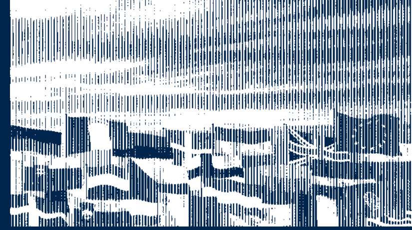

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THE ROLE AND ACTIVITIES OF THE BANK OF LATVIA IN EUROPEAN MONETARY INTEGRATION (2004–2012)

The history of central bank cooperation is almost one century long. At all times, it has been influenced by the economic environment and political context. The Bank of Latvia activities on an international scale, seeking to find ways for foreign trade settlements and investing its foreign reserves, started immediately after its foundation.

After Latvia regained its independence, the Bank of Latvia was vested with the implementation of central bank functions and tasks in compliance with the Latvian legislation, international institutional standards and best practices of its counterparts in other countries. The Bank of Latvia recommenced its international cooperation activities in end-1991, boosting them substantially in 1992 when Latvia got the IMF membership, the Bank of Latvia renewed its participation in the BIS, and the country received technical assistance and established contacts necessary for foreign settlements and foreign reserve management.

Latvia entered a qualitatively new stage of international cooperation in 1995 when it signed an association agreement with the EU and the government of Latvia submitted to Spain holding the EU Presidency at that time an application stating Latvia's commitment to join the EU. On 1 May 2004, Latvia became a Member State of the EU but the Bank of Latvia joined the ESCB. At the current juncture, the activities to improve the Bank of Latvia operation are going on, as it plans to integrate with the Eurosystem when Latvia has adopted the European single currency, the euro; in addition, the central bank functions and operational organisation aimed at attaining the objectives continue to evolve.

Central banking: establishment, responsibility areas and international cooperation

The process of central bank formation in the present-day EU countries was long and gradual, starting with the establishment of *Sveriges Riksbank*[1] in 1668 (deemed to be the oldest central bank in the world) and ending in 1998 when, following the transformation of the Luxembourg Monetary Institute, *Banque centrale du Luxembourg* was created. In the Baltic States, Estonia's central bank *Eesti Pank* was founded in 1919, while *Lietuvos bankas* in Lithuania and *Latvijas Banka* in Latvia came into being in 1922. Their activities were discontinued in 1940 and resumed only in the 1990s. The Bank of Latvia took over the assets (but no liabilities) of the central bank which was founded in 1922.[2]

The initial purpose of creating a central bank was to bring uniformity to the system of money note issuing, to centralise and to manage national gold reserves, and to improve the performance of payment systems. The central position these banks held in the financial system, how they oversaw most of national precious metal reserves, and their ability to provide additional liquidity turned them into bankers' banks.[3] Via striving to implement specific goals of monetary policy, central banks consolidated their power and turned into influential informative authorities with quite profound knowledge of the respective financial system's position.[4] The role of central banking in the financial market becomes particularly instrumental during financial crises when the interbank market fails to function properly.

Generally, the evolution of central banking goes through three stages.[5] During the first stage, central banks engage in money issuing, interbank settlements and provision of banking services to the government; the second stage foresees the development and pursuit of monetary policy, foreign reserve and exchange rate management, monitoring and supervising financial institutions, and acting as a financial advisor to the government. In the third stage of evolution, consultative functions dominate the central bank activities. From a historical perspective, the Bank of Latvia's operation in the 1920s and 1930s was in line with the first stage of central bank evolution. In the 1990s and early 21st century, its activities corresponded to the second stage of development, while after joining the ESCB the Bank of Latvia entered the third stage of central bank evolution. Accordingly, the Bank of Latvia today needs to attract and employ highly qualified staff, both experts and researchers, who are able to provide recommendations and advice not only to the government of Latvia but also to the EU institutions. Monetary integration enhances banking integration across the EU countries, and part of the decisions are made in a centralised manner.

The ECB acts as an institution coordinating cooperation within the ESCB, while the Bank for International Settlements is considered to be a centre to foster global cooperation among central banks. The Bank of Latvia became a BIS member in 1930. Towards the end of 1939, the Bank of Latvia cooperated with the Bank of England, *Banque de France*, the Federal Reserve Bank of New York and other central banks. Despite the occupation of Latvia that terminated the operation of the Bank of Latvia, the assets of the latter at foreign central banks and the BIS were preserved and regained in the 1990s. This enabled the Bank of Latvia to form national gold and foreign currency reserves to provide backing for the national currency. Likewise, the Bank of Latvia renewed its participation in the BIS.

In 2004–2012, the Bank of Latvia continued collaboration and exchange of information with central banks of other countries. Over the time, the Bank of Latvia has gradually emerged as a central bank able to render technical assistance to other central banks. Under a World Bank project, in 2004, the Bank of Latvia provided technical aid on issues related to foreign reserve management to central banks of Costa Rica, Cyprus, Iran, Romania, Tanzania, Ukraine and Venezuela.[6] In 2006, it came forth with a survey of banking sector's accounting practices in Georgia and Ukraine and consulted central bank experts in Trinidad and Tobago on the issues of reporting foreign currency reserves.[7] Moreover, under the IMF technical assistance programme in 2004–2006, recommendations related to accounting and financial reporting were provided for central banks of Albania[8] and Belarus.[9] In 2008 and 2009 under the ECB and national central bank technical assistance programme, a report on the balance of payments statistics at the National Bank of Serbia with recommendations for improving the data collection in view of winning the EU membership and meeting the ECB standards in the area of balance of payments statistics was delivered.[10]

The employees of the Bank of Latvia have made presentations at various international gatherings in Europe and Asia; in the premises of the Bank of Latvia, seminars and other similar events have taken place for central bank staff of Bulgaria, Georgia, Kazakhstan, Lithuania, Moldova, Montenegro and Russia; consultations on monetary policy instruments, bank liquidity, foreign reserve management as well as accounting, financial reporting, statistical, personnel management, internal audit, information system, public relations and similar issues were held for central bank staff of Armenia, Bulgaria, Egypt, Georgia, Hungary, Kazakhstan, Lithuania, Moldova, Slovenia and Turkmenistan.

The Bank of Latvia has also hosted a number of international events. It is holding the meetings of the deputy representative group of the Nordic-Baltic Monetary and Financial Committee on a regular basis. In April 2005[11] and September 2009[12], a meeting of the Nordic-Baltic Monetary and Financial Committee which tackled strategic issues of the IMF policy and cooperation with other international financial institutions was held in Riga.

Likewise in 2005, the Bank of Latvia organised the annual meeting of the Baltic and Nordic central banks which was dedicated to payment and securities settlement systems[13]; in 2012 a similar meeting tackled topical issues of statistics. A meeting on foreign reserve management attended by the EU12 central bank and the World Bank representatives took place at the Bank of Latvia in 2006.[14] At the initiation of the Bank of Latvia, the Bank of England's Centre for Central Banking Studies jointly with *Banque de France* and *De Nederlandsche Bank* experts organised an international seminar entitled "Monetary Policy Strategies on the Road to the Euro" in 2007.[15] Latvia has run (every third year) meetings for the central bank officials from the Baltic States to exchange opinions and experience on such central-bank-related topicalities as monetary policy, market operations, public relations, publications and translations, etc.

Working jointly with the IMF, on 5 June 2012 the Bank of Latvia welcomed top officials to a high-level conference *Against the Odds: Lessons from the Recovery in the Baltics*.[16] This conference brought together outstanding national and international policymakers and academics to review the strategy that helped the Baltic States to emerge from a deep recession, restore balanced growth, make progress towards or achieve the goal of euro adoption as well as the remaining complex challenges and ways to address them. At this conference, the opening addresses were made by Latvian President Andris Bērziņš and IMF Managing Director Christine Lagarde (who took part also in the panel discussion). Speakers included Latvian Prime Minister Valdis Dombrovskis and Bank of Latvia Governor Ilmārs Rimšēvičs, EC Vice-president Olli Rehn, Swedish Finance Minister Anders Borg, ECB Executive Board Member Jörg Asmussen, and Baltic Ministers of Finance Jürgen Ligi, Ingrida Šimonytė and Andris Vilks.

International financial institutions and foreign central banks continue to invite the Bank of Latvia staff to seminars and courses hosted by these organisations and to receive advice on issues related to central banking. The Bank of Latvia employees have attended courses held by the ECB, the IMF Institute, the World Bank, the EC, and the Joint Vienna Institute as well as seminars at central banks of Austria, Belgium, Bulgaria, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Iceland, Italy, Lithuania, the Netherlands, Poland, Spain, Switzerland, Turkey and the UK, and the Federal Reserve Bank of New York. The Bank of Latvia specialists have made exchange-of-experience visits to the central banks of Belgium, the Czech Republic, Denmark, Estonia, Italy, Lithuania, Poland, Slovakia and Sweden.

The Bank of Latvia specialists regularly participate in the work of several committees and special working groups of the EU Council and the EC. Thus within the Economic and Financial Committee of the EU Council and through its sub-committees the Bank of Latvia representatives participated, on a regular basis, in the process of making decisions on the EU economic and financial progress, discussed the euro adoption problems, reviewed the relations with third countries and the policy of international financial institutions as well as jointly with other EU countries prepared recommendations for the improvement of economic policy strategy and its instruments.

The Bank of Latvia is also represented in the working groups of the EC and Eurostat where the euro coin issues, payment systems, economic forecasting and statistics are reviewed.

The exchange of information among central banks is of paramount importance, and the areas they deal with most often are solvency and liquidity of international financial institutions as well as the future effects of those economic principles that might intensify the systemic risk.[17] It became particularly significant during the US housing bubble when the information to assess the circumstances had to be obtained instantly. With regard to cooperation in the ESCB, it is the closest within the Eurosystem, as the euro area countries pursue the single monetary policy. The central bank cooperation, which today is spurred also by capital mobility, does not cease; new ways are being sought for to maintain and enhance the stability of the economy and financial system.[18]

Goals, objectives, institutional structure and governance of the ESCB

The establishment of the ESCB is an institutional achievement and a result of the economic policy pursuit, supported by earlier-formed central bank cooperation. The latter was driven by the views shared by all central banks on the cruicial role of low inflation in securing the economic growth and financial stability. According to the Treaty on the Functioning of the European Union, the primary objective of the ESCB shall be to maintain price stability in the EU.[19]

The monetary integration required the establishing of specific institutions. Thus on 1 January 1994[20], the EMI was created for the purpose of developing necessary preconditions for the ESCB to commence its activities in accordance with the Treaty on European Union[21] signed in Maastricht. It was charged with the task to define the regulatory, institutional and logistic framework for the ECSB operation in the third stage of EMU. The ECB was established on 1 June 1998 and was a successor of the EMI.[22] The ECB is a multi-national institution; hence in the pursuit of its monetary goal it is less exposed to political pressures than the euro area central banks.[23] The Protocol on the

Christine Lagarde, IMF Managing Director, and Ilmārs Rimšēvičs, Governor of the Bank of Latvia, in Old Riga on 5 June 2012. Photograph: Aivars Liepiņš.

Statute of the ESCB and the ECB is annexed to the Treaty on European Union and the Treaty on the Functioning of the European Union.[24]

The basic tasks of the ESCB are laid down in the Treaty on the Functioning of the European Union, and they are as follows: to define and implement the monetary policy of the EU, to conduct foreign exchange operations, to hold and manage the official foreign reserves of the Member States, and to promote the smooth operation of payment systems.[25] The ECB has been granted the exclusive right to authorise the issue of euro banknotes by the euro area national central banks. The ESCB is obliged to assist competent authorities in their efforts to implement policy relating to the prudential supervision of credit institutions and to the stability of the financial system. In view of the monetary policy implementation in countries with different economic structures and at distinctive growth levels, the need to obtain ever more extensive and complex statistical information increases. The importance of collecting statistical information is implied also by the numerous ECB regularly hosted international conferences dealing with new opportunities enabling improvements in the quality of statistical information. As of 1 January 2011, the ECB has been entrusted additional new tasks relating to the operation of the ESRB.[26] The ECB is charged with ensuring the Secretariat to the ESRB and, accordingly, providing analytical, statistical, logistical and administrative support to the ESRB. This task requires the assistance of all the EU national central banks, the Bank of Latvia among them, whose specialists have assisted the ESRB Secretariat in their operational routine.

Within the Eurosystem, the process of decision making is centralised not only relating to defining the euro area monetary policy but also its implementation by the ECB and the euro area national central banks. The antinomy between centralisation and decentralisation is inherent in the ESCB. When making decisions on almost all areas of central banking (national banks, currency matters, means of payment, collection, compiling and distribution of statistical information, payment and settlement systems, regulations that may substantially affect the stability of financial institutions and market), the EU national central banks must first consult the ECB.[27] The Bank of Latvia has applied for the ECB opinion prior to the Bank of Latvia Council adopted legislation on monetary policy instruments, collection of statistical information, functioning of payment and settlement systems, and other aspects of the Bank's operation. In 2005–2012, the ECB issued 22 official opinions on the Latvian regulatory documents and draft legal acts of the Bank of Latvia and the FCMC.[28]

The institutional structure of the ESCB is complex and contradictory. The ESCB is of a dual structure, organised and operating at two levels: the EU and national.[29] The central ESCB institution is the ECB, while the EU national central banks are representatives of the ECB engaging in transactions with EU credit institutions using euro denominated financial instruments.[30]

The ESCB is an open and dynamic system. The Treaty on European Union and the Treaty on the Functioning of the European Union are supplemented with protocols[31], which, building on the notifications by the Danish government in 1993 and the UK government in 1996 and 1997 on the intention not to move to the third stage of the EMU, define the special status of these two countries with regard to the adoption of the euro. These countries are not obliged or committed to introduce the euro, which is a constant derogation of different scope. Nevertheless, they maintain the right to join the euro area provided only that all necessary conditions for the euro adoption are satisfied. Sweden, on the other hand, as its legal acts at that time did not meet the requirements for full EMU membership and the Swedish krona had not participated in the ERM[32], has derogation. The central banks of these countries were not involved in the pursuit of the ECB monetary policy. Because of it and in order to alleviate the public perception of the ESCB structure, in November 1998[33], the ECB Council took a decision to create a subsystem called the Eurosystem, which comprises the ECB and the central banks of those Member States whose official currency is the euro. Initially, the ESCB comprised 15 central banks of the EU Member States, including central banks of 12 EU countries within the Eurosystem. Later on, the proportion of national central banks within the ESCB and the Eurosystem cardinally changed when on 1 May 2004 ten new countries, Latvia including, joined the EU, and the emergence of potential EU or Eurosystem members is likely to introduce new changes in the future as well. The Eurosystem has generally assumed the leading role, acting as a catalyst for market participants due to its unique position of simultaneously being a public administration authority and an active market participant implementing the tasks of a central bank.[34]

Institutions governing the ECB are simultaneously the governing bodies of the ESCB. Consequently, the decisions of the ECB governing bodies are binding also on the EU national central banks. The Eurosystem is administered by two main decision-making bodies: the ECB Governing Council and the Executive Board. The third decision-making body, i.e. the General Council, will exist until the euro has become the single currency of all EU Member States.

When the ECB was created, the governors of all euro area central banks were entitled to vote for monetary policy decisions; however, with the number of EU Member States increasing, a decision to alter the procedure was made in 2003, and a system of rotating voting rights was introduced.[35] However, later in 2008, the ECB Governing Council resolved to continue its current voting regime and to introduce the rotation system only when the number of governors of the euro area national central banks in the Council exceeds 18.[36]

The Bank of Latvia specialists participate in the ESCB activities and processes through the ECB General Council (Governor of the Bank of Latvia is its member) and ESCB committees and working groups. By the end of 2011, Bank of Latvia employees had attended and participated in the work of 12 ESCB committees and over 30 working groups, tackling the issues of monetary policy, bank supervision, euro banknote production, statistics, accounting, market operations, payment systems, international relations and the like.[37] In 2005, the Human Resources Conference, which serves as a platform for experience, know-how and information exchange among personnel managers of all EU national central banks, was established.[38] The Head of the Personnel Department represents the interests of the Bank of Latvia in the Human Resources Conference. Participation in the decision-making process requires from the Bank of Latvia and other central banks of the EU countries serious investment of their human resources. Central banks of major EU Member States enjoying better opportunities in this respect are in a more favourable position.

Having obtained the ESCB membership, the Bank of Latvia organised several ESCB committee and working group meetings. In June 2006, a meeting of the ESCB Statistics Committee's Working Group on External Statistics was held in Riga with the participation of experts in the balance of payments area.[39] In May 2007, a meeting of the ESCB Information Technology Committee's Information Systems Security Working Group was also held in Riga[40], while other two meetings of the Working Group on Accounting Issues and Financial Reporting and Working Group on Allocation of Monetary Income, both under the ESCB Accounting and Monetary Income Committee, took place in Riga in May 2008[41]. In July 2010, the Bank of Latvia hosted meetings of the ESCB Banking Supervision Committee and the Internal Auditors Committee[42], but in May 2011, the meeting of the Payment Systems Policy Working Group of the ECB Payment and Settlement Systems Committee worked in Latvia.[43]

In 2006, the Bank of Latvia organised a seminar for specialists of the EU national central banks and the ECB on the internal audit quality assurance and enhancement system; likewise, the ECB and Bank of Latvia experts who are involved in the law-making process and preparation of publications and various texts in the Latvian language were invited to a seminar entitled "The Development of the Bank of Latvia Functions", at which the issues of monetary policy, accounting, oversight of payment systems and market operations were discussed.[44] In 2007, the Bank of Latvia hosted a meeting of the ESCB IS Network Expert Group on the issues of upgrading and optimisation of the ESCB information systems infrastructure.[45] Meanwhile in 2008, Riga was the venue of a seminar entitled "Financial Crises (Context and Terminology)" for the ECB and Bank of Latvia translators, editors and terminologists.[46] The seminar aimed at expanding the insight into the financial market developments and raising the awareness of recent terminology trends in the area of financial instruments.

Through its activities in the ESCB committees and working groups, the Bank of Latvia is involved in the process of making and passing decisions, except on issues addressing monetary policy; its links with the community are strengthened via compiling and publishing of the ECB documents; it actively participates in various operations like collecting statistical information, making payments and conducting payment system oversight; it also takes part in the ECB capital formation (paying up its share in the ECB subscribed capital only in part).

Monetary policy decisions of the Bank of Latvia and their drafting

After Latvia joined the EU, the Bank of Latvia continued to define and implement its own monetary policy aimed at attaining its main objective of price stability in the country.

An in-depth study of macroeconomic development trends and their mutual interaction employing statistical, mathematical and econometric methods forms the underlying basis for a contemporary central bank to pursue its monetary policy effectively. Economic research and analysis are indispensable for quantitative and scientifically founded accounts on processes in the economy and in developing econometric models for macroeconomic forecasting and assessment of alternative scenarios. When making decisions on changes in interest rates (on 16 such instances in 2004–2012), the Bank of Latvia Council strictly adheres to the reports of its macroeconomic experts, in which the national economy is profoundly analysed and well-founded inflation forecasts and arguments in favour of such changes are provided. Additionally, the Council Members of the Bank of Latvia engage in extensive debate on potential monetary policy decisions during thematic meetings held at the Bank. A number of forecasting models are used in the economic analysis conducted at the Bank of Latvia. Most important of all is Latvia's macroeconomic model, replicating the one used by the ECB. As an additional tool, it supports the Bank of Latvia specialists in their efforts to carry out macroeconomic analysis and to produce medium-term forecasts. At the Bank of Latvia, the forecasting methods and expert skills are improved using the research and practices of the ECB and other national central banks.

In 2008, the Macroeconomic Indicators Database was developed, opening up a centralised access to the data produced by the CSB, the Treasury, the Road Traffic Safety Directorate (on newly registered cars), the State Unified Computerised Land Register, the State Land Service, and commercial real estate companies. Data integrity is enhanced and their analysis rendered more extensive by system-inherent data monitoring, calculation of additional indicators, and updating after regular data uploads.

Working papers of the Bank of Latvia specialists (totalling 33 in 2004–2012) are regularly published on Bank's website to assist the readers in grasping the economic growth processes and aspects of the Bank of Latvia monetary policy. In 2009, the Bank of Latvia launched a new series of research papers – Discussion Papers – on its website.[47] This series reflects the analytical work done at the Bank of Latvia and presents the resulting inferences in order to promote, in public at large, fruitful discussions about problems vital for the Latvian economic development. Some of these publications have been used in the round-table discussions of Bank's experts dedicated to diverse economic issues and held on a regular basis. Articles contributed by the Bank of Latvia experts have also appeared in international peer-reviewed journals.

The quarterly *Macroeconomic Developments Report*, replacing the publication *Monetārais Apskats. Monetary Review* which came out in 1994, has been issued since the third quarter of 2009.[48] It deals with the developments in exports and the external sector, financial markets, domestic demand and supply, costs and prices, and the balance of payments. This publication also presents economic and inflation forecasts of the Bank of Latvia and focuses on monetary and financial statistics as well as key economic indicators.

The use of monetary policy instruments at the Bank of Latvia is flexible and creative and aimed at a more effective attainment of its basic objective. During the period of economic overheating, the minimum reserve requirement for banks dominated as the main monetary policy instrument. The Bank of Latvia increased the reserve ratio and expanded the minimum reserve base for banks. By contrast, when the economic growth decelerated notably, the reserve ratio was lowered. In November 2006, the Council of the Bank of Latvia approved the "Regulation for the Use of the Bank of Latvia's Monetary Policy Instruments"[49], consolidating into one document the regulations for particular monetary policy instruments and aligning them with those used by the Eurosystem. The Bank of Latvia requested and was issued an ECB opinion on this legislative draft.[50] The Bank of Latvia Council (upon the receipt of another ECB opinion[51]) approved a revised version of this document in May 2007[52], so as to harmonise the access criteria for Bank of Latvia counterparties in monetary operations and to improve the regulatory content and formalisation of regulations in accordance with legal requirements for external legislative acts (the Regulation was amended in 2009, 2010 and 2011).

To stir the interbank market to activity, the Council of the Bank of Latvia resolved at the close of 2008 to differentiate the lending facility rate depending on facility's maturity: the rate on marginal lending facility remained unchanged, while those on facilities used for 6–10 working days and over 10 working days within the previous 30 day period were rigorously raised.[53]

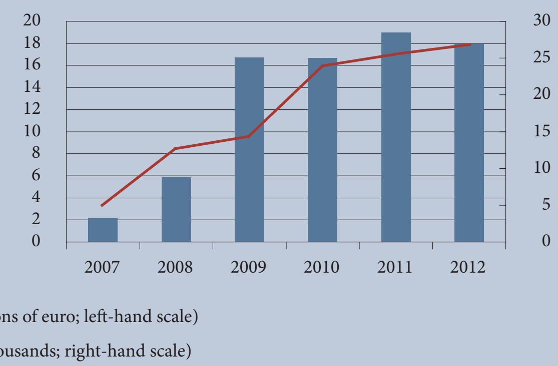
The ECB has positively assessed the efforts of the Bank of Latvia to gradually bring its monetary policy instruments in conformity with the Eurosystem's standards, which is to be achieved for proper operation of Latvian credit institutions after the adoption of the euro. Such conformity will also alleviate the integration of the Bank of Latvia into the Eurosystem. Nevertheless, serious inconsistencies in monetary policy regulatory frameworks of the Eurosystem and the Bank of Latvia are still in place. That is why the Bank of Latvia, thinking ahead of the euro changeover process, will have to proceed with its policy instrument aligning activities so as to succeed in complete conformity with the Eurosystem's requirements.

Payment systems of the Bank of Latvia

Along with the task to build monetary environment for the national economy, central banks are charged with the creation and maintenance of sound payment and settlement systems and their oversight. Close cooperation among the EU national central banks, attainable under the ECB guidance, is a precondition in this area. Payment systems form a crucial component of financial infrastructure, and their smooth operation supports country's economic processes. Likewise, fast, accurate and complete execution of payments and settlements predetermines effective functioning of the overall financial sector. Credit institutions are enabled to monitor their settlement account balances with the central bank, and, thus, to manage their liquidity more efficiently. Financial stability is a broad concept capturing different aspects of the financial system, of which one is the financial market infrastructure. Meanwhile, payment systems constitute an important component of this infrastructure.[54]

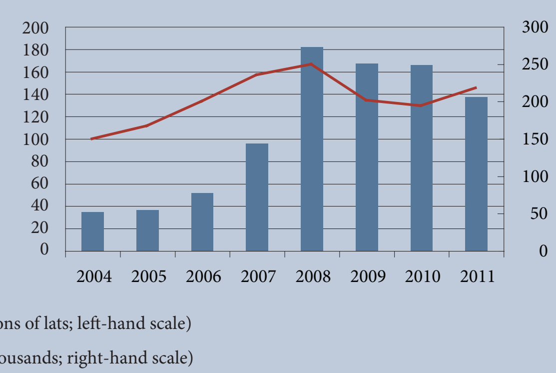
In the 1990s, preparation for the euro changeover in the EU required an adequate payment system to be launched. This need was supported by both EU national central banks and credit institutions. In March 1995, the EMI Council made a decision to develop a new system – the Trans-European Automated Real-time Gross Settlement Express Transfer System (hereinafter, TARGET).[55] The launching of the TARGET system on 4 January

Chart 1. VOLUME AND VALUE MONTHLY AVERAGES OF PAYMENTS PROCESSED IN TARGET2-LATVIA (November 2007–June 2012)



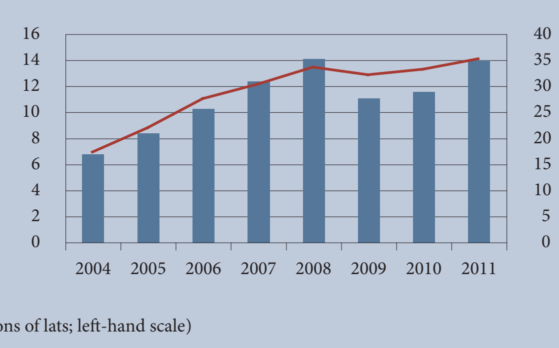
Source: Bank of Latvia interbank payment system statistics.

Chart 2. VOLUME AND VALUE OF PAYMENTS PROCESSED IN SAMS (2004–2011)



Source: Bank of Latvia interbank payment system statistics.

Chart 3. VOLUME AND VALUE OF PAYMENTS PROCESSED IN EKS (2004–2011)



Source: Bank of Latvia interbank payment system statistics.

1999 enabled efficient integration of the euro area money markets into an effectively operating single euro money market.

Progress in financial markets, technology and information systems as well as potential enlargement of the EU and decentralised nature of TARGET were the factors underpinning the need to improve the system. As a result, TARGET2, i.e. a system of new generation, was developed to replace it. The Bank of Latvia, the Treasury and Latvia's credit institutions commenced improving the payment systems as early as the 1990s, attempting to ensure their compatibility. Consequently, jointly with the ECB, other EU national central banks and domestic credit institutions, the Bank of Latvia succeeded in launching the TARGET2-Latvia system, a component of the TARGET2 system, in Latvia as early as 19 November 2007. In the first months of TARGET2-Latvia operation, 4.8 thousand payments in the value of 2.2 billion euro were executed on a monthly average basis, whereas in the first half of 2012, the monthly average of executed payments amounted to 27.0 thousand in the value of 18.3 billion euro (increases of 5.6 and 8.3 times in volume and value respectively; see Chart 1).

In 2004–2012, the Bank of Latvia continued to operate other two payment systems: the SAMS (real-time gross settlement system for interbank and urgent customer payments in lats) and the EKS (clearing and settlement of net positions of batch retail payments in lats and, as from 2008, also in euro). In 2004–2011 overall, 1.6 million payments in the value of 873.0 billion lats were processed in the SAMS. In 2011, 216.4 thousand payments were made (an increase of 1.5 times against 2004) in the value of 137.8 billion lats (an increase of 4.0 times; see Chart 2).

Meanwhile, the EKS-processed payments totalled 230.3 million in the value of 88.9 billion lats in 2004–2011. In 2011, 35.1 million payments were executed (an increase of 2.0 times against 2004) in the value of 14.0 billion lats (an increase of 2.1 times; see Chart 3), in such a way in terms of volume outpacing and in terms of value almost levelling out with the level in 2008.

The Bank of Latvia provided the system participants with high accessibility to these systems. Thus in 2011, the accessibility to the SAMS was 99.93%, and that to the EKS was 99.77%.[56]

The Bank of Latvia does not stop to improve the operation of payment systems. For instance, in 2010, the EKS was transformed into a SEPA compliant payment system, as a result of which the EKS enabled the Latvian banks, the Treasury and the Bank of Latvia to execute fast, efficient and secure customer payments in euro both domestically and within the entire SEPA space (EU countries, Iceland, Liechtenstein, Monaco, Norway and Switzerland).[57] Thus via the EKS, 4.5 thousand banks and an economic area comprising 490 million population can be reached.[58] The transformation of EKS into SEPA compliant payment system contributed to the introduction of uniform SEPA requirements for the bank-to-client domain in Latvia as well. In 2011, a new clearing cycle for processing payments in euro was implemented in the EKS, ensuring an even faster execution of cross-border euro payments and crediting the customer accounts within the same day.[59] Together with the other ESCB participants, a new release of TARGET2 was implemented, enhancing liquidity management options for participants.[60]

The interbank payment systems maintained by the Bank of Latvia enable real-time settlements among the financial market participants and the execution of customer payments, crediting the payee's account on the same or, at the latest, next day after the initiation of payment.

Macro-prudential supervision, stability of the financial system and payment system oversight

Already the EMI was tasked to identify possible means for the ESCB to use in assisting supervisory institutions in their pursuit of financial system stability enhancing policy. The ESCB adheres to the principle of an open market economy with free competition and efficient allocation of resources, where the stability of prices, financial and monetary systems as well as the balance of payments is the underlying rule. That this would require fresh approaches and solutions in the future is well confirmed by the euro area summit statement on 29 June 2012 on establishing a single EU supervisory mechanism involving the ECB[61]. The EU high-level political initiatives of the previous years aimed at consolidating cooperation in cross-border supervision emphasised the need to establish a centralised supervisory authority in Europe. It materialised in part, as on the basis of Jacques de Larosière's Group report published in February 2009[62], the EC proposed to alter the supervisory framework for the EU financial sector. The framework proposed in this report evolved, gradually becoming more complex. Towards the close of 2010, a number of legal acts establishing the EFSF were passed. This system commenced operation in 2011 and comprises the three European Supervisory Authorities[63], the Joint Committee of the European Supervisory Authorities, the ESRB[64], and the EU national central banks responsible for supervision or national supervisory authorities. Due to the financial crisis, the establishment of this system took place in a hurry, and some emerging problems were addressed after the new bodies started operation.

The ESRB is responsible for macro-prudential oversight of the financial system to assist in the prevention or mitigation of systemic risks to financial stability in the EU that arise along with the evolution of the financial system; it takes into account macroeconomic developments so as to avoid periods of widespread financial distress. It contributes to the smooth functioning of the internal market and thereby ensures a sustainable contribution of the financial sector to economic growth. Representatives of the EU national central banks and respective national and European supervisory authorities take part in the work of the ESRB. The Governor of the Bank of Latvia and the Chairman of the FCMC represent Latvia in the ESRB General Board. The Bank of Latvia is represented also in the ESRB Advisory Technical Committee and working groups. With the FCMC's consent, a Bank of Latvia representative participates in the work of the EBA Board of Supervisors (the objective of the EBA is to protect public interests by contributing to short-, medium- and long-term stability and effectiveness of the financial system for the EU economy, its citizens and businesses[65]).

In 2004, the Bank of Latvia and the FCMC signed the Memorandum of Understanding on High-Level Principles of Cooperation between the Banking Supervisors and Central Banks of the European Union in Crisis Management Situations and the Memorandum of Understanding on Cooperation Between Payment Systems Overseers and Banking Supervisors in Stage Three of Economic and Monetary Union. These cooperation agreements became binding as of 17 June 2004.[66] The purpose of the first is to promote safe and continuous operation of large-value interbank payment systems, whereas the second lays down a set of principles and procedures relative to cross-border cooperation in managing crisis situations among the EU national central banks and supervisory institutions.

In 2005, the Bank of Latvia, the FCMC and the Ministry of Finance of the Republic of Latvia together with central banks, supervisory authorities and Ministries of Finance of the other EU countries signed the Memorandum of Understanding on Co-operation in Financial Crisis Situations (in effect from 1 July 2005 to 31 May 2008). This Memorandum of Understanding stipulated a set of principles and procedures providing for the exchange of information, stances and assessments for the involved public institutions to enhance the stability of the financial system. In April 2006, the Bank of Latvia together with the FCMC and the Ministry of Finance participated in the crisis simulation exercise organised by the EFC with the aim of testing the provisions under this Memorandum. To foster co-operation among the EU countries and common stances in the event of potential cross-border crises, a new edition of the Memorandum of Understanding on Co-operation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on Cross-Border Financial Stability was signed in 2008 (in effect as of 1 June 2008)[67]. A new stage was ushered in by the proposal the EC made on 6 June 2012 for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms.[68] The EU proposal specifies a comprehensive set of measures, both authorising and regulatory, to assist national authorities of the EU countries in managing troubled banking institutions.

Pursuant to the Memorandum of Understanding signed in 2008, a cooperation agreement on cross-border financial stability, crisis management and resolution between relevant Ministries, Central Banks and Financial Supervisory Authorities of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden was signed (in effect as of 17 August 2010).[69] The above agreement stipulates the procedure for information sharing and coordination, and the procedures enhancing cooperation of the stakeholders in cross-border financial supervision, crisis management and resolution. The key objective of the agreement is to reduce the risk of cross-border financial crisis and ensure efficient crisis management in the Nordic and Baltic regions. To coordinate the addressing of these issues, a new body – the Nordic-Baltic Stability Group with a number of working sub-groups has been formed.

In December 2006, the Bank of Latvia signed a Memorandum of Understanding with *Sveriges Riksbank* and the central banks of the Baltic States on cooperation in crisis situations.[70] In autumn 2007, the Bank of Latvia participated in the common exercise of the Nordic-Baltic central banks to assess the practical application of mutually concluded memoranda of understanding and of that concluded at the EU level in 2005.[71]

In 2011, the EBA conducted a stress test, using consolidated data of 90 major banks.[72] Even though the Latvian credit institutions were not included, their parent banks were represented. Relying upon the basic elements of the EBA methodology, the Bank of Latvia conducted stress tests of all Latvian credit institutions in 2011.[73]

Being aware of the particular importance of bank lending to the Latvian economy and its implications for financial stability and monetary policy decision-making, the Bank of Latvia has been conducting regular surveys of major lending banks since the autumn of 2007[74] with the aim to identify changes in lending guidelines, obtain additional information on factors affecting loan demand and supply, and detect other lending-related problems. The credit institution survey results have been published on the Bank of Latvia website since 2011, thus ensuring feed-back.[75]

The Bank of Latvia publishes the Financial Stability Report[76], in which the financial system's operation and such risks that could impair the financial stability in Latvia are discussed and assessed; the related development trends are likewise tackled, and information on attainments in payment and settlement system oversight is provided. In this area, the Bank of Latvia has improved the models used in credit risk assessment and the stress test methodology for credit institutions.

Joint activities of the Bank of Latvia and the FCMC are gaining in closeness and importance. A program of exchange of experience among employees of the two institutions, which was launched in 2011, figures as an important instrument entailing improvements in credit institution risk analysis.[77]

The Council of the Bank of Latvia approved "The Bank of Latvia Payment and Securities Settlement System Policy" in January 2011, which stipulates the role and key tasks of the Bank of Latvia regarding the oversight of payment and securities settlement systems, and replaces the "Oversight Policy for the Securities Settlement Systems of Latvia" approved in 2006 and "The Bank of Latvia's Payment System Policy" approved in 2001.[78]

The Bank of Latvia conducts day-to-day oversight of the payment systems maintained by it and the securities settlement system operated by the LCD, analysing technical and operational functions of the systems and compiling statistical data on them. Within the framework of payment system oversight, the Bank of Latvia cooperates with the institutions ensuring operation of clearing and payment systems by providing advice and opinion on payment system issues.

Within the scope of payment system oversight, the Bank of Latvia assesses the compliance of payment systems with "The Core Principles for Systemically Important Payment Systems" published by the Committee on Payment and Settlement Systems of the BIS[79]. For instance, in 2011, the compliance assessment of the EKS[80] and the direct debit payment system JSC Itella Information[81] was conducted.

The Bank of Latvia has participated in the ECB surveys and polls on, e.g. correspondent banking transactions in euro and innovative payment services in Europe. In 2007, the Bank of Latvia assessed the efficiency of liquidity usage in the SAMS.[82]

In order to promote the integration of Latvia's payment systems into the SEPA, the Bank of Latvia coordinated the SEPA Project in Latvia. The EKS for payments in euro has been a SEPA compliant system since 9 November 2010, enabling system participants to send and receive payments in euro across the entire SEPA.[83] In January 2011, the Bank of Latvia renewed self-assessment of the EKS for SEPA compliance in accordance with the modification of the system due to migration to the SEPA requirements.[84] Starting with 2011, the Bank of Latvia jointly with the FCMC participated in the European Forum on the Security of Retail Payments established by the ECB and was involved in drafting recommendations for card payments for online purchases and bank electronic payment services.[85]

In cooperation with the FCMC and LCD, the Bank of Latvia commenced the assessment of compliance of the LCD securities

settlement system and the related infrastructure with the recommendations of the ESCB and the Committee of European Securities Regulators (CESR; the European Securities and Markets Authority (ESMA) since 1 January 2011), targeting its completion in 2012.[86]

In order to facilitate the integration of Latvia's securities market into the single European securities market, the Bank of Latvia, jointly with the LCD and within the framework of securities settlement system oversight, headed the Latvian User Group of the Eurosystem's TARGET2-Securities (T2S) Project (with representatives of the LCD, the Bank of Latvia, the FCMC, the Treasury and the Latvian Commercial Bank Association participating), which approved the impact assessment of TARGET2-Securities system for Latvia in 2011.[87] The Bank of Latvia and LCD took part in the ESCB committees and working groups reviewing the issues relevant to the implementation of TARGET2-Securities Project. According to the ECB Governing Council Resolution of 20 October 2011, the TARGET2-Securities is planned to be launched in June 2015.[88]

Compilation of statistical data

The Bank of Latvia collects and compiles financial and monetary statistics and balance of payments statistics as well as prepares quarterly financial account statistics. In accordance with the ECB's request, the Bank of Latvia has also been involved in addressing issues related to statistical methodology of some economic sectors and compiling specific aggregates.

The Bank of Latvia has set the requirements for compiling statistical data in compliance with the stances of the ECB, the IMF and other international institutions. In addition, the Bank of Latvia closely follows the latest developments in the area of statistics and conducts data quality updating. With the demand for statistical information for the needs of the economic analysis and financial stability assessment growing, the Bank of Latvia has, in accordance with the cost effectiveness principle, considered the necessity for additional data and opportunities of employing mathematical methods. In order to minimise the reporting burden of respondents, the Bank of Latvia has found it possible to accept statistical data in electronic form, to reduce the regularity and volume of data submission, and to make use of registry and other institutions' data.

The Bank of Latvia takes care of providing a feed-back for respondents and possibly more extensive access to statistical information. In 2011, information furnished in the field of statistics was substantially updated and improved by expanding and restructuring the Statistics Section on the Bank of Latvia's website.[89] In 2012, the Bank of Latvia launched a new internet statistical database for the purpose of providing users with modern, user-friendly and adaptable means for data access and analysis, including also graphic tools; its evolution is currently on its way. In 2011, the Bank of Latvia began to publish the quarterly financial account statistics on its website, disseminating financial system's data on households, non-financial corporations, financial institutions and government, their interrelations as well as interrelations with non-residents.[90]

The Bank of Latvia engages in regular transmission of statistical data to the ECB, the BIS and the IMF, and provides statistical information to other domestic and foreign data users. To furnish timely information to a wide range of data users, the Bank of Latvia disseminates financial and monetary statistics and balance of payments statistics of Latvia via its regular publications and the Bank's website, and compiles data for the ECB publications (*Blue Book, Orange Book, EU Banking Structures*, etc.) and the ECB Statistical Data Warehouse as well as the IMF publications *International Financial Statistics* and *Balance of Payments Statistics Yearbook*, and within the IMF Special Data Dissemination Standard.

Bank of Latvia Balance Sheet Developments

The central bank operation and its interaction with economic sectors are reflected in its balance sheet, while the profit and loss statement provides an insight into income and expense of a central bank. At the same time, financial reports enable the assessment of the degree of bank's openness and the comparison of various performance indicators of a number of central banks to follow the integration trends. The balance sheet of a central bank illuminates what economic resources are held under its control, and what are its legal and economic commitments, in addition disclosing the financial structure, liquidity and solvency aspects of the bank.[91]

In 2007, the Bank of Latvia Council approved the "Financial Accounting Policy of the Bank of Latvia"[92], which forms the legal framework for the Bank of Latvia accounting system and its management. Events and financial transactions of the Bank of Latvia relating to the implementation of monetary policy and management of foreign reserves as well as the participation in the ECB capital are accounted for in accordance with the principal accounting and financial reporting policies established by the ESCB, at the same time taking into account that the Bank of Latvia is not a participant in the Eurosystem. In 2009, the Bank of Latvia Council complemented the "Financial Accounting Policy of the Bank of Latvia", defining requirements for the notes to annual financial statements. In 2011, the Council of the Bank of Latvia amended the "Financial Accounting Policy of the Bank of Latvia", stipulating to report the equity instruments in the balance sheet at fair value, with participation in the ECB capital stated at initial cost in the balance sheet as an exception.

The Bank of Latvia publishes a monthly balance sheet, annual financial statements and other financial information also available on the Bank of Latvia website.

The Bank's integrated information system ensures a standardised, automated, secure and efficient execution of the Bank of Latvia's financial transactions and their uniform accounting as well as preparation of financial statements. The top management and specialists of the Bank of Latvia receive updated information about the Bank of Latvia operation on a daily basis. Within the framework of the internal financial control system, the Bank of Latvia's top management assesses, on a regular basis, changes in the Bank of Latvia's assets and liabilities as well as income and expense, paying particular attention both to the results of managing foreign currency and gold reserves as well as to the consistency of operating costs and long-term investment with the Bank's budget approved for each current year.

As a rule, financial results of central bank performance are calculated once a year, summarising the annual performance. In the course of the year, the EU national central banks record retained earnings or loss of the reporting year differently, i.e. either as other liabilities or as capital and reserves. Likewise, annual financial reports reflect the financial performance differently. Starting with the financial reports for 2006, the Bank of Latvia changed the recording of financial performance and included it within capital and reserves.[93] As a result, fluctuations in capital and reserves decrease, thus providing a more thorough insight into central bank buffering against potential risks.

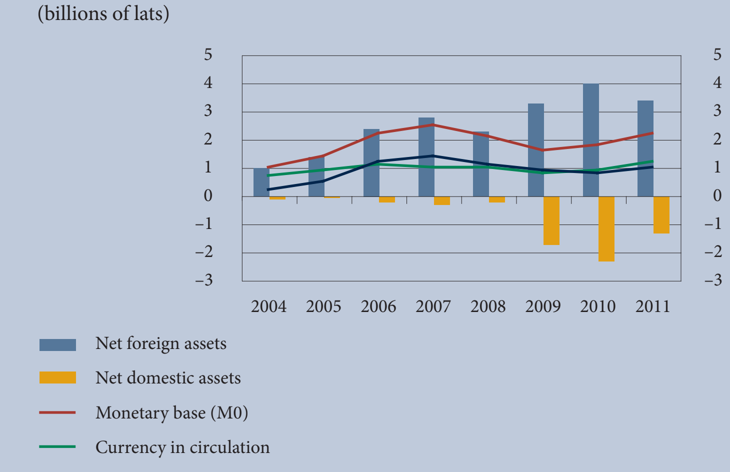
The liabilities side of the Bank of Latvia balance sheet is made up of money supply or monetary base M0, which includes cash issued by the Bank of Latvia and demand deposits attracted from credit institutions (see Chart 4). The calculation of such an indicator is possible for the Bank of Latvia and other non-euro area national central banks, while it is impossible, in classical terms, for the euro area national central banks, as on the liabilities side of their balance sheets only the adjusted outstanding amounts of issued euro banknotes are recorded (in line with the internal liabilities and claims of the Eurosystem, which reflect the share of the respective euro area national central bank in issued outstanding euro banknotes recorded on the ECB balance sheet).

In 2004–2011, currency in circulation increased 1.6 times and at the end of 2011 amounted to 1.2 billion lats. The share of banknote value in this period fluctuated from 92.8% at the end of 2009 to 95.5% at the end of 2006. Banknotes and coins received from banks were checked for wear and tear and authenticity by using automated cash processing systems of the Bank of Latvia. In 2004–2011, the amount of processed cash (21.1 billion lats in total) 3.2 times on average per annum exceeded the average outstanding currency in circulation. Of the amount of cash processed, 3.1 billion lats or 14.7% was withdrawn from circulation. The total nominal value of detected counterfeits (195.3 thousand lats) accounted for a mere 0.001% of total cash processed. In 2011, the Bank of Latvia jointly with the central banks of Belgium, Finland, Ireland, Luxembourg and the Netherlands implemented a project aimed at improving the organisation of cash circulation.[94] This project provides for launching new information systems *CashSSP* and *MyCashSSP*, migration to sealed cash packing and bar code identification; among other things, it also ensures a uniform exchange of information regarding cash transactions in lats between the Bank of Latvia, on the one hand, and credit institutions and merchants authorised by them on the other, and higher efficiency of internal logistics and currency processing.

Bank of Latvia net worth and foreign reserves

Exposure to financial risks as a rule brings about substantial changes in central bank performance indicators. Financial strength of a central bank is positively related to good policy implementation practices, while financially weak central banks suffer losses, thus undermining macroeconomic stability.[95] On

Chart 4. BANK OF LATVIA BALANCE SHEET POSITIONS AT END 2004–2011
(billions of lats)



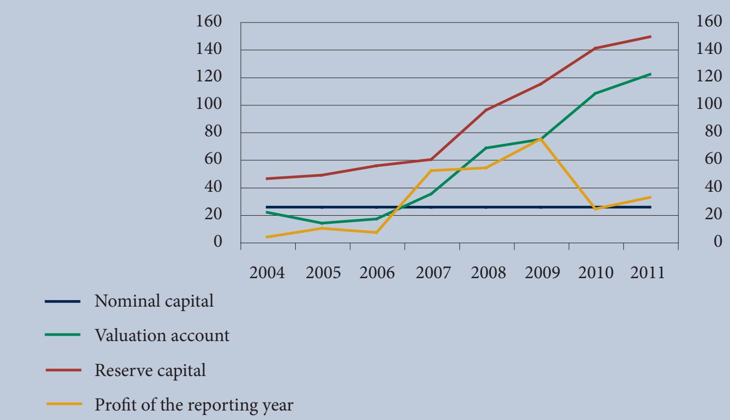
Source: Bank of Latvia Annual Reports 2004–2011.

account of their special status, central banks do not need bulky capital, though they prefer to maintain at least a positive capital balance, which helps them be independent from the government and avoid requesting additional funding.[96] The independence of a central bank and its losses are mutually intertwined. A central bank which is not independent is likely to incur losses, whereas an independent central bank which incurs losses is likely to lose some of its independent status over time, as the government should be obliged to tighten oversight as it should have for any other troubled public institution.[97] In normal circumstances, a central bank should be able to generate profit. Inability to cover current losses or further problems with negative net worth might impair monetary policy management and jeopardise independence and creditworthiness of banks.[98] As the latter is an important aspect of financial policy implementation, central banks must be financially strong in view of their obligations and assumed risks, and able to earn profit on a regular basis.[99]

The Law "On the Bank of Latvia" stipulates that all the expenses of the Bank of Latvia shall be covered from its income, simultaneously providing for the formation of reserve capital to cover potential losses. Provided that the reserve capital is not sufficient, there is an opportunity to use nominal capital for the purpose. The amount of nominal capital of the Bank of Latvia is fixed (2.5 million lats initially, 25 million lats after amendments made to the Law "On the Bank of Latvia" in 1997)[100], while the amount of reserve capital is unlimited, as it depends on Bank's profit to be transferred to the reserve capital after making the prescribed deductions to the state budget. So far, the Bank of Latvia has not been compelled to use the above opportunity. The Bank of Latvia nominal capital reached the amount stipulated by the Law "On the Bank of Latvia" at the end of 2002[101] and hence after remained constant. The amount of profit the Bank of Latvia earned in 2004–2011 varied by year (see Chart 5). The largest profit was earned in 2009 (74.4 million lats) when it amounted to 29.2% of total profit for 2004–2011. The steepest drop was recorded for 2004 when profit vis-á-vis the previous year contracted 3.6 times, while its strongest growth was observed in 2007, when the amount of profit vis-á-vis the previous year increased 7.8 times.

Given that the result of central bank foreign reserve management may trigger cardinal changes in its financial performance, the dynamics of central bank foreign reserves and net worth shall be compared. In 2004–2011, the trend dominating over the developments in Bank of Latvia outstanding foreign reserves (gold, SDR and foreign convertible currencies) and net worth was that of growth (see Chart 6). Instances of Bank of Latvia foreign reserves contracting were observed only in 2008

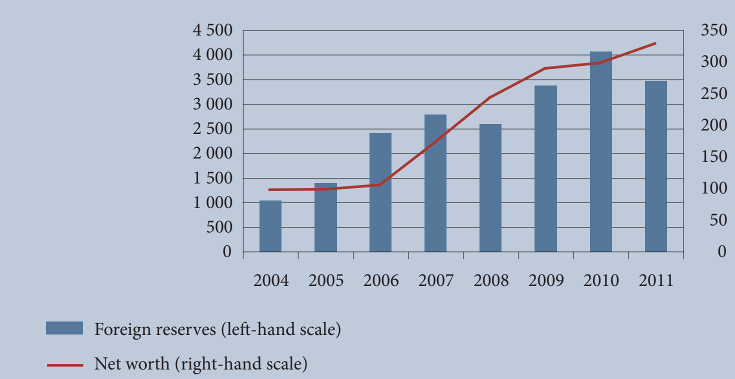
Chart 5. BANK OF LATVIA NET WORTH COMPONENTS AT END 2004–2011 (millions of lats)



Source: Bank of Latvia Annual Reports 2004–2011.

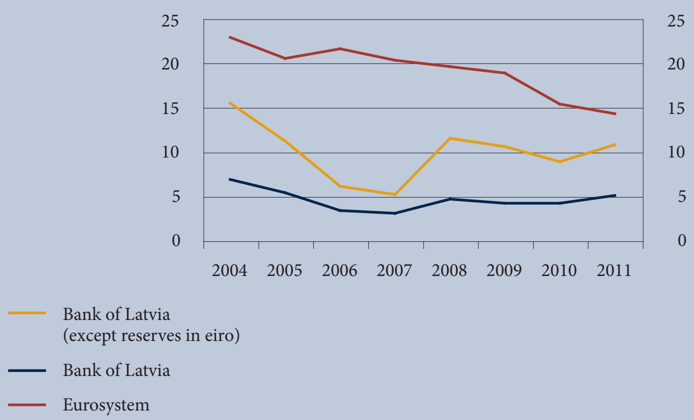
Note: Outstanding nominal capital and reserve capital have been adjusted against the Bank of Latvia Financial Statements for 2004 and 2005, which record annual profit in breakdown.

Chart 6. BANK OF LATVIA FOREIGN RESERVES AND NET WORTH AT END 2004–2011 (millions of lats)



Source: Bank of Latvia Annual Reports 2004–2011.

Chart 7. RATIO OF CAPITAL AND RESERVES TO FOREIGN RESERVES OF THE BANK OF LATVIA AND THE EUROSYSTEM AT END 2004–2011 (%)



Sources: Bank of Latvia Annual Reports 2004–2011 and ECB Annual Reports 2004–2011.

and 2011, but towards the close of 2011, the Bank of Latvia foreign reserves and net worth increased 3.3 times and 3.4 times respectively. At the same time, the ratio of the Bank of Latvia net worth and foreign reserves fluctuated within the range of 4.3% at the end of 2006 and 9.4% at the end of 2011. Speaking about the Bank of Latvia ratio of capital and reserves to foreign reserves, in 2004–2011 it fell notably behind the respective indicator of the Eurosystem, which was characterised by a downward trend, while the Bank of Latvia ratio, having hit the low in late 2007, went upward and reached 5.0% at the end of 2011 (see Chart 7). It should be reckoned, however, that a significant part of the Bank of Latvia foreign reserves are made up of assets in euro, which, instead of being recorded under foreign reserves, will be included in domestic assets in the Eurosystem. With the assets in euro excluded from the Bank of Latvia foreign reserves, the ratio of Bank of Latvia capital and reserves to foreign reserves (10.7% at end-2011) approximates that of the Eurosystem (14.2% at end-2011). It is vital for the Bank of Latvia to proceed with raising its reserve capital and building of its financial provisions to ensure fair value of capital and assets.[102]

The Bank of Latvia invests its foreign reserves in safe and liquid financial instruments. The Bank of Latvia's foreign reserves are managed in accordance with the guidelines adopted by the Bank's Council, which are reviewed and amended as necessary. The new edition of "The Guidelines for Managing the Bank of Latvia's Foreign Reserves" was approved by the Bank's Council in 2004.[103] This move was primarily determined by the change in lats peg. To minimise the currency risk to the largest extent possible, the euro has been established as the base currency of the benchmark portfolio. The Bank of Latvia has used services of several external managers of its reserves. They manage a minor portion of foreign reserves pursuant to the guidelines adopted by the Council of the Bank of Latvia.

In the foreign reserve management, much attention is paid to risk management and control. The compliance of foreign reserve portfolio with the guidelines is checked on a business day basis, and the risk allocation in accordance with various investment decisions is monitored as well. At the same time, the Bank of Latvia specialists are looking for new solutions to foreign reserves management. New financial instruments, the expansion of global market, and the introduction of the euro have had a substantial impact on the central bank foreign asset management. The development of the global financial market urges central banks to diversify their foreign asset portfolios by making investments in financial instruments issued not only by governments but also by other issuers. With the establishment of the ECB and introduction of the euro, the EU national central banks focus less on maintaining liquidity than on generating certain income.[104] As a result, risks to incur losses from foreign reserve management increase, hence central banks have started to resort more to risk management methods, assessing the effects of risks on their budgets. That is why central banks need to improve their risk management and decision-making processes.

Participation of the Bank of Latvia in the ECB capital

The dual nature of the ECB[105] first consists in the fact that the ECB is an institution belonging to national central banks of the EU Member States because the latter are sole holders of ECB capital shares; the ECB, at the same time, is the highest institution administering daily operation of the EU national central banks. ECB laws and regulations refer to the term "shareholders", meaning the euro area central national banks, because they have paid up their subscribed capital in full. Each EU national central bank has its share in the ECB capital or capital key. It is calculated on the basis of five-year averages of the Member States in the total population and gross domestic product of the EU as reflected by aggregated EU indicators. This also implies that respective adjustments are conducted on a five-year basis, with recalculations starting at the end of 2003. Readjustment is determined by the EU enlargement, i.e. the time and number of new countries joining it. However, duly accounting for the ECB exposure to market and credit risks, the ECB Governing Council decided, at the end of 2010, to increase its subscribed capital by 5 billion euro[106] (the euro area national central banks should pay their additional capital contributions in three equal annual instalments during 2010–2012). The initial capital of the ECB was 5 billion euro. When the EU10 countries joined, the capital was increased by 11.3%, and when Bulgaria and Romania became the EU Members States in January 2007, it additionally rose by 0.7%.[107] After the accession, the capital key of the EU10 national central banks totalled 10.1% (see Table 1). At the end of 2011, the Bank of Latvia's share in the ECB capital amounted to 0.2837%, which corresponds to 30.5 million euro.[108] As Latvia does not participate in the euro area, the Bank of Latvia is to contribute to the operational costs of the ECB by paying 3.75% (1.1 million euro) of its total subscribed capital in the ECB.[109]

The ECB capital key is an important indicator for income and profit distribution, determining the amount of foreign assets to be transferred to the ECB and voting on issues binding on shareholders. The mechanism of ECB capital distribution is an objective reflection of the place each EU Member State holds in the EU economy; in view of growing ECB assets, the augmenting of ECB capital is a positive development.

Independence as an essential quality of modern central bank

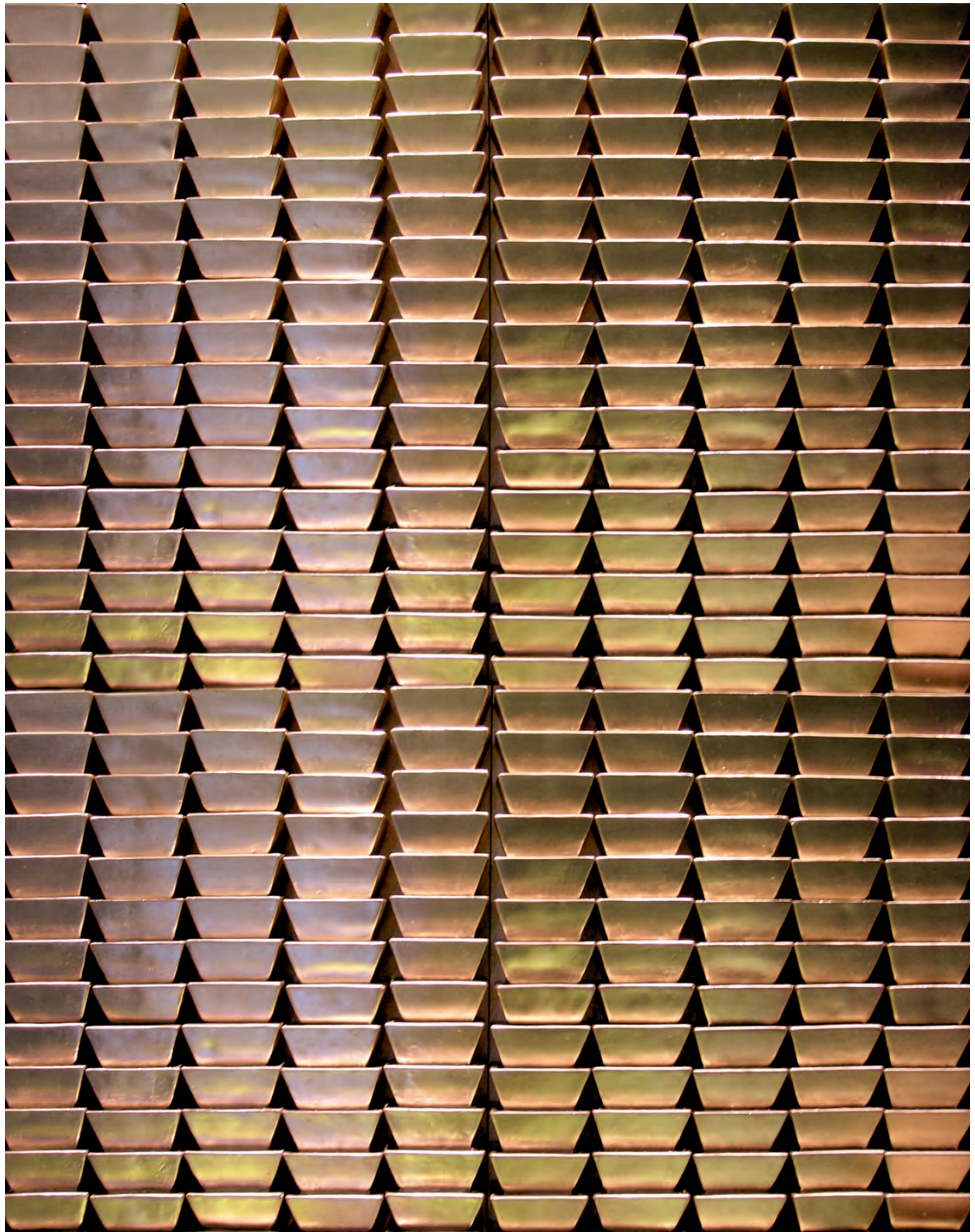
Political independence is related to central bank ability to act in compliance with its monetary policy strategy, which is compatible with price stability; functional independence, in turn, concerns monetary policy tactics, i.e. the ability to freely opt for monetary policy control instruments and techniques that lead to price stability.[110] In accordance with the Treaty on the Functioning of the European Union, the national legal framework is expected to ensure the independence of the EU national central banks. This independence, however, is, to some extent, lost or is diminishing, as the EU national central banks have to comply with the ECB decisions and directions. The concept of the EU national central bank independence developed by the EMI in 1997 comprises four aspects of independence (functional, institutional, personal and financial independence).[111]

The ECB Convergence Report of December 2006 states that, even though the amendments made to the Law "On the Bank of Latvia" in December 2005[112] and June 2006[113] support meeting the requirements under Article 109 of the Maastricht Treaty, Latvia has to proceed with improving the said law[114]. In accordance with the ECB Convergence Report of May 2012, the Law "On the Bank of Latvia" shall be amended so as to enhance the functional, institutional, personal and financial independence of the Bank of Latvia.[115] Consequently, the amendments to this law have been drafted accordingly and were promulgated at the Republic of Latvia Cabinet of Ministers' meeting of State Secretaries on 7 June 2012; it is the task of the Ministry of Finance to submit the above draft for approval to the Ministry of Justice of the Republic of Latvia, the FCMC, and the Inter-sectoral Coordination Centre.[116] Likewise, the ECB is expected to issue opinion on this draft law as well. Upon the receipt of a positive ECB opinion and approval of the *Saeima*, the draft law will ensure the independence of the Bank of Latvia at such a level that is appropriate for its participation in the Eurosystem.

Table 1. ECB CAPITAL KEY

National central bank groups	ECB capital key (%)				Changes in ECB capital key (in percentage points)	
	After regular changes (01.01.2004)	After EU10 accession (01.05.2004)	After regular changes (01.01.2009)	After increase of capital (01.01.2011)	01.05.2004–01.01.2011	01.01.2009–01.01.2011
Euro area	79.6384	71.4908	69.6546	69.9705	−11.6677	0.3159
Non-euro area	20.3616	28.5092	30.3454	30.0295	11.6677	−0.3159
Total	100	100	100	100	–	–
of which EU15	100	89.8526	86.8281	86.8281	−3.0245	–
EU10	–	10.1474	9.8388	9.8388	−0.3086	–
of which Bank of Latvia	–	0.2978	0.2837	0.2837	−0.0141	–

Source: ECB Annual Reports 2004, 2009 and 2011.

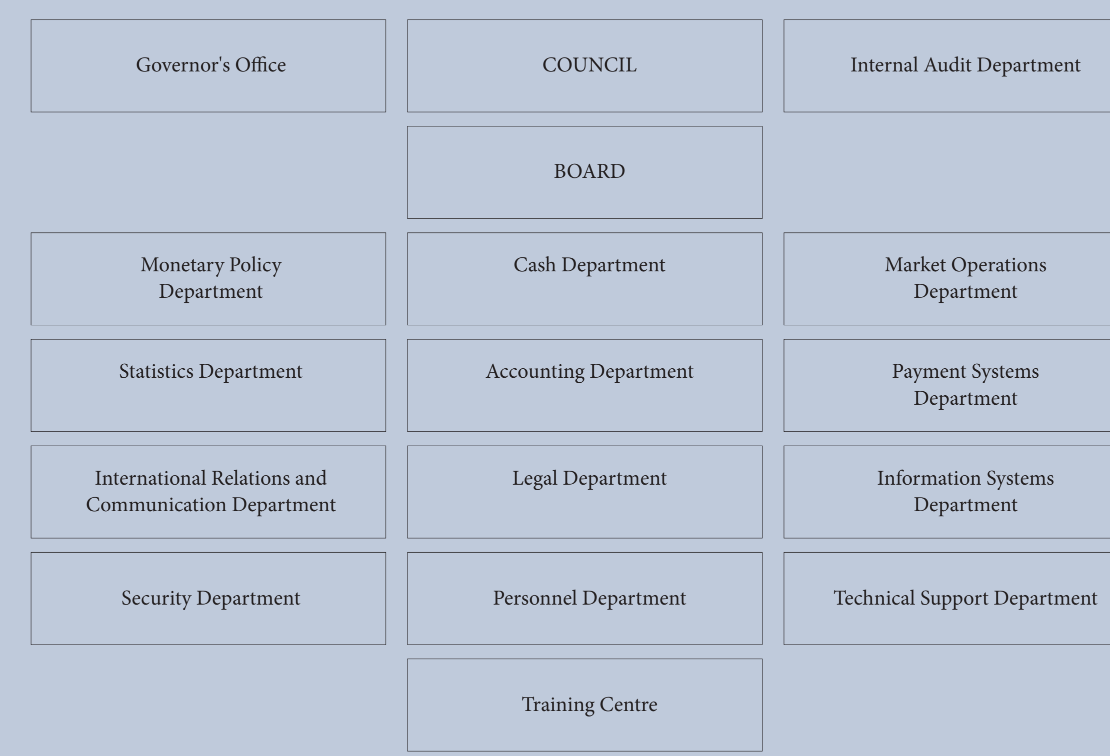


Governance and risk management at the Bank of Latvia

One of the principles of the Code of Good Practices on Transparency in Monetary and Financial Policies prescribes accountability and assurances of integrity by the central bank. Along with being public, the internal processes of central bank governance shall provide for operational integrity, including the internal audit. Good governance implies central bank accountability, the degree of which is rising along with greater central bank independence. Although the Principles of Corporate Governance[117] are not directly applicable, central banks resort to them, to the extent possible, more often. In 2005, the IMF and the World Bank assessed the effectiveness of the given standards and the Code of Good Practices and concluded that the initiative scored fairly high in terms of its overall worth, although less in terms of some specific benefits.[118]

The Bank of Latvia is constantly improving its organisational structure (see Chart 8 for Bank of Latvia structure at end-2011) and the strategic management process, taking into account the best practices of management systems. In July 2006, the Council of the Bank of Latvia approved "The Bank of Latvia Statements of Its Vision, Mission and Values"[119] (see Box). The Statement of Vision presents the Bank of Latvia's long term goal and its perception, while the Statement of Mission reveals the essence of central bank's operation and sets its future direction. The values of the Bank of Latvia illuminate what the central bank holds in high esteem and what it strives to achieve.

Chart 8. THE BANK OF LATVIA ORGANISATIONAL STRUCTURE AT THE END OF 2011



Source: Bank of Latvia Annual Report 2011.

Box

THE BANK OF LATVIA STATEMENTS OF ITS VISION, MISSION AND VALUES

Vision

The Bank of Latvia is an independent entity that carries out its tasks in the public interests with a high sense of professional responsibility. It is a full-fledged participant in the ESCB and cooperates with other institutions of the EU, developing stable and favourable environment for the economic growth of Latvia.

Mission

The objective of the operation of the Bank of Latvia as central bank is price stability promoting Latvia's long-term economic growth.
The Bank of Latvia is an active and responsible participant of the ESCB, enhancing integration and stability of the financial systems of Latvia and other EU countries.
The Bank of Latvia raises the perception level of Latvian public at large about the economic issues, promoting understanding and credibility.
In order to implement its objectives in a professional and continuous manner, the Bank of Latvia operates effectively, ensuring high quality and minimising exposure to risks.
The Bank of Latvia is a reliable cooperation partner.

Our Values

Our employees are of utmost value to us. We maintain a safe and healthy working environment. Motivation, creative approach and responsibility of the employees are essential preconditions for successful operation of the Bank of Latvia. In its employees, the Bank of Latvia highly values the following qualities:
1. orientation towards service quality and result;
2. use of high technologies and corporate governance principles;
3. teamwork and maintaining favourable working environment;
4. professionalism:
– quality performance of tasks, meeting the deadlines,
– taking initiative,
– ability to identify drawbacks, inform about them or correct them, if possible,
– ability and willingness to admit mistakes and correct them,
– application of the principles of best practice,
– ability to be prudent and risk-appraising when making decisions,
– ability to safeguard information,
– willingness to acquire knowledge and ability to be flexible regarding reasonable changes,
– ability to be part of the team and share know-how and experience with colleagues;
5. ethical attitude towards work and colleagues:
– intelligence in mutual relationships,
– honesty and integrity,
– good fellowship,
– respectful attitude and behaviour, no discrimination on the grounds of nationality, gender, religion and opinions,
– awareness of special responsibility and of importance of central bank employees' duties in order to promote the Bank of Latvia's credibility;
6. civic qualities: patriotism and sense of duty towards the country and its people.

RĪGA-800
MILLENNIUM
FOR FREEDOM AND DEMOCRACY
RĪGAS DOMS
SOLTLEIKSITIJA 2002
OLIMPISKĀS SPĒLES
FIFA PASAULES KAUSS 2006 VĀCIJA
2006 FIFA WORLD CUP GERMANY
MUSTELA LUTREOLA
LATVIJAI 90
KOKNESE
LIMBAŽI
20 LATI 1922
LATVIJAS REPUBLIKA
KURZEME
VIDZEME
1 LATS
10 LATU

Chart 9. NUMBER OF BANK OF LATVIA EMPLOYEES
AT END 2004–2011

Source: Bank of Latvia Annual Reports 2004–2011.

Following the best practices of the other EU national central banks and the ECB in personnel management, a set of basic principles has been laid down for the Bank of Latvia to attract and employ qualified and skilled staff for long-term business relationship, providing a motivating work environment, opportunities for professional improvement and growth, and, in turn, expecting the employee to demonstrate a high quality performance, reach the pre-set goals, take initiative, show creativity and integrity. The number of Bank of Latvia employees at the end of 2011 (see Chart 9) had contracted by 20.3% in comparison with the end of 2004.

In 2004, the Bank of Latvia Council approved "The Bank of Latvia Code of Conduct"[120] including the principles of professional conduct, rules and recommendations, which the Bank of Latvia employees have to comply with in their attitude towards their tasks, interpersonal relations and relations with other institutions and public at large. The "Bank of Latvia Code of Conduct" is a substantial component of the Bank's operational organisation, indicating the quality of services other persons may expect in their collaboration with the Bank of Latvia. Compliance with the core principles of "The Bank of Latvia Code of Conduct" fosters successful fulfilment of the Bank's tasks.

The statements of the Bank of Latvia vision, mission and values form the foundation for its operation and development planning. In November 2006, the Council of the Bank of Latvia approved the first strategic guidelines for the next four years, setting forth the central bank's priority goals and various functional objectives.[121] The Bank of Latvia has been implementing its basic tasks and planned activities consistently seeking to reach the objectives stated in its strategic guidelines. The year 2011 saw the completion of the strategic planning phase and identification of strategic goals for the next four years. Four areas for the Bank of Latvia to place a particular focus on were specified. During this period, it will be essential to ensure high quality implementation of the core tasks, promote Latvia's entry into the euro area, strengthen links with public, raise professional competence, and improve performance.

For the first time in 2008, the Bank of Latvia operation was assessed in accordance with specific function target indicators.[122] The results of customer and personnel surveys and qualitative and quantitative measurements of different functions were used in the assessment. On the basis of these results and in order to ensure better operational effectiveness, several processes have been improved.

In 2004–2012, the Bank of Latvia was continuously improving the risk management process. The Bank of Latvia engages in managing strategic, financial and operational risks. It manages risks pursuant to "The Bank of Latvia Risk Management Policy"[123], "The Bank of Latvia Business Continuity Policy"[124], "The Bank of Latvia Information and Information Systems Security Policy"[125], and "The Bank of Latvia Physical Security Policy"[126] approved by the Council of the Bank of Latvia. The Bank of Latvia's Security Supervision Commission carried out a comprehensive and uniform oversight of the policies.

The Bank of Latvia manages financial risks in accordance with "The Guidelines for Managing the Bank of Latvia's Foreign Reserves"[127].

The Bank of Latvia manages its operational risks related to processes and projects. The processes are classified by significance and criticality, depending on their impact on the execution of Bank of Latvia core functions or attainment of its objectives. Risks are identified, analysed and appraised, opting for the most appropriate risk hedging measures. Risk management is implemented by the Bank of Latvia employees responsible for its processes, department heads involved in the processes as well as project managers and other employees of the Bank of Latvia. Operational risk management is supervised by the Bank of Latvia Operational Risk Management Committee appointed by the Board of the Bank, which ensures the coordination of daily activities under the risk management process and gives support to the Board of the Bank of Latvia in the area of risk management.

Operational continuity at the Bank of Latvia is managed with the aim to secure continuity of Bank's critical processes or renewal of such critical processes at appropriate level and in acceptable time in the event of their discontinuation, and to ensure efficient incident and crisis management. Within the framework of the Bank of Latvia business continuity management process, particular focus is placed on the improvement of action plans to ensure operational continuity. The risk analysis of Bank of Latvia critical and top-importance information systems is based on information system risk management methodology. Risk analysis of information system development and upgrading projects is also conducted.

Once a year, the Board of the Bank of Latvia reviews and approves the Bank's risk report and submits to the Council of the Bank of Latvia a statement about the situation in the area of risk management in the previous year.

The Bank's staff has received training in the areas of information and information system security, business continuity, and risk management.

The Bank of Latvia's management must ensure excellent implementation of the tasks stipulated in the Law "On the Bank of Latvia" on a sustainable basis. In 2000, the Bank of Latvia introduced a quality management system meeting the Quality Management System Standard ISO 9001:2000.[128] Internal audits and certification oversight audits of this system were conducted on a regular basis. However, practical operation of this quality management system showed that it no longer could offer any work improvement opportunities; that is why new growth directions were sought for. The conceptual development of integrated management system was finalised in 2008, with the quality management system integrated as part of it.[129] In 2009, the Bank of Latvia carried out self-assessment of management processes in compliance with the Common Assessment Framework developed by the European Institute of Public Administration.[130] During the assessment, areas calling for improvement were identified and measures towards the enhancement of the management system were considered. The Bank of Latvia's management applies the "Plan-Do-Check-Act (PDCA)" cycle.[131] It enables the detection of any gaps in the management and leadership of strategy, resources, staff and processes, as well as provides an opportunity to measure the results achieved with regard to customers, staff and public.

The internal audit is organised and conducted according to "The Internal Audit Policy of the Bank of Latvia" approved by the Council of the Bank of Latvia.[132] In its conduct, the Institute of Internal Auditors' "International Standards for the Professional Practice of Internal Auditing"[133] and "The Code of Ethics"[134], as well as Control Objectives for Information and Related Technology[135] and Information System Audit and Control Association[136] standards are applied. The internal audit covers all business areas of the Bank of Latvia operation. It provides the management of the Bank of Latvia with an independent evaluation of the effectiveness of risk management, control systems and processes, and gives recommendations for their improvement.

Internal audits are planned and conducted on the basis of risk assessment. The results of internal auditing are reported to the Council of the Bank of Latvia once a year. In 2010, the external assessment of internal audit quality confirmed that the internal audit practice of the Bank of Latvia complies with the Institute of Internal Auditors' "International Standards for the Professional Practice of Internal Auditing", "The Code of Ethics" and the ESCB requirements. The Bank of Latvia internal auditors participate in the work of the Internal Auditors Committee of the ESCB and conduct internal audits of the Bank of Latvia in accordance with the audit plan approved by this Committee.

In compliance with the Law "On the Bank of Latvia", the central bank's business activities and financial statements of the reporting year are audited by an Audit Commission whose composition is approved by the State Audit Office of the Republic of Latvia.[137] Recommendations resulting from these audits help the Bank of Latvia improve its control system and increase the process efficiency.

LATVIA'S COIN OF THE YEAR

The collector coins created and circulated by the Bank of Latvia have won international recognition and many prestigious awards. In order to find out the public opinion about these coins, the Bank of Latvia has been conducting regular coin-of-the-year public surveys on an annual basis since 2004, inviting every inhabitant of the country to name and cast a vote for the most appealing coin due to its artistic design, emotional expressiveness, original attractiveness, and topical validity. The coin collecting the largest number of votes is as a rule nominated Latvia's Coin of the Year.

2004

COIN OF TIME

Weight: 17.15 g
(weight of the central circle – 7.15 g,
weight of the outer ring – 10.00 g)
Diameter: 34.00 mm (diameter of the
central circle – 23.00 mm)
Metal: the central circle – niobium;
the outer ring – silver of .900 fineness
Quality: UNC
Struck by Münze Österreich *(Austria)*
Artists: Laimonis Šēnbergs (graphic design)
and Jānis Strupulis (plaster model)

2005

BARON MÜNCHHAUSEN

Weight: 31.47 g
Diameter: 38.61 mm
Metal: silver of .925 fineness
Quality: proof
Struck by Koninklijke Nederlandse Munt
(the Netherlands)
Artists: Arvīds Priedīte (graphic design)
and Jānis Strupulis (plaster model)

2006

COIN OF DIGITS

Weight: 27.00 g
Diameter (the longest diagonal): 38.61 mm
Metal: silver of .999 fineness
Quality: proof
Struck by Münze Österreich *(Austria)*
in 2 007 copies with numbered certificates
Artists: Ilmārs Blumbergs (graphic design)
and Jānis Strupulis (plaster model)

2007

COIN OF TIME II

Weight: 17.15 g
(weight of the central circle – 7.15 g,
weight of the outer ring – 10.00 g)
Diameter: 34.00 mm (diameter of the
central circle – 23.00 mm)
Metal: the central circle – niobium;
the outer ring – silver of .900 fineness
Quality: UNC
Struck by Münze Österreich *(Austria)*
Artists: Laimonis Šēnbergs (graphic design)
and Jānis Strupulis (plaster model)

2008

LUCKY COIN

Weight: 22.00 g
Diameter: 35.00 mm
Metal: silver of .925 fineness
Quality: proof
Struck by Rahapaja Oy *(Finland)*
Artists: Arvīds Priedīte (graphic design)
and Jānis Strupulis (plaster model)

2009

COIN OF WATER

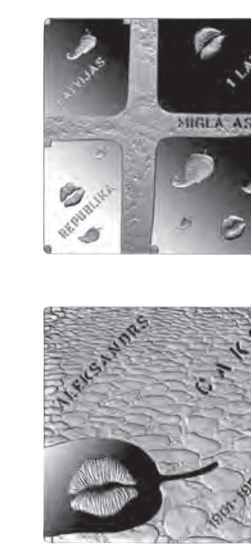
Weight: 26.00 g; shape: square; area
measurement: 32.00 x 32.00 mm
Metal: silver of .925 fineness
Quality: proof
Struck by Rahapaja Oy *(Finland)*
Artists: Ilmārs Blumbergs (graphic design)
and Jānis Strupulis (plaster model)

2010

AMBER COIN

Weight: 20.70 g
Diameter: 35.00 mm
Material: silver of .925 fineness
and amber
Quality: proof
Struck by Rahapaja Oy *(Finland)*
Artist: Aigars Bikše

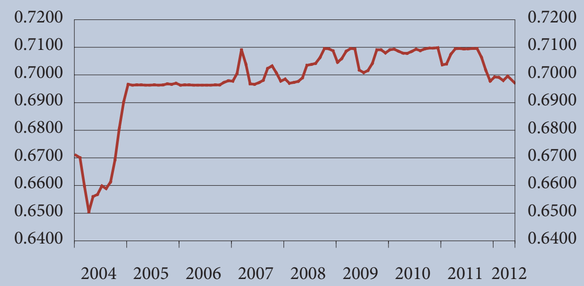
2011



FOG MISTS THE PAIN

Weight: 26.00 g; shape: square; area
measurement: 32.00 x 32.00 mm
Metal: silver of .925 fineness
Quality: proof
Struck by Rahapaja Oy *(Finland)*
Artists: Ilmārs Blumbergs (graphic design)
and Ligita Franckeviča (plaster model)

Chart 10. ECB AVERAGE REFERENCE RATE
(January 2004–June 2012; lats against euro)



Source: ECB Statistical Data Warehouse.

Getting ready for euro changeover

After the accession to the EU, Latvia joined the EMU, i.e. the highest stage of economic integration of the EU Member States, in which it has been granted the status of a country with derogation. When the single European currency, the euro, is introduced in Latvia, the country will become a full-fledged member of the EMU. On 9 December 2003, the Latvian government approved the timeframe for euro changeover, fixing the target dates for lats repegging and implementation of the Maastricht criteria (1 January 2005 and 1 January 2007 respectively).[138] Unfortunately, then the Maastricht criteria implementation target was not attained.

Stability of the lats exchange rate against the euro, which is to be achieved within the ERM II, is one of the indicators used in assessing Latvia's maturity for full participation in the EMU.[139] For at least two years prior to the euro changeover, the lats is to be pegged to the euro to ensure a ±15% exchange rate fluctuation corridor around the central parity rate. With this in mind, the Bank of Latvia Council passed the Resolution "On Pegging the Lats to the Euro and Setting Foreign Exchange Rates" in November 2004.[140] In accordance with this Resolution, the Bank of Latvia repegged the lats from the SDR currency basket to the euro as of 2005. On 30 December 2004, the Bank of Latvia set the lats peg rate to the euro (EUR 1 = LVL 0.702804). As 2005 set in, the fixed exchange rate regime was preserved in Latvia, while the peg currency did change. The repegging was economically founded, for the share of the euro denominated foreign trade flows was markedly above 50% and continued to rise, whereas the US dollar denominated flows hardly accounted for 20% or even less.[141] Since 2 May 2005, the lats has been participating in the ERM II.[142] The ECB Convergence Report of May 2012 emphasises that the lats exchange rate had remained close to the central rate for the last two years, and, in the reference period, its maximum upward deviation from the ERM II central rate was 0.9% and the maximum downward deviation was 1.0%.[143] The exchange rate of the lats against the euro fluctuated on average within the range of 0.6502 in April 2004 and 0.7096 in December 2010 (see Chart 10).

By Prime Minister's Decree No. 308 of 18 July 2005, a Steering Committee was formed to coordinate and supervise the activities leading to the introduction of the single European currency in Latvia.[144] Having assessed the experience of several euro area countries, the Steering Committee formed five working groups for the implementation of tasks in definite areas (public administration, currency and payment system, financial system, non-financial corporations and consumers, and public awareness and communication). The central bank is actively involved in the work of the Steering Committee and its working groups.


Latvia's euro circulation coin country-specific design patterns.
1 and 2 euro coins feature the historical profile of folk-maid also borne on 5 lats silver coins; 50, 20 and 10 euro cent coins display the large coat of arms of Latvia, while the small coat of arms is depicted on the obverse of 5, 2 and 1 cent coins.

The Deputy Governor of the Bank of Latvia is a member of the Steering Committee and the Chairperson of the Money and Payment Systems Working Group. This group is in charge of the euro cash changeover, payment and securities settlement systems, and financial statistics issues in the euro environment, which are the main areas of responsibility of the Bank of Latvia in the euro changeover process. The Money and Payment Systems Working Group has been actively working since its conception in 2005, with the scope of activities growing in 2012, as its members have been involved in drafting the euro changeover legislation and addressing the issues related to the introduction of euro notes.[145] The Bank of Latvia staff members are participating in the work of other task groups as well. The Euro Changeover Project Manager is responsible for the implementation of the Steering Committee's decisions and coordination of the working group activities. The euro implementation process is monitored by the Cabinet of Ministers, to which the Steering Committee submits semi-annual progress reports.

In January 2004, the Bank of Latvia announced an idea competition for the euro coin design, inviting any resident of Latvia to participate with ideas for the design of Latvia's new money. More than one thousand works were submitted for the competition. Incorporating as it did several ideas, the design with the motto "Freedom: a European value" was acknowledged as the best work (author Ilze Kalniņa from Jēkabpils). The jury was of the opinion that the Freedom Monument, folk-maid once portrayed on the Latvian 5-lats silver coin, and the Latvian coat of arms also represent Latvia and its key values best.[146] The design has been improved in line with technological advances. The Latvian 1 and 2 euro coins feature the portrait of Latvian maid, the coins of 10, 20 and 50 cents display the large coat of arms of the Republic of Latvia, and 1, 2 and 5 cent coins show the image of the small coat of arms of Latvia. 1 and 2 euro coins have been designed by Guntars Sietiņš, whereas the author of the euro cent design is Laimonis Šēnbergs.[147] The EU Council has the power to approve the national sides of euro circulation coins.

In general, the euro notes and coins send out symbolic messages about the national values of the European countries, therefore the Bank of Latvia jointly with the EC organised an exhibition "The Origins of Euro Coins" in July 2006.[148] The display traced the process of choosing the euro coin designs and offered an opportunity to see the designs and samples of coins. The presentation of the Bank of Latvia was the very first occasion when draft designs of the Latvian euro coins were on public display.

In March 2006, the Latvian government approved Latvia's National Euro Changeover Plan[149] identifying the key euro introduction tasks in Latvia and their implementation stages, defining the spheres of accountability and euro introduction principles and scenarios. This plan was updated in October 2007, specifying the control processes, and in March 2010, establishing 1 January 2014 as the target date of the euro changeover in Latvia.

On 27 June 2012, the Cabinet of Ministers approved the submitted versions of timeframe for adjusting the legislative framework as included in the "Conception on the Adjustment of Laws and Regulations in Relation to the Euro Changeover" and charged the Ministry of Finance with the responsibility (shared with the other ministries) for the implementation of this conception.[150] The ministries will have to draft lots of laws and other legislative acts. The Bank of Latvia will be obliged to make amendments to 30 of its regulations and declare invalid a part of them. In a number of cases, an ECB opinion confirming the compliance of draft legislative acts with full-fledged participation of Latvia in the EMU will be required.

The partnership agreement on the organisation of euro changeover information and communication campaigns, which was signed on 10 July 2012 in Brussels, is an important step towards the euro implementation.[151] The agreement between the EC and the Latvian government envisages close cooperation in and mutual support to Latvia's euro currency-related communication activities, in such a way bolstering public awareness of the euro implementation activities. As the EC is committed to support several activities of Latvia, it is planned to sign an additional agreement specifying those that require EC support by the end of 2012.[152]

The action plan for the implementation of single European currency in Latvia developed by the Steering Committee highlights the main activity areas. The Euro Settlements Implementation Working Group established at the Bank of Latvia has drafted and is updating a detailed plan for the implementation of euro settlements and ensuring internal processes of the Bank of Latvia. For the Bank of Latvia, the road to the euro is a labour-consuming and intensive process, demanding creative and committed contribution of each and every employee.

CONCLUSIONS

After Latvia regained its independence, the Bank of Latvia, owing in part to international technical assistance, soon emerged as a modern central bank and an equal cooperation partner. The Bank of Latvia is an independent, competent and dedicated central bank. Its operational evolution took place simultaneously with the improvement of the management processes, promoting transparency, efficiency and effectiveness of central bank's activities.

In 2004, the Bank of Latvia became a member of the ESCB. It offered opportunities to have a say in the EU financial system processes and seek for new growth horizons via the activities of the Bank of Latvia Governor in the ECB General Council and its employees in the ESCB committees and working groups. Through the establishment of the ESCB, the central banks of the EU countries have entered a new stage of institutional integration leading to ever greater monetary stability.

By the time Latvia has become a full-fledged member of the EMU and has adopted the euro, the Bank of Latvia will continue to implement an independent monetary policy. It will proceed with performing other functions as well, ensuring, inter alia, smooth operation of the payment system, cash circulation, compilation of financial statistics and Latvia's balance of payments. It will also gradually expand its macroeconomic analysis and research work, addressing the EU economic development trends as well.

Following the establishment of the EFSF in 2011, the Bank has been involved in the macro-prudential supervision of the EU financial system through the Governor of the Bank of Latvia in the position of the General Board Member of the ESRB and the Bank being represented in the Advisory Technical Committee of the ESRB and its working groups.

The joining of the Eurosystem and participation in addressing and making decisions on the single monetary policy issues will be a new challenging phase of the Bank of Latvia's integration.

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5 lats.
Weight: 25.00 g; diameter: 37.00 mm; metal: silver of .925 fineness.
Struck in 2012 by the British Royal Mint *(the UK) using the original electrotypes of 1929 which were used when striking the coins in 1929, 1931 and 1932. The coin design created by Rihards Zariņš (1869–1939) features an image of Latvian folk-maid with ears of corn overlaying her shoulder, a rich braid stretching down her back, and her collar and head dress embroidered with an ornamental design characteristic of Latvian folk costume. Serene beauty and simultaneous lucidity, lightness and firmness of the silhouette intensify the artistic expression. When during World War II the occupational regimes replaced one another and Latvia lost its independence and national currency, this silver coin became a symbol of freedom and statehood for the nation, a comforting ray of hope for those scattered in Siberia or in exile across the globe. The Bank of Latvia dedicated a gold coin to the 10th anniversary of the renewed national currency of Latvia which also featured the design of the historical 5 lats coin.*

2012

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MMXII

New days, duties and events are still nascent. Instead of being disposed of, let us bring them together, bit by bit, as national treasures for public appreciation and new pages in the history book of the Latvian State, its national economy and the central bank.