

Latvia

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Key country facts

- **System of government:** parliamentary republic
- **Head of state:** President Vaira Vike-Freiberga
- **Prime Minister:** Aigars Kalvitis
- **Government website:** Saeima, the Parliament (www.saeima.lv), Cabinet of Ministers (www.mk.gov.lv)
- **Population:** 2.31 million (end of 2004)
- **Capital (population):** Riga (735,200)
- **Major cities:** Daugavpils (111,200), Liepaja (86,500), Jelgava (66,100), Jurmala (55,500)
- **GDP (USD):** USD 13.5797 billion (2004)
- **Economic data websites:** Central Statistical Bureau of Latvia (www.csb.lv)



Key financial facts

- **Currency:** Lat (LVL)
- **Average 2004:** 0.540 USD/LVL
- **FX regime:** since 2005 LVL has been pegged to EUR at the rate of 0.702804 LVL = 1 EUR, fluctuation band +/-1%
- **SWIFT code:** LV
- **Central bank:** Central Bank of Latvia (www.bank.lv)
- **Treasury association:** no
- **Other professional financial/banking associations:**
 - Association of Latvian Commercial Banks (www.bankasoc.lv)
 - Financial and Capital Market Commission (www.fktk.lv)
- **IGTA member:** no
- **FATF member:** no

Financial regulatory framework

■ Bank supervisory bodies and key requirements/processes

Regulation of the banking system in Latvia complies fully with EU directives. Latvia has implemented the International Accounting Standards for bank financial reporting and auditing. Financial markets are supervised by the Financial and Capital Market Commission (before July 2001 by Bank of Latvia). Commercial banks are subject to several regulations of the Bank of Latvia.

The Law on Credit Institutions (in effect since 24 October 1995) has been amended several times. The Law on the Prevention of the Laundering of Criminal Proceeds (1 June 1998) requires client identification, the maintenance of all records, and defines suspicious and strange deals that banks must report. Another law applicable to credit institutions is the Law on Deposit Guarantees (1 October 1998).

■ Exchange controls

Both current and capital account operations in Latvia are fully liberalised. There are almost no restrictions on cash or non-cashflows. The Bank of Latvia ensures the convertibility of the Lat by purchasing and selling EUR in unlimited amounts.

■ Restrictions on foreign investment/ownership

There are no substantial restrictions on foreign ownership. The Latvian Lat is freely convertible to common foreign currencies.

The opening of foreign currency accounts is permitted in Latvia and no governmental approvals are required to open such accounts. Using a foreign currency account is no different from using any other account and depends only on the terms and conditions set forth in the agreement between the bank and the client.

Taxation framework

■ Residency

A legal person is a resident if it is established pursuant to Latvian law. If a person stays in Latvia for more than 183 days per year, they can register as a resident.

■ **Table 1 : Largest banks in Latvia**

| End of 2004 | Assets | | Deposits | | Loans | |
|---------------|---------|--------------|----------|--------------|---------|--------------|
| | LVL mln | Market share | LVL mln | Market share | LVL mln | Market share |
| Hansabanka | 1,297 | 16.5% | 791 | 15.5% | 969 | 22.1% |
| SEB Unibanka | 1,163 | 14.8% | 626 | 12.3% | 952 | 21.7% |
| Parekss Banka | 1,399 | 17.8% | 1,043 | 20.4% | 667 | 15.2% |
| TOTAL | – | 49.1% | – | – | – | – |

■ **Tax year**

For corporate income tax purposes the period of taxation is one calendar year. For other taxes, such as VAT, personal income tax, social tax – the taxation period is one month.

■ **Corporate income tax**

The corporate income tax rate is 15%. A company's taxable income is determined as a profit or loss amount prior to income tax calculation (as set out in the income statement of the annual report), which is adjusted (increased or decreased) in accordance with the provisions of the law 'On Corporate Income Tax'.

■ **Taxation of dividends**

Non-residents, including legal or private persons from zero or low tax zones, are subject to a 10% withholding tax on dividends paid by residents and permanent establishment offices of non-residents, except for dividends payable to an EU-based resident company, if such company owns no less than 25% of the share capital and voting rights in the company paying the dividends for at least two years.

■ **Other transactions regarded as profit distribution**

The Law 'On Corporate Income Tax' provides for recognition and adjustment of these transactions as being subject to corporate income tax.

■ **Capital gains**

Capital gains in general are not taxable for non-resident and resident companies.

■ **Interest taxation**

Interest paid to non-residents or to resident legal persons is generally not taxable. Interest is taxable only if the interest rate is essentially higher than the average market interest rate on similar debt obligations. Thus if resident and non-resident legal persons make interest payments to each other, or if a resident legal person makes interest payments to other resident legal persons, then these are generally not taxable in Latvia.

Interest payments from a resident to a non-resident related party are subject to a 10% withholding tax.

A 5% withholding tax is applied on interest payments made by a resident bank to companies based in offshore countries.

■ **Indirect taxes**

The main indirect tax is VAT. The standard rate is 18%, but on some products a reduced rate of 9% or 5% applies.

Banking service provision

Twenty-two banks and a branch of Nordea Bank Finland Plc operate in Latvia. In addition, there are several representative offices of foreign banks. 57.8% of banks' equity is owned by non-residents (2004) and 10 banks are controlled by foreigners. The Latvian State owns only 5.95% of bank capital (2004). This corresponds to one state bank (Hipot_ku un Zemes banka) and a small shareholding in another bank (Latvijas Kr_jbanka).

The three largest banks (see Table 1) account for 49.1% of the market.

Clearing and payment systems

The main payment and collection types used are bank transfers, direct debit, standing orders, card payments, and transfers through telephone banking or on-line internet banking.

More than 75% of payments are processed through electronic channels.

The settlement of a bank's clearing position is effected through the Bank of Latvia (Central bank).

Pursuant to the Law 'On the Bank of Latvia', it is the duty of the Bank of Latvia to organise and ensure the functioning of the payment and settlement systems in Latvia.

Currently there are two systems in operation at the Bank of Latvia and both are used for inter-bank settlements.

The Electronic Clearing System (EKS) began operating on 17 November 1998, replacing the previous paper-based clearing system. The EKS is used for the processing of retail payments (up to LVL 50,000). It can be regarded as an ACH (Automated Clearing House) system in which payment processing is fully automated and only electronic documents are accepted.

A new real-time gross settlement system (SAMS) was 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. It replaced the previous electronic gross settlement system. The system enhances risk control and is an effective tool for the implementation of monetary policy. It has a positive impact on economic activities both in domestic and foreign markets.

With the implementation of the SAMS, the Bank of Latvia inter-bank payment systems became fully automated and harmonised with EU requirements.

■ Payment collections

- *Card payments* – a frequently used payment method is card payment. Nearly 60% of card users make a card payment at least once a month. Internationally acknowledged debit and credit cards are widely accepted and used and the extensive network of POS terminals and ATMs foster wide usage of card payments. The card market is debit driven, as debit cards account for 80% of the total.
- *Direct debit* – direct debit is widely used for recurring low-value payments. It is mostly used by private individuals to pay regular bills (telephone bills, life insurance and public utility payments). Further growth of the direct debit payment market is forecast for next year. Currently direct debit constitutes 4% of total payment volumes.
- *E-bills* – E-bills have recently become available in the Latvian market. The E-bill service provider in Latvia is AS Itella. At the moment, customers can view their monthly bills on the homepage of the service provider company as well as in the internetbank, which also serves as a client authorisation tool. This option is becoming increasingly popular, although the vast majority of bills are still being delivered in the traditional way i.e. paper-based bills via post.
- *Clearing systems* – domestic non-urgent retail payments are cleared through EKS (Electronic clearing system). Clearing takes place twice a day.

Urgent payments and payments exceeding 50,000 lats are sent through the real-time gross settlement RTGS system in real time; there is however no minimum amount of payment determined for RTGS. The RTGS system operates on SWIFT from 8:30-16:30 and is used for inter-bank transfers, central bank operations, the netted balances of retail and the securities settlement system.

Cross-border payments are based on SWIFT procedures.
- *Accessibility of bank accounts* – many Latvian banks have extensive branch networks. It should be noted however that Latvian banks offer highly developed electronic banking solutions to both resident and non-resident companies. Of electronic banking solutions, internet banking has become increasingly popular amongst companies. Multinational companies can also access their bank accounts via SWIFT services using their main banking relationships abroad to monitor and initiate payments in their Latvian bank accounts. UN/EDIFACT financial message formats are supported by a number of local banks.

Payment factories, lock-boxes, and shared service centres are not used or offered by Latvian banks.

Cash and bank account management

Non-resident companies have to present the following documents to open a bank account in Latvia:

- Certificate of Incorporation or Certificate of Organisation of the legal person;
 - Memorandum and Articles of Association, Memorandum of Association, By-Laws, Operating Agreement and Articles of Organisation; and
 - Document proving the right of representation (Power of Attorney, Minutes of the Meetings of Directors, extract of the register etc).
- A customer must submit attested copies of the above-mentioned documents. The copies can be attested by a notary or legalised in the appropriate consulate or attested with apostille under the Convention de La Haye du 5 Octobre 1961 on the cancellation of legalisation requirements for foreign public documents. Private individuals representing the customer must present their passport to prove their identity.

■ Money laundering

Cases of suspicion of Money Laundering related activities must be reported by credit or financial Institutions to the Financial Intelligence Unit. The Money Laundering and Terrorist Financing Prevention Act and regulations issued by the Financial Supervisory Authority were composed taking into consideration regulations issued by the European Union and the Financial Action Task Force on Money Laundering.

The Law of the Republic of Latvia 'On the Prevention of the Laundering of the Criminal Proceeds' is binding.

■ Cash pooling

Thanks to the strong influence that Scandinavian banks have had on the Latvian banking industry, cash management products are quite highly developed and today all banks with Scandinavian stockholding offer cash pooling.

The main users of cash pooling in Latvia are international companies with local subsidiaries, together with some local companies and municipalities.

■ Domestic notional pooling

Notional pooling is permitted in Latvia. The cash pool structure may include both resident and non-resident companies under the same legal name or different legal entities, as the bank accounts offered to residents and non-residents are the same. Notional pooling is mainly offered per currency on the basis of interest rate enhancement and internal limit setting services. Most of the groups of companies including different legal entities prefer to manage their liquidity using notional pooling.

■ Domestic cash concentration

Cash concentration is permitted among resident and non-resident accounts, among accounts owned by a single legal entity and among accounts owned by multiple legal entities. The most commonly used methods of cash concentration are zero-balancing and target-balancing. Cash concentration is primarily used by companies whose cash pool includes a single or limited number of legal entities holding a large number of bank accounts in the same bank.

■ Cross-border cash pooling

To date there has been little demand in the Baltic states for cross-border cash pooling services. Pan-Baltic cash pooling (covering all three Baltic states) has been considered by

several regional banks as a value added service to its customers, however implementation has been hampered by factors such as different currency bases and the diversity of regulatory legislation. The situation is expected to change radically once all three Baltic countries adopt one single currency on entering the euro-zone.

- Rietumu Banka – www.rietumu.lv
- Nordea Banka – www.nordea.lv

Liquidity management

■ Benchmark rates

The Bank of Latvia calculates local lat money market rates RIGIBID (inter-bank deposits) and RIGIBOR (inter-bank loans) using 6 of the most active bank quotations on the money market. These indices are provided for terms starting from overnight up to 12 months.

■ Short-term investments

The main instruments used for short-term investments by companies are overnight and term deposits in the banks. Money market funds have lately become a viable option for the placement of short-term liquidity.

■ Short-term borrowing

The main types of short-term financing provided by banks are overdraft facilities, factoring and loans.

Short-term loans issued by Latvian banks are in lats, US dollars and EUR with terms of up to one year. Interest rates on loans are mainly linked to the six month EURIBOR, 6 month LIBOR and three month RIGIBOR.

Corporate finance

The equity market in Latvia is rather undeveloped. Consequently, banks tend to be the main source of extra capital for companies. Most of the listings on the Riga Stock Exchange have been privatisation deals and only a few have been solely to raise capital (e.g. IPO for SAF Tehnika and the secondary offering of Grindeks). Bank debt (both short and long term) and leasing have been developing very rapidly. The market capitalisation of the domestic stock market (if applicable) is EUR 1.453 billion (26 September 2005). The Latvian bond market is dominated by government bonds and only a few financial institutions have issued corporate bonds.

Useful websites

- Ministry of Finance – www.fm.gov.lv
- Latvian Investment and Development Agency
www.liaa.gov.lv
- Customs Tariff – www.vid.gov.lv
- Riga Stock Exchange – www.rfb.lv
- Latvian laws are available in English – www.ttc.lv

Leading banks:

- Hansabanka – www.hansabanka.lv
- SEB Unibanka – www.seb.lv
- Parex Banka – www.parex.lv
- NORD/LB – www.nordlb.lv