branches still under state control, was separated from the parent institution to become Unibanka. SEB bought an initial strategic stake in Unibanka in November 1998 and increased it to over 50% in 1999. In the autumn of 2000 SEB acquired more than 98.8% of Unibanka's shares. In April 2005 the brand name of the bank was changed from Unibanka to SEB Unibanka and then in April 2008 to SEB Bank. The SEB Banka Group is composed of the bank, a leasing company, a public pension fund and a life insurance company, which the bank purchased in the summer of 2005.

SEB serves more than 400,000 corporate customers and institutions and more than five million customers in the Nordic and Baltic countries, Germany, Poland, Russia and the Ukraine and strategic presence through its international network in another ten countries.

SEB has a strong position on the private market in Sweden, Estonia, Latvia and Lithuania and is one of ten banks with nation-wide coverage in Germany. SEB has a total of 600 branch offices in these countries. SEB is represented in some 20 countries, with 20,000 employees, of whom half are found outside Sweden. Approximately 50 per cent of SEB's operating profit is generated in markets outside Sweden.

In Latvia, SEB banka has 61 branch offices and client service centres, of which 23 are found in Riga, and more than 805,000 clients.

Parex Banka served clients via 70 branches throughout Latvia

Parex Banka

Parex Banka was established in 1992 as one of the first commercial banks in Latvia, and acquired the first 2 branches from the Bank of Latvia in 1993.

Parex Banka served clients via 70 branches throughout Latvia, and is further represented as Parex Banka in Lithuania, and via branches in Estonia, Germany and Sweden. The bank also maintains a network of representative offices in several CIS countries, Japan, Switzerland, and the UK. Parex Banka was among the fastest growing retail banks in Latvia serving the financial needs of more than 400,000 retail customers. As at 30 September 2008, Parex Banka was the market leader in Latvia in terms of deposits with 19.2% market share, according to the information provided by Association of Latvian Commercial Banks.

On the 8th of October 2008, the Latvian government bought 51% of Parex Banka. Therefore, the government has taken over the controlling stake in Parex Bank through Latvia's Hipoteku un Zemes Banka (Mortgage and Land Bank). Parex Bank has become a daughter company of Mortgage and Land Bank. The 51 voting shares in Parex Bank will become the property of Mortgage and Land Bank,

Recently formed as a joint venture, stretching from Northern Germany to the Bal-

DnB NORD Banka

In 2005 the mother company of NORD/LB Latvija signed an agreement with the largest financial services group of Norway DnB NOR on foundation of a new joint

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venture in the Baltic region, Poland and Scandinavia: DnB NORD.

The bank has 176 branches in Denmark and Finland (corporate focused), Estonia, Latvia, Lithuania and Poland (corporate and retail). DnB NOR owns 51 per cent of the bank, which is headquartered in Copenhagen. As part of the agreement, DnB NOR took over the Swedish operations of NORD/LB in the third quarter of 2005 and thereby doubled the Group's bank operations in Sweden. DnB NOR Bank also has branches in all of the Nordic capitals as well as in the major financial centres of the world.

The bank focuses on retail and corporate segments in Latvia. It serves its customers via 35 branches and 3 sub-branches in major towns throughout the country. DnB NORD Banka has set an ambitious goal: to become one of the top banks in Latvia rendering the best financial products and services as well as offering great service within a large branch network.

The Nordic's largest banking group

Nordea

Nordea Bank Latvia Branch has been in operation since 1998, and a Lithuania branch was opened in 2000. The Nordea group includes banks in the Nordic and Baltic countries plus Poland. The group operates three business areas: Nordic Banking, Banking & Capital Market Products, and Savings & Life Products (asset management, insurance and pension products). The bank's vision is "to be the leading Nordic bank, acknowledge for its people, creating superior value for customers and shareholders" and its mission is "making it possible". Nordea has 10 million retail and 800,000 thousand corporate customers, of which 4.9 million are net-banking users, and more than 1,300 branch offices.

The bank's largest shareholder, the Swedish state, is expected to sell its 20% stake in 2008 putting the bank in play for either a Nordic or European acquisition. Furthermore, the Sampo Group owns 10% of the bank following its sale of its banking operations to Danske Bank.

Recently purchased by Danske Bank, Denmark's largest bank, Sampo is present throughout the Baltic and is Finland's third largest bank

Danske Banka

Sampo Banka is one of the newest banks in Latvia. In 2004 Sampo Banka acquired Maras Banka. Then in November 2006, Denmark's Danske Bank Group acquired Sampo Banka's parent in Finland, the Sampo Bank Group, for approximately USD 5 billion in cash. Sampo Bank is Finland's third-largest bank with a market share of 16% and 121 branches; subsidiaries in Estonia, Latvia and Lithuania; and a recently acquired bank in Russia. The transaction also comprised various investment services companies, the most significant of which are Mandatum Asset Management Ltd, Sampo Fund Management Ltd, Mandatum & Co Ltd and Mandatum Stockbrokers Ltd.

Sampo Bank is now a branch of Danske Bank and name changed to Danske Banka in June 2008.

Measured by total assets, the Danske Bank Group is the largest financial enter-

prise in Denmark and one of the largest in the Nordic region offering services in banking, insurance, mortgage finance, and asset management. The vision of the Group is “One platform – exceptional brands” and its mission is to be “the best local financial partner”. In total, the Group serves 5 million retail customers and a large number of public sector and institutional organisations. Some 2 million customers use the Bank's online services in Scandinavia, and the isle of Ireland.

Clearing Systems

There are three interbank payment and settlement systems in Latvia

SAMS is Latvia's RTGS system with a link to TARGET

Latvia will accede to TARGET2 on 19 November 2007

Overview

There are three main interbank payment systems in Latvia – TARGET2-Latvia, SAMS and EKS. Latvia joined the pan-European TARGET2 SSP (Single Shared Platform) RTGS system at its inception on 19 November 2007; the system used in Latvia for large-value and urgent payments in EUR. Meanwhile, the Bank of Latvia operates SAMS, the national RTGS system for large-value and urgent payments in LVL, and the EKS retail payment system, a multilateral net settlement system for low value retail payments in LVL and EUR. The Latvian Post Office also has its own payments clearing network.

High Value Clearing – SAMS

SAMS (interbank automated payment system) is the national RTGS system, launched on 8 September 2000. SAMS is designed for large volume, urgent payments related to inter-bank market transactions, open market and other Bank of Latvia monetary policy operations.

- Participants: 24 direct participants (including the Central Bank)
- Transaction types: SAMS ensures high-value urgent interbank payments, the Bank of Latvia's monetary policy operations, the final settlement of other payment systems and customer payments (urgent payments and payments above LVL 50,000).
- Price indication: there is no entry fee for participation in the system. For the time being only a volume-based regressive fee is levied from participants. The current transaction fee is LVL 0.80 (€1.15) for the first 100 payments per month, LVL 0.50 (€0.72) for the next 900 payments per month, and LVL 0.20 (€0.29) for all subsequent payments. In addition, the participants in the system bear all of the expenses related to the implementation of their SAMS participant workstations, as well as any expenses arising from SWIFT membership.
- Opening hours: 08.30 – 16.00 (GMT +2) Monday to Friday. Cut-off time for customer transactions and interbank transactions are however 15.00 and 15.30 respectively.

With the implementation of the SAMS, the Bank of Latvia interbank payment systems are fully automated and harmonised with EU requirements.

TARGET2

The current pan-European RTGS system, TARGET, migrated to a single shared platform (SSP) called TARGET2 making the 16 decentralised RTGS systems of individual Eurosystem countries and the ECB's payment mechanism (EPM) obsolete. The changeover took place in three migration waves, starting 19 November 2007 and ending 19 May 2008.

Latvia migrated over in the first country window together with Austria, Cyprus, Germany, Lithuania, Luxembourg, Malta and Slovenia on 19 November 2007, indicating the initiation of operations for TARGET2-Latvija. The Latvian commercial banks, the Bank of Latvia and the Treasury have joined Target2-*Latvija* as the direct participants.

Legally and operationally the decentralisation principle is retained with respect to each Member State joining the TARGET2 system. The Swedish Central Bank and the Bank of England will not migrate to TARGET2.

- Participation: options include direct and indirect participation, “addressable BICs” and “multi-addressee access” to the system, also known as “technical BIC access”. Direct participation criteria for TARGET2 is the same as for the current TARGET system. Only supervised credit institutions established within the EEA can become indirect participants.
- Transaction types: large-value payments related to inter-bank operations
- Price indication: between €0.125 and €0.80 depending on participation type.
- Operating hours: the operational day in TARGET2 will be longer than that of the current TARGET system. TARGET2 will start the new business day on the evening of the previous day. The night-time window will be available from 19:30 to 6:45 the next day, with a technical maintenance period of three hours between 22:00–01:00. Daytime hours for customer payments 07:00–17:00 CET with the day ending at 18:00 + 30 minutes for the use of standing facilities on the last day of a minimum reserve period.
- Transaction details:
 - Direct participation: For the exchange of payments information, TARGET2 will use the SWIFTNet FIN service, while the SWIFTNet services “InterAct”, “Browse” and “FileAct” will be used for information and control services.

EKS is used for processing bulk retail payments and low value corporate transactions

Low Value Clearing – EKS

The Electronic Clearing System (EKS) began operating on November 17, 1998, replacing the previous, paper-based clearing system. The EKS is used for processing bulk retail payments as well as low value corporate transactions below LVL 50,000. It can be regarded as an ACH (Automated Clearing House) system where payment processing is fully automated and only electronic documents are accepted.

Since TARGET2-*Latvija* ensures interbank settlement also for domestic payments in euro, EKS, the electronic clearing system of the Bank of Latvia, started to process retail euro payments in 2008. This enables to settle customer payments in euro among Latvian banks within one day, similarly to the current processing of lats payments.

Since TARGET2-*Latvija* ensures interbank settlement also for domestic payments in euro, EKS, the electronic clearing system of the Bank of Latvia, will start processing retail euro payments in 2008.

- The message format of the payments processed corresponds to the SWIFT message types MT 100 (customer transfer) and MT 103 (single customer credit transfer).
- Price indication: to cover the system's operational costs, banks are charged a monthly regressive fee based on the volume of transactions. The fee is LVL 0.017 (€0.026) for the first 10,000 payments per month, LVL 0.007 (€0.01) for the next 90,000 payments per month, and LVL 0.002 (€0.003) thereafter.
- Operating hours:
 - LVL clearing - batch payment instructions are accepted between 8.30 and 10.30 in the first clearing cycle and from 10.30. to 15.00. (GMT +2) in the second clearing cycle.
 - EUR clearing - batch payment instructions are accepted between 8.30 and 11.00 in the first clearing cycle and from 11.00. to 15.30. (GMT +2) in the second clearing cycle.

Payments & Collections Methods & Instruments

Electronic means of payments are widespread

Introduction

While cash remains widely used (mainly by individuals in face-to-face transactions for goods and services) electronic transfers are widespread. Furthermore, to encourage customers to use electronic payment instruments, banks have raised fees for payment instructions handed over in paper form. Strong growth in all types of cashless payment forms shows that this strategy is working. Credit transfers account for the vast majority of the payments although this payment method has matured; cheque volumes are rapidly declining while card payments are increasing rapidly and direct debits also have seen strong growth.

The ordinary domestic electronic transfers are at receiving bank's disposal one day after the payment is made. Same day value payments can be made as domestic express transfers as well.

Banks in Latvia have been implementing SEPA (Single Euro Payments Area) standards for EUR-denominated payments. The country's banks now issue SEPA-compliant debit cards (since 1 January 2008) and also offer pan-European SEPA credit transfers (since 28 January 2008). SEPA direct debits however will not be available until 2009 at the earliest (the launch date depends on the implementation of the harmonising EU Payment Services Directive in each member state).

It is not yet known how long the transition period will last for national payment products to be fully replaced by SEPA payments. However it is hoped the Single Euro Payments Area (SEPA), an initiative of the European Payments Council, will be fully operative by around 2013. It will consist of all EEA member states plus Switzerland. Final transition dates and a completion date are expected to be decided in mid- to late 2009.

Volume of Transactions (millions)

	2004	2005	2006	% change
Debit cards	28.19	38.87	51.92	33.6
Credit cards	1.34	2.82	5.34	89.4
Credit transfers	77.15	89.80	107.00	19.2
Direct debits	0.82	1.38	3.70	168.1
Cheques	0.05	0.04	0.033	-17.5
Total	107.55	132.91	168.04	26.4

Value of Transactions (LVL billions)

	2004	2005	2006	% change
Debit cards	0.392	0.540	0.724	34.1
Credit cards	0.062	0.138	0.198	43.5
Credit transfers	273	270	335.27	24.6
Direct debits	0.033	0.052	0.092	76.9

Cheques	0.0178	0.018	0.019	5.5
Total	273.50	270.74	336.3	24.2

Note: Percentage change calculated from 2005-2006

Sources: ECB Statistical Data Warehouse

Credit cards are becoming increasingly popular

Card Payments

The use of cards in general is rapidly increasing and has nearly tripled from 1999 to 2006 in terms of cards issued. The total number of payment cards issued by mid year 2008 is approximately 2.56 million, of which 942,130 are credit cards and the remaining group is closely split between normal debit cards and debit cards with an overdraft facility. There are an additional 5,438 retailer cards in circulation.

As a result of comprehensive advertising campaigns launched by banks and First Data Latvia (FDL), payments made by payment card have quintupled in volume and quadrupled in value over the last five years and accounted for 34.9% of the total volume and 0.3% of the total value of payments made with cashless payment instruments.

FirstData (established in 1992 by the Latvian banks) and the Baltic Card Centre (BCC) process card transactions and manages Latvia's ATMs and 4 POS networks. As of end-September 2008 there were 1,231 ATMs and 23,720 payment terminals. All terminals accept the various international payment cards. The IBIS Internet commerce is a solution designed for servicing card transactions on the Internet.

Banks in Latvia are implementing a service called "Cashback". Cashback is the opportunity for card users to receive a small amount of cash from merchants if they pay for their purchases with a card. Cashback will be relevant in places where there is no possibility to withdraw cash at ATMs or bank branches.

All measures necessary for meeting the EMV standard requirements are implemented in Latvia.

In value terms, credit transfers account for more than 99% of all payments in Latvia

Credit Transfers

In terms of value, credit transfers account for more than 99% of all payments in Latvia (and for approx. 67.5% in terms of volumes) in 2005. The majority of banks in Latvia offer electronic banking systems with access to payment initiation for clearing in both SAMS and EKS (for payments above and below LVL 50,000 respectively).

Direct debit usage is growing rapidly

Direct Debits

In 1994, Direct debits were introduced in Latvia, and its usage is still increasing rapidly. They are primarily used for settling of recurring payments like telephone,

electricity and other utilities. Itella (previously the National Payment Centre of Latvia) introduced a direct debit processing solution, which provides access to any commercial bank, utility companies etc. Itella has also introduced features for direct debits for mobile phones and Internet, developed in co-operation with a number of Latvian commercial banks.

Almost all cheques are drawn in foreign currencies

Cheques

The role of cheques has traditionally been very limited, and cheques are rarely used as a payment instrument in Latvia. Almost all cheques are drawn in foreign currencies.

Electronic Banking

There are no countrywide standards or multi-banks offerings

Introduction

In recent years almost all sorts of banking services suited for electronic processing have been migrated to the Internet. There are 11 electronic money institutions registered with the Central Bank as of January 2008. There are no countrywide standards or any multi-banks offerings on the Latvian market. Internet banking is increasing in availability and offered by most banks in Latvia to both retail and corporate customers. Some banks also offer mobile (WAP) banking services.

Web-based platforms are becoming increasingly advanced

General Functionality of EBS Offerings

Many banks have shifted their focus from PC based electronic banking systems to web-based platforms. The services offered through the World Wide Web include payment transactions, account information, inter-company netting solutions, FX dealings and information etc. (in quasi real-time). Even though the web-based solutions are becoming more and more advanced, still, a number of banks offer more sophisticated services via PC-based tools only.

Host-to-host solutions are available

EDIFACT / Host-to-Host Solutions

The corporations growing effort of streamlining payment processing is primarily supported by the banks with foreign ownership, as the demand for the most part comes from corporates with headquarters outside Latvia. Host-to-host solutions are provided for domestic as well as international payments.

Neither e-payments nor e-invoices are commonly used in Latvia

E-payments and E-invoice / EBPP

Neither e-payments nor e-invoices are commonly used in Latvia, however, service providers exist. For example, Nordea Bank Finland's branch, SEB banka, Swedbanka provide e-payments. Also, Itella (a Finnish company) and TietoEnator (a Finnish-Swedish company) in cooperation with local banks each provide e-invoice services.

Cash Pooling Solutions

Foreign banks have pushing the use of cash pooling in recent years

Introduction

Cash pooling solutions offered are influenced by the fact that banks cannot set off their credit and debit balances for capital adequacy ratio purposes. Foreign banks, primarily Nordic, which have entered the Latvian market, have however pushed the use of cash pooling in recent years. The Central Bank's reporting requirements however, make Latvia a less attractive environment for pooling of resident and non-resident cash balances.

Notional pooling is not commonly used due to Central Bank reporting requirements

Notional Pooling

Notional pooling is allowed but not that commonly used due to the above mentioned restraint. However, the banks offer interest compensation/enhancement services.

Cash concentration is allowed

Cash Concentration

Cash concentration is allowed and available as both single legal account pooling - balance netting - and zero and target balancing solutions. It is primarily the banks with Nordic ownership that offer these solutions.

Multicurrency and/or cross border liquidity optimisation solutions exist

Multicurrency and Cross Border Pooling

On a cross-border basis notional as well as cash concentrating pooling schemes are offered. However, the primary tool for pooling continues to be the sweeping and funding of cash across borders.

Cash pooling solutions across currencies are usually not part of the services offered by the major cash management banks. However, some of the more sophisticated banks and the majority of foreign owned banks do offer such solutions, domestically as well as cross-border, as interest compensation / enhancement solutions.

Other means of optimising liquidity is inter-company netting or leading and lagging of supplier payments.

Tax Issues

Tax information is general and individual advice should be sought

A company is considered resident and thus liable to tax in Latvia if it is incorporated in Latvia

The corporate tax rate is 15%

Introduction

The following tax information, last updated by PricewaterhouseCoopers in November 2008, should be considered general and individual advice should always be sought.

Tax Liability

A company is considered resident and thus liable to tax in Latvia if it is incorporated in Latvia. Resident companies are subject to tax on their worldwide income whereas foreign companies are liable to tax on Latvian source income only.

Limited partnerships are treated as transparent entities for tax purposes.

Tax Base

In general, taxable profits are determined on the basis of a profit and loss account prepared in accordance with Latvian accounting principles, which to a large extent follow international accounting standards. Accounting profits are adjusted for differences between accounting and taxation principles.

The corporate tax rate is 15%. Companies, branches and permanent establishments are subject to similar rules, with the exception of allocations of management fees, interest, royalties and rental payments between head office and branch. If the period for permanent establishment in Latvia does not exceed 12 months it may opt to calculate corporate income tax under simplified method.

The income year corresponds to the calendar year unless a different income year is elected. Corporate tax is usually paid in monthly instalments and a final adjustment is made when the annual tax returns are submitted. Monthly corporate tax instalments are due on the 15th of each month and are determined based on the tax liability in the previous fiscal year. For a new company, the advance payments are voluntary during the first 12 months of operation. If a company anticipates a reduction in profitability in a coming year, it is possible to make arrangements to reduce the amount of tax paid monthly in advance.

Annual depreciations on assets are generally made under the declining method, but the straight-line method is used for intangibles. Any depreciation recapture in connection with a sale of an asset will be subject to corporate tax.

Restructuring, such as mergers, divisions and transfers of assets as a going concern may be carried out tax free with succession, provided certain conditions are met.

Tax losses can be carried forward for up to 5 years, but there is no possibility for

carry back.

Tax consolidation is available

Tax Consolidation

Latvian tax law provides for domestic tax consolidation with 90% owned subsidiaries as well as with Latvian sister companies directly held by a parent company that is either Latvian or resident in a country with which Latvia has a double tax treaty. Subject to strict conditions, Latvian tax consolidation allows immediate loss utilization by means of pooling the taxable income and losses of the companies involved. The result is an offset of losses of one group member against profits of another. Cross-border transfer of losses may also be possible but only when tax laws prevent a foreign company from transferring tax losses in its country of residence.

No taxed on dividends received from Latvian or EU/EEA resident subsidiaries

Inbound and Outbound Taxation of Dividends

A Latvian company is not taxed on any dividends received from a Latvian and other EU and EEZ resident subsidiaries. Dividends received from other foreign subsidiaries are non-taxable provided the Latvian company holds at least 25% of the shares of that foreign company.

Dividends received from shareholdings in foreign companies resident in a country black-listed by Latvia (so-called tax havens) are taxed in full, irrespective of the participation.

In principle, dividend payments to foreign companies are subject to a 10% withholding tax unless a more favorable treatment is allowed under a particular double tax treaty or the recipient of dividends is an EU member state or an EEZ state resident.

The tax treatment of a disposal of shares varies depending on whether the shares are listed on the stock exchange in the EU or EEA

Taxation of Capital Gains and Losses on Shares, Bonds, Debts, Receivables and Financial Contracts

The tax treatment of a disposal of shares varies depending on whether the shares are listed on the stock exchange in the EU or EEA.

Gains and losses on the sale of publicly traded securities in the EU or EEA are neither taxable nor tax deductible. Profits on the sale of any other securities by companies are subject to corporate income tax at 15%. Losses on the sale of other securities can be carried forward for up to 5 years and offset against future profits on the sale of other such securities. Slightly different rules apply if the vendor of the securities is not trading with securities regularly (no more than once per year) and if the holder of the securities has held them for at least 12 months. In this case, the vendor is entitled to set off any loss against its taxable profit from all commercial activities.

There are no CFC rules in Latvia

CFC Taxation

There are no CFC rules in Latvia.

Withholding taxes can apply

Withholding Tax

Interest payments to related parties are subject to a 10% withholding tax. Latvia has obtained permission to defer implementation of the Interest and Royalties Directive until 2013. However, transitional rules exist to reduce the rate to 5% from 1 July 2009.

Withholding tax on payments for copyright or for the right to use copyright in literary works or in works of art, including cinema films, video films or sound recordings is currently 15%. The transitional rules provide for:

- 10% from 1 July 2005 to 30 June 2009;
- 5% from 1 July 2009 to 30 June 2013.

Withholding tax on payments for other types of intellectual property during the period from 1 July 2005 to 30 June 2013 will continue to be levied at the current rate of 5%.

Management and consulting services are subject to 10% withholding tax. However, if payment is made to countries which have ratified double tax treaties with Latvia, withholding tax could be completely avoided, provided the recipient of the services does not have a permanent establishment in Latvia.

Rental payments on property in Latvia is subject to 5% WHT. Sale of real estate (tax on sales proceeds) is subject to 2% WHT. As from 12 June 2007 2% WHT applies also to sale of shares in a real estate company, i.e. such company where real estate in Latvia forms directly or indirectly more than 50% of assets.

Transfer pricing must be at arm's length

Transfer Pricing and Thin Capitalisation

Under Latvian law, prices between related parties must be at arm's length. This is an area that is receiving increasing interest from the Latvian tax authorities. Some significant developments in this area have been made over the last few years. The first is the requirement that an accounting report is prepared for the Enterprise Registry stating all transactions with related enterprises. The second is an Appendix to the corporate tax return, which requires disclosure of any inter-company transaction not priced at arm's length. The third is a considerably beefed up international division within the State Revenue Service resulting in a growing number of transfer pricing enquiries being made during state tax inspections. Finally, the legislation has been amended to introduce profit based methods in determining the arm's length price.

As Latvia is a country where form is important, it is advisable that all inter-company transactions are properly supported with appropriate documentation and any pricing chosen justified. However, to date, Latvia has not proscribed that pricing of related party transactions should be documented in a particular way. It is expected that Latvia will follow the Code of Conduct on Transfer Pricing Documentation adopted by EU Member States on 27 June 2006. Until the necessary

changes are implemented in the local level, the companies are advised to follow the requirements set by the Code of Conduct.

The Latvian thin capitalisation rules limit the deductibility of interest by applying the total debt figure 1.2 times the average short-term interest rate at credit institutions. It is also limited to a debt-to-equity ratio of approximately 4:1. The thin capitalisation rules apply neither to credit institutions and insurance companies nor interest payments for credits and loans, which are received from:

- credit institutions registered in the Republic of Latvia or in another European Union country;
- the Latvian Treasury;
- the Nordic Investment Bank and World Bank group;
- the Latvian residents.

Under the Latvian CIT Act, a Latvian company paying interest to a related EU/EEA company must withhold a 5% or 10% tax. If a Latvian company takes a loan from a related Latvian company then there is no withholding on interest payments. This withholding tax treatment both restricts the free movement of capital and discriminates against EU/EEA companies because the same withholding is not required when interest is paid to Latvian companies.

Stamp duties apply on real estate transfers

Capital or Stamp Duties

There is no ad valorem capital duty or stamp duty when establishing a Latvian company or share transfer duty on the transfer of title to shares. The only significant stamp duty is on the transfer of title to the first and second real estate, where for a sale, the rate is 2% up to an upper amount of LVL 30,000 per transaction, for the third real estate the rate is 4%. Other rates apply to gifts.

VAT is 18%

VAT and Payroll Duty

VAT is levied on the supply of goods and services at a rate of 18%. All companies with a taxable income exceeding LVL 10,000 are required to register for VAT. Certain services are VAT exempt, e.g. the transfer of real estate, insurance and reinsurance, and certain financial services. VAT exempt activities reduce the right to deduct input VAT relating to the activities.

Income taxes are withheld on a monthly basis

Employer Obligations – Tax and Social Security Withholdings

Employers are required to withhold income tax on wages on a monthly basis. Employers are also liable for an additional national social security contribution. Such contributions are deductible for corporate tax purposes by the employer. The normal payroll rates are:

- 9% national social insurance, withheld from the employee and tax de-

ductible for the employee.

- 24.09% national social insurance paid by the employer on the total employee cost.
- 25% personal income tax rate withheld from the employee.
- A small tax-free personal allowance of LVL 960 per year (planned LVL 1,200 in 2009).
- National social insurance payments are capped on the first LVL 29,600 of gross income. It is planned that the existing restrictions will be lifted in 2009 when national social insurance contributions will be from the whole amount.

Source and Contacts

Sources used for this country profile

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Financial and Capital Markets Commission	www.fktk.lv
Latvian Chamber of Commerce and Industry	www.chamber.lv
Riga Stock Exchange	www.rfb.lv
Latvian Investment and Development Agency	www.liaa.gov.lv
Itella	www.itella.lv
FirstData	www.firstdata.lv

Contact Danske Bank for cash management services

Danske Bank Contacts

See www.danskebank.com/corporate for contact persons.

Tax information provided by PricewaterhouseCoopers

Tax Contacts

PricewaterhouseCoopers
Kr. Valdemara iela 19
LV-1010 Riga
Latvia

Zlata Elksnina	Partner	+371 709 4514	zlata.elksnina@lv.pwc.com
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Country Research

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