

Financial and Capital Market Commission Regulation No. 233  
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(Financial and Capital Market Commission  
Supervisory Board Meeting Minutes No. 40, p.5)

## **Regulation on Establishment of the Internal Control System**

*Issued pursuant to Section 34.<sup>1</sup> (2) of the Credit Institutions Law and  
Section 124 (1.<sup>1</sup>) of the Financial Instruments Market Law*

1. *Regulation on Establishment of the Internal Control System* (hereinafter – the Regulation) shall be binding on credit institutions registered in the Republic of Latvia and those investment firms registered in the Republic of Latvia which are institutions within the meaning of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (hereinafter – EU Regulation No. 575/2013) (both jointly hereinafter referred to as an institution).

1.<sup>1</sup> Those investment firms registered in the Republic of Latvia which are not institutions within the meaning of Regulation (EU) No. 575/2013, shall comply with the requirements of Points 20, 25, 26, 27, 40.<sup>2</sup>–40.<sup>9</sup>, 55 –57.<sup>1</sup>, 59 and 60, taking into account their organisational structure, the scale, nature, complexity of specificity of the activities thereof.

2. Institutions mentioned in Point 1 of the Regulation shall comply with the requirements of Chapters I, II, III, IV, VI, VII, VIII, IX, X and XI of this Regulation individually and on a consolidated or sub-consolidated level and the requirements of Chapter V of this Regulation on a consolidated or sub-consolidated level in accordance with Section 50.<sup>8</sup> and 50.<sup>9</sup> of the Credit Institutions Law and Section 123.<sup>3</sup> and 123.<sup>4</sup> of the Financial Instruments Market Law.

2.<sup>1</sup> An institution being a parent undertaking, shall ensure the introduction of the group level policy in the field of the establishment of the internal control system with respect to all subsidiary undertakings belonging to the consolidating group in accordance with regulation No. 575/2013, (hereinafter – prudential consolidating group), taking into account the requirements of the legal framework in the country of location of a subsidiary undertaking, as well as shall supervise the implementation thereof. A parent undertaking and subsidiary undertakings belonging to a prudential consolidating group shall also ensure the introduction of the relevant group level policies in their subsidiaries not bound by legal acts transposing the requirements of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (hereinafter - Directive 2013/36/EU), taking into account the requirements of the legal framework in the country of location of a subsidiary undertaking, as well as shall supervise the implementation thereof.

3. Definitions of the terms used in the Regulation:

3.1. compliance laws, rules and standards - laws and other legal acts governing the activities of an institution, standards established by self-regulatory authorities with respect to

the activities of an institution, codes of professional conduct and ethics and other best practice standards related to the activities of an institution;

3.2. capital adequacy assessment process – policy and procedures established and measures taken by an institution for a regular capital adequacy assessment and for maintaining adequate capital for covering the inherent and possible risks arising from the activities of an institution;

3.3. supervisory board of an institution – supervisory board of the credit institution or shareholders' meeting or supervisory board, where established, of the investment firm;

3.4. officer - the member of the supervisory board (management body in its supervisory function) or executive board (management body in its management function) or a key function holder of an institution;

3.5. risk profile – risk assessment of an institution taking into account its size, volume, diversity and complexity of transactions, the economic environment where an institution operates, as well as the economic cycle;

3.6. chief risk officer – officer of an institution in charge of the overall risk control function in an institution, monitoring of the risk management system and coordinating the activities of all structural units of an institution involved in risk management;

3.7. key function holders - persons (employees) persons who, through their position, have significant influence over the direction of an institution, but who are not members of the supervisory or executive board of an institution. Key function holders are, for example, heads of business lines specific to an institution, heads of branches or subsidiary undertakings established by an institution in a Member State, heads of the support and internal control functions, incl., chief risk officer, head of compliance function, head of the internal audit function, person in charge of fulfilment of the requirements of anti-money laundering and combating the financing of terrorism and proliferation, procurement holder, company controller;

3.8. other terms shall have the same meaning as ascribed to them in the Credit Institutions Law, the Financial and Capital Market Commission (hereinafter – the Commission) Regulation No. 199 of 29 November 2016 "Regulation on Establishment of the Capital and Liquidity Adequacy Assessment Process" and Regulation No. 575/2013.

## **Chapter I**

### **General requirements for setting up the internal control system**

4. An institution shall organise the internal control system in such a way that the management of an institution has reasonable confidence that the assets of an institution are secured against losses and unauthorised management and use, risks arising from the activities of an institution are continuously identified and managed, the capital of an institution, in terms of its size, elements and the share thereof, is adequate for covering the risks inherent and possible risks arising from the activities of an institution, transactions take place in accordance with the procedure set in an institution, an institution operates soundly, prudently and effectively, in full compliance with the requirements of laws and other legal acts.

5. An institution shall set up the internal control system, taking into account its size, volume, diversity and complexity of transactions performed, scale of risks with respect to each area of activity, degree of centralisation of the management, information technologies and other factors relevant for the achievement of the operational objectives of the particular institution. An institution shall not apply the principles mentioned in this Point when ensuring the fulfilment of the requirements of Point 17 of this Regulation.

6. The supervisory board and the executive board of an institution shall be responsible for the establishment and effective functioning of the internal control system.

7. The core elements of the internal control system are:

- 7.1. setting the development strategy of an institution, planning of activities for each year and long-term future;
- 7.2. organisation of the activities of an institution;
- 7.3. identification and management of all material risks arising from the activities of an institution, including the measurement, assessment, control and reporting of risks;
- 7.4. capital adequacy assessment process;
- 7.5. accounting records;
- 7.6. management information system;
- 7.7. safeguarding of assets and information systems;
- 7.8. regular review of the internal control system, assessment of effectiveness and enhancement in accordance with changes in the activities of an institution and external factors influencing the activities of an institution;
- 7.9. remuneration system;
- 7.10. assurance of compliance of the activities;
- 7.11. management of outsourced services, where used by an institution;
- 7.12. management of new financial services or significant changes in the existing financial services.

## **Chapter II**

### **Setting the development strategy and planning of the activities**

8. An institution shall develop and document its development strategy, specifying therein:

- 8.1. operational objective, *inter alia*, planned financial situation, types of activities, target markets, target clients;
- 8.2. risk strategy, *inter alia*, risk profile and risk appetite of an institution, risk tolerance and maximum possible risk tolerance in line with the risk capacity of an institution, conduct for ensuring the observance of the risk tolerance, as well as the conduct of an institution in the event, where the risk profile exceeds the risk tolerance;
- 8.3. capital adequacy maintenance strategy, *inter alia*, the capital requirement for risks associated with the prospective activities of an institution, desirable capital level (capital adequacy objectives) and the plan for the achievement thereof, sources of capital increase, expected expenses for additional capital attraction, plan for ensuring the observance of the capital adequacy regulatory requirements, plan for maintaining capital adequacy in emergencies;
- 8.4. objectives in the field of liquidity management, considering the characteristic indices of the activities and financial situation of an institution, as well as the regulatory requirements.

9. When setting the capital adequacy maintenance strategy, an institution shall analyse, assess and document possible development scenarios of the activities of an institution depending on various development scenarios of external factors, taking into account various development scenarios of macroeconomic indices of the countries where an institution carries out or plans to carry out its activities, possible development trends of the industries influencing the activities of an institution, for example, when introducing innovative financial services (incl., *FinTech* services), possible changes in the compliance laws, rules and standards, activities of competitors and other factors which may have a significant influence

on the achievement of the objectives of an institution. During the analysis of development scenarios of external factors, an institution shall also carry out stress testing – shall identify such possible events or possible changes in market conditions that may have an adverse effect on the activities of an institution and which may hinder the achievement of objectives of an institution, as well as shall assess the impact of such events or changes in market conditions on the size of the capital of an institution.

10. An institution shall develop the plan of activities for each year, specifying the financial situation of an institution planned for at least the following year, its market position, operational objectives during the respective period, types of activities and most typical transactions, potential risks and risk tolerance ratios, performance assessment criteria.

### **Chapter III Organisation of the activities of an institution**

11. An institution shall ensure the appropriate organisation of its activities, *inter alia*:

11.1. shall establish transparent organisational structure corresponding to the scale and operational risks of an institution;

11.2. shall avoid the formation of complex structures;

11.3. shall establish the corporate values and high standards of professional conduct and ethics of an institution;

11.4. shall ensure the governance of conflict of interest situations;

11.5. shall determine and implement appropriate risk culture;

11.6. shall develop the staff remuneration system, remuneration policy and staff policy, as well as shall ensure the compliance of the staff of an institution to the positions held.

#### ***Organisational structure***

12. An institution shall establish the transparent organisational structure thereof, taking into account the scale, nature, complexity and specificity of the activities of an institution, as well as the need to ensure that the established organisational structure promotes compliance with the regulatory requirements and other laws and regulations, incl., in the field of anti-money laundering and combating the financing of terrorism and proliferation.

12.<sup>1</sup> An institution shall document its organisational structure, laying down the duties (functions), powers and responsibilities of the supervisory board (including the chairperson of the supervisory board and the committees of the supervisory board), executive board (including the chairperson of the executive board), structural units and heads of structural units regarding the performance and control of transactions, and shall prepare job descriptions (official instructions) for the responsible employees. When documenting the organisational structure, an institution shall determine the structural units in charge of the risk control function, compliance control function and internal audit function (hereinafter – internal control functions) in an institution in compliance with the requirements of Chapter XI of this Regulation.

12.<sup>2</sup> An institution shall ensure the transparent and clear distribution of individual duties (functions) of the executive board members, ensuring distribution among the executive board members of the fields most relevant to an institution (incl., institution-specific types of activities, risk management field, compliance field, the field of management of anti-money laundering and combating the financing of terrorism and proliferation), considering the functions of the executive board referred to in Chapter X of this Regulation. It is

recommended to also apply the distribution of individual duties referred to in this Point, in light of the fields most relevant to an institution, to the supervisory board of an institution, considering the functions of the supervisory board of an institution referred to in Chapter IX of this Regulation.

12.<sup>3</sup> An institution shall ensure that the composition of the executive board is appropriately structured, considering the specificity of the activities of an institution and collective and invalid competence of the executive board members, implementing commensurate representation of the executive board members in charge of the control areas.

12.<sup>4</sup> An institution, when documenting its organisational structure, shall determine the direct lines of contact (reporting) between the structural units performing internal control functions, the heads and the supervisory board, as well as the relevant supervisory level committees, where established.

12.<sup>5</sup> An institution shall ensure that the distribution of the fields of responsibility and functions among the supervisory and executive board members of an institution corresponds to the established organisational structure, as well as shall ensure the hierarchically appropriate position of the responsible employees of the structural units performing internal control functions within the organisational structure of an institution, considering the independence and authority requirements laid down in this Regulation, *inter alia*, an institution shall ensure that within its organisational structure:

12.<sup>5</sup>1. internal audit function is not subordinated to the executive board;

12.<sup>5</sup>2. the heads of the risk control function and compliance control function hold one of the following positions:

12.<sup>5</sup>2.1. executive board member;

12.<sup>5</sup>2.2. head of the senior management structural unit, who is organisationally and functionally directly subordinated to the relevant executive board member, provided that the requirements of Point 62 of this Regulation are met with respect to the independence of the internal control function from the activities of an institution it controls;

12.<sup>5</sup>3. independence of persons performing internal control functions from the business functions is ensured, *inter alia*, it is ensured that the chairperson of the executive board (chief executive officer) is not concurrently in charge of the performance or monitoring of the duties of a person in charge of the fulfilment of the risk control function, compliance control function and requirements of anti-money laundering and combating financing of terrorism and proliferation.

12.<sup>6</sup> An institution shall ensure that the organisational structure thereof is reviewed at least on an annual basis and updated when necessary.

13. When documenting the organisational structure, an institution shall set the procedure for reporting and information exchange in an institution, *inter alia*, shall prescribe what information is to be provided and received, by whom and when, and what information is confidential and proprietary in accordance with the provisions of Commission Regulation No. 40 of 2 March 2016 "Regulation on Materiality of Information, Proprietary and Confidential Information and Frequency of Disclosure of Information".

13.<sup>1</sup> An institution shall ensure the effective and timely exchange of information necessary for ensuring the operation of structural units of the entire institution among such structural units, incl., the supervisory and executive board and structural units of internal control functions of an institution.

13.<sup>2</sup> An institution shall ensure that its supervisory and executive board members are well aware of the material aspects relating to the organisation of the activities of an institution, financial condition and risk assessment thereof, as well as are made aware of all decisions having a significant influence on the operation of an institution.

13.<sup>3</sup> An institution being a parent undertaking shall ensure:

13.<sup>3</sup>1. information exchange among the group undertakings;

13.<sup>3</sup>2. appropriate and transparent overall group structure;

13.<sup>3</sup>3. compliance of the types and scale of risks of the group undertakings with the risk profile defined in the group strategy;

13.<sup>3</sup>4. compliance of the activities of the group undertakings with the overall established operational strategy of the group and regulatory requirements thereof on an individual, prudential consolidated or sub-consolidated level, concurrently considering that which is laid down in Point 2.<sup>1</sup> with respect to the undertakings not directly subject to the legal acts transposing the requirements of Directive 2013/36/EU.

14. When defining the duties of the staff and granting powers thereto, the segregation of duties principle shall be observed, expressed as the segregation of such duties (functions), which, if combined, would enable an employee to entirely unilaterally carry out any transaction alone.

15. When documenting the granting of powers, the type of powers granted, the delegation rights of a person (specifying the position) and structural unit which the powers have been granted to, rights of substitution, as well as all restrictions for exercising granted powers, shall be specified. When granting powers to employees, an institution shall ensure that the employees are acquainted with the scope of authority granted to them.

16. Performance of any transaction shall require a permit or order from the corresponding employee or officer of an institution or a decision of the structural unit (for example, committee) of an institution, in line with the levels of responsibility prescribed by the organisational structure. An institution applying solutions of digital technologies for assessing and approving transactions shall define suitable limits for the amount of such transactions and shall ensure the regular verification of such transactions, as well as the assessment of conformity of the automated decisions to the risk strategy of an institution.

17. The executive board shall review and approve the pledging of assets of a credit institution, if the sum total of one or several of such evidently related transactions exceeds 10 per cent of the appropriate own funds of a credit institution, except for the following transactions:

17.1. repo transactions;

17.2. deposits to ensure payment card settlements;

17.3. letters of credit;

17.4. guarantees secured by the collateral issued by the client and arising from a loan agreement between a credit institution and the client;

17.5. transactions where the adoption of an executive board decision is impossible, because the adoption of the decision on concluding the transaction requires urgent action (one business day), but which are concluded within the limits previously approved by the executive board.

18. For material types of activities an institution shall develop and document the procedure for the performance and control of transactions (operational procedures). Operational procedures shall at least entail the procedure for authorising the person concluding the transaction (*inter alia*, shall specify the documents required to be completed during the process of adoption of the decision until the approval of the performance of the transaction, and the responsible employees or officers confirming the adoption of the respective decisions), the setting of restrictions to ensure the conformity of the transaction to the policy of an institution and compliance laws, rules and standards, as well as the procedure for processing and control of the transaction.

***Transparency of a complex structure***

18.<sup>1</sup> An institution shall avoid the creation of such structural units or subsidiary undertakings, which limit the transparency of the activities of an institution and the transparency of the prudential consolidating group structure, and the formation thereof lacks rational economic justification. An institution shall take into consideration that the formation of such structural units or subsidiary undertakings creates an elevated risk of forming a link to financial crime (incl., increase of risks of money laundering and financing of terrorism and proliferation), as well as that such structures may adversely affect the reputation of an institution.

18.<sup>2</sup> An institution, when considering the creation of such structural units or subsidiary undertakings, which would limit the transparency of the activities of an institution and the transparency of the prudential consolidating group structure, shall take into account:

18.<sup>2</sup>1. compliance of the jurisdiction, where it is planned to create the corresponding structural unit or subsidiary undertaking, with the European Union's and international tax transparency standards and compliance with the standards of anti-money laundering and combating the financing of terrorism and proliferation, as well as other standards directed towards limiting economic and financial crime;

18.<sup>2</sup>2. economic and legal substantiation of the planned complex structure to be created, incl., where the creation of such structure arises out of the request of a client or a client group;

18.<sup>2</sup>3. possible difficulties in clarifying the ultimate beneficial owner as a result of the formation of the relevant structural unit or subsidiary undertaking;

18.<sup>2</sup>4. the ability of the supervisory and executive board of an institution to monitor the established structural unit or subsidiary undertaking, as well as the risks pertaining to the created complex structure;

18.<sup>2</sup>5. possible restrictions for the Commission to supervise an institution or the prudential consolidating group.

19. If an institution establishes such structural units or subsidiary undertakings, which limit the transparency of the activities of an institution (for example, subsidiaries registered in the low-tax countries or tax-free countries stated as such by the relevant laws and regulations (i.e., establishes subsidiaries registered offshore), or establishes subsidiaries registered in such countries where the legislation essentially gives the subsidiaries the possibility to carry out economic activities similar to those of the subsidiaries registered offshore), an institution shall develop, document and implement an appropriate policy and procedures, in order to ensure that:

19.1. the objectives of the establishment of such structural units or subsidiary undertakings are defined and documented;

19.2. the powers and responsibilities of such structural units or subsidiary undertakings are clearly defined and documented;

19.3. all risks associated with the activities of such structural units or subsidiary undertakings (*inter alia*, reputational and legal risks) are identified and managed;

19.4. prudent procedures for the approval of transactions and risk control are established, *inter alia*, adequate transaction restrictions and limits are set, risk mitigation measures are provided for, incl., the scope and procedure for the application thereof;

19.5. the supervisory and executive board of an institution shall receive, on a regular basis, information about the type and scale of activities of such structural units or subsidiary undertakings, about the risks inherent to their activities and scale of such risks, as well as other information necessary for the adoption of decisions;

19.6. the evaluation of the activities of such structural units or subsidiary undertakings is carried out on a regular basis, *inter alia*, analysing the necessity and feasibility of the establishment and operation thereof, assessing the compliance thereof with the set operational objectives, compliance laws, rules and standards, and plans, policies and procedures approved by an institution;

19.6.<sup>1</sup> control over the relevant structural units or subsidiary undertakings is carried out, within the scope of internal control functions;

19.7. internal audit function carries out the inspections of the activities of these structural units or subsidiary undertakings on a regular basis, but at least on an annual basis, taking the risk-based approach into account.

19.<sup>1</sup> In addition to that which is specified in Point 19.5, the operational and risk assessment of the relevant structural units or subsidiary undertakings shall be, on a regular basis, communicated to the executive board and the supervisory board (where established) of the parent undertaking, as well as the certified auditor or the commercial company of certified auditors (hereinafter both jointly referred to as the certified auditor) carrying out the audit of financial statements of an institution or institutions of the consolidating group.

### ***Corporate values, code of conduct and standards of ethics***

20. An institution shall define and document an institution's corporate values, including the establishment of high standards of professional conduct and ethics aimed at ensuring that the supervisory board members, the executive board members, key function holders, heads of structural units and other employees of an institution carry out their duties with the utmost integrity, are unbiased in the fulfilment of their job duties and decision-making, observe the compliance laws, rules and standards, respect the confidentiality and trade secret of transaction and customer information, *inter alia*, observe the basic principles of personal data protection, and ensure their conduct and behaviour is consistent with high ethical standards. It is especially important that standards address corruption, insider dealing and any other unlawful, unethical or questionable conduct, as well as mitigate risks pertaining to the operational activities and reputation.

20.<sup>1</sup> Employees of an institution, when providing information to the clients or potential clients, shall ensure that it is clear, accurate, true and complete (all material risks are disclosed to the client), and it is not misleading. Employees of an institution shall observe the basic principles of the protection of clients' interests in their everyday work and communication with clients or potential clients.

20.<sup>2</sup> An institution, when ensuring the governance of conflict of interest situations in an institution, shall take appropriate organisational and administrative measures preventing an adverse influence on the interests of the clients or potential clients.



20.<sup>3</sup> An institution shall provide the employees of an institution with the possibility for whistleblowing on actual or potential weaknesses in the internal control framework, making proposals for the prevention thereof and reporting unlawful or unethical transactions, *inter alia*, conflict of interest situations. An institution shall develop and document appropriate procedures, shall communicate them to the employees of an institution and shall ensure adherence to the following principles:

20.<sup>3</sup>1. ensuring the confidentiality of the employee reports and employee protection against possible discriminating or disciplinary measures both with respect to the whistleblowing employee and the employee subject to whistleblowing, until the clarification of all circumstances and implementation of any corrective or disciplinary measures, concurrently ensuring that the whistleblowing employee preserves anonymity and immunity insofar as prescribed by national legal acts or the procedural order of investigation of competent authorities, if applicable to the relevant whistleblowing case;

20.<sup>3</sup>2. rights of persons involved in the whistleblowing process to the personal data protection and confidentiality are ensured in accordance with the requirements of Regulation (EU) 2016/679 of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and on the free movement of such data and repealing Directive 94/46/EC (General Data Protection Regulation);

20.<sup>3</sup>3. employees are given the possibility to report weaknesses in the internal control system, unlawful or unethical transactions, avoiding the subordination laid down by the organisational structure of an institution (for example, by reporting directly to the head of the structural unit in charge of the performance of compliance control functions or the head of the structural unit carrying out the internal audit function);

20.<sup>3</sup>4. descriptions of procedures are available in writing in paper or electronic form to all employees of an institution;

20.<sup>3</sup>5. the supervisory and executive board of an institution receive information on the reports of the employees on weaknesses in the internal control system, unlawful or unethical transactions, and resolve upon the necessity to take corrective measures.

### ***Management of conflict of interest in an institution***

21. An institution shall develop and document the overall policy and procedures for the governance of conflict of interest situations with respect to all employees and officers of an institution ensuring the timely identification and governance of actual or potential conflict of interest situations and prescribing the conduct for the prevention of conflict of interest situations, which might arise between the interests of the relevant persons and the interests of an institution, *inter alia*:

21.1. shall prevent the formation of circumstances, where the conflict of interest situation occurs or might occur, for example, by ensuring the appropriate distribution of duties among the employees and officers of an institution;

21.2. shall ensure that the employee or officer of an institution, in the fulfilment of their duties, abstain from the adoption of decisions regarding the transactions of an institution or other professional activities in an institution, where the relevant employee or officer incurs or might incur a conflict of interest situation;

21.3. shall ensure that the structural units, carrying out activities among which a conflict of interest situation occurs or might occur, are mutually independent (for example, certain information barriers, different organisational subordination);

21.4. shall ensure that the terms of transactions of an institution with the shareholders of an institution having a qualifying holding in an institution, officers and other employees of an institution authorised to carry out planning, management and control of the activities of an institution and in charge thereof, as well as with the spouses, parents and children of such

persons, are not more favourable than the terms of similar transactions with persons not related to an institution and do not conflict with the interests of an institution and its depositors or investors.

21.<sup>1</sup> An institution shall ensure that personal data obtained for the purposes of fulfilling the requirements of Point 21.4 of this Regulation shall be stored for at least three years following the termination of the employment legal relationship of the relevant person with an institution, or for a longer time period, in the case if persons specified in Point 21.4 of this Regulation have an actual client relationship with an institution, ensuring that after the day of termination of the client relationships' status, the data of the relevant person are no longer stored, if it does not conflict with other laws and regulations.

21.<sup>2</sup> When developing the policy of governance of conflict of interest situations and the relevant procedures, an institution shall ensure the appropriate identification of conflict of interest situations and implementation of the prevention or limitation measures, which shall entail:

21.<sup>2</sup>1. assessment of materiality of the identified conflict of interest situations, considering the threshold for the conflict of interest situations referred to in Point 21.<sup>3</sup> of this Regulation, from which they shall qualify as material conflict of interest situations;

21.<sup>2</sup>2. breakdown of the identified conflict of interest situations by categories, considering the type of the conflict of interest situation, for example, persistent types of conflict of interest situations, requiring the constant governance thereof, or conflict of interest situations of an incidental nature and requiring a one-off governance measure;

21.<sup>2</sup>3. adequate distribution of duties, entrusting the performance of duties of an employee or officer under the conflict of interest situation to another appropriate employee, relating to the activity under the conflict of interest situation;

21.<sup>2</sup>4. the establishment of procedures for transactions with persons specified in Point 21.4 of this Regulation in accordance with the requirement of a legal framework, for example, stipulating the coordination of the most material transactions at the shareholders' meeting, at the same time ensuring the limitations of scope of such transactions and prevention of conflict of interest situations during the process of the coordination of such transactions.

21.<sup>3</sup> An institution, in line with the principles of governance of a conflict of interest situation referred to in this Regulation and the risk strategy, shall define the threshold of the scope of the conflict of interest situation, from which it shall qualify as a material conflict of interest situation. An institution shall define appropriate treatment of conflict of interest situations depending on whether they qualify as material or non-material.

21.<sup>4</sup> An institution shall determine and document the description of duties of the employees or structural units in charge of the governance of conflict of interest situations within an institution, taking into account the principles of governance of the conflict of interest situations referred to in this Regulation and the functions of the supervisory and executive board of an institution.

21.<sup>5</sup> An institution shall document any identified conflict of interest situation in an institution with respect to the employees and officers of an institution, as well as the governance measures prescribed for the governance or prevention of such situation, taking into account the materiality of the identified conflict of interest situation.

21.<sup>6</sup> An institution being a parent undertaking, when establishing the overall policies and procedures for the governance of conflict of interest situations of the prudential consolidating and sub-consolidating group, shall take into consideration the identified existing actual or potential conflict of interest situations within the scope of the group, by assessing not only the protection of overall interests of the group, but also the protection of interests of separate undertakings belonging to the group.

21.<sup>7</sup> When ensuring the governance of conflict of interest situations, an institution shall take into account the policies and procedures for governance of the conflict of interest situations existing within the scope of the prudential consolidating group and sub-consolidating group.

***Additional requirements for the management of conflict of interest with respect to the officers***

21.<sup>8</sup> An institution, when developing the policy for the governance of conflict of interest situations with respect to the officers, shall prescribe the assessment of at least the following aspects of such persons:

21.<sup>8</sup>1. economic interests (for example loan issued exceeding the amount of exposure restriction referred to in the Credit Institutions Law);

21.<sup>8</sup>2. personal, professional and economic relations with other employees or officers of an institution, persons holding a qualifying financial shareholding in an institution and other external stakeholders, as well as the employees of the undertakings belonging to the same prudential consolidating group as an institution;

21.<sup>8</sup>3. employment legal relationship over the period of the last five years;

21.<sup>8</sup>4. shareholding in the capital of other commercial companies, where such shareholding influences or might influence the interests of the relevant person.

21.<sup>9</sup> It shall be the duty of an institution to obtain information from the officers, in order to assess and prevent the adverse effect of the activities of such persons outside an institution with regard to an institution and its interests, incl., information characterising the influence of political nature and political relationships of such persons.

21.<sup>10</sup> An institution, when developing the policy of and procedures for the governance of conflict of interest situations with respect to officers, in addition to that which is stated in Point 21.4 of this Regulation, shall also identify actual or potential conflict of interest situations with respect to the spouses, parents and children of the persons concerned, as well as shall carry out the revision of the identified actual or potential conflict of interest situations at least on an annual basis.

21.<sup>11</sup> An institution shall set limitations for the supervisory and executive board members to hold positions in the companies competing with an institution, except for the companies belonging to the same prudential consolidating group as an institution.

21.<sup>12</sup> An institution, in addition to that which is referred to in Point 21.<sup>5</sup>, shall document any identified conflict of interest situation in an institution with respect to the supervisory and executive board members of an institution both individually and collectively, as well as the governance measures intended for governing or preventing such situation, *inter alia*, where such situation has been identified as a non-material conflict of interest situation in accordance with the threshold referred to in Point 21.<sup>3</sup> of this Regulation.

21.<sup>13</sup> An institution shall ensure that the governance of conflict of interest situations with respect to the supervisory and executive board members of an institution is organised so that the supervisory and executive board members of an institution, when taking decisions, would act with independence of mind and solely in the interests of an institution, taking into consideration the policy of governance of conflict of interest situations developed by an institution with respect to officers, *inter alia*, the threshold set by an institution for the scope of the conflict of interest situation, from which it is to be qualified as a material conflict of interest situation, in accordance with that which is referred to in Point 21.<sup>3</sup> of this Regulation.

22. An officer of an institution, while performing his/her official duties, shall prevent the occurrence of a conflict of interest and shall abstain from taking decisions on transactions where the relevant officer faces or might face a conflict of interest. The supervisory or executive board member of an institution shall report to the supervisory board of an institution, but the key function holder shall report to the supervisory or executive board of an institution, the transactions where such officer directly or indirectly faces, might face or has already faced a conflict of interest. An institution shall document its decisions on and approach to the governance of the conflict of interest situations reported under the procedure laid down in this Point.

### ***Risk culture***

23. An institution shall ensure the overall risk culture of an institution, facilitating the implementation of effective risk management processes, in line with the development strategy, incl., the risk strategy of an institution. The establishment of risk culture shall entail:

23.1. action plan developed by an institution, setting out the tone from the top of the supervisory and executive board of an institution with respect to the expected conduct of all employees and officers of an institution in ensuring risk management processes, taking into account the most significant core values of an institution;

23.2. informing employees and officers, whose official duties entail risk-taking on behalf of an institution, regarding their role and responsibility when performing the relevant duties;

23.3. ensuring effective communication in an institution, facilitating critical assessment of the opinions provided in the field of risk management;

23.4. ensuring compliance of the activities related to risk-taking with the risk profile of an institution, long-term interests thereof and objectives set by an institution.

### ***Staff compliance and remuneration system***

24. An institution shall ensure that its employees are informed about their duties (*inter alia*, with respect to risk identification and management), know the information related to their official duties and possess appropriate qualification and sufficient experience to fulfil their duties. To ensure the compliance of the employees, an institution shall:

24.1. develop and document staff policy and procedures laying down the procedure for the selection, remuneration, monitoring and succession planning for employees in executive positions, requirements for the skills in various positions, criteria and procedure for the suitability (eligibility) assessment of potential employees;

24.2. provide employees with information related to the fulfilment of the official duties of the employees concerned (development strategy, operational plan for each year, corporate values, standards of professional conduct and ethics, policy of governance of conflict of interest situations and the relevant procedures, operational procedures, risk management policies and control procedures, risk culture, compliance laws, rules and standards);

24.3. develop and document a professional training programme for the employees aimed at preparing employees for the fulfilment of the duties of the relevant position and continuously enhancing their knowledge, as well as the procedure for informing employees about changes in policies, procedures, compliance laws, rules and standards related to the fulfilment of official duties of the employees concerned;

24.4. develop and document the staff remuneration system, ensuring that it does not only depend upon the achievement of short-term objectives (*inter alia*, short-term profit gaining) and does not encourage taking such risks which an institution cannot effectively manage. An institution shall ensure the development of the remuneration policy in accordance with Commission Regulation No. 126 of 2 July 2014 "Regulation on Core Principles of the Remuneration Policy " (hereinafter - Remuneration Regulation).

25. An institution shall ensure that both the supervisory and executive board collectively possess sufficient experience and knowledge about all significant types of activity and risks of an institution. An institution shall also ensure that both the supervisory and executive board collectively possess sufficient experience and knowledge (or, if necessary, the possibility to receive advice) at least in fields such as finance, accounting and audit, lending, payment systems, strategic planning, governance, risk management, internal control functions and compliance laws, rules and standards. An institution shall perform the suitability assessment of the supervisory and executive board members in accordance with the requirements of Commission Regulation No. 186 of 27.11.2019. "Regulation on the Assessment of the Suitability of the Executive and Supervisory Board Members and Key Function Holders" (hereinafter - Suitability Assessment Regulation).

26. To ensure that each supervisory and executive board member has sufficient experience and skills to fulfil the official duties in the work of both the supervisory or executive board and the committees thereof (where established), an institution shall ensure that, if necessary, each supervisory and executive board member has the possibility to receive appropriate internal or external training or consultation (for example, regarding material new or planned financial services, types of activities and risk profile, or regarding laws and regulations in the countries where an institution operates).

26.<sup>1</sup> Where an institution has established the risk or nomination committee, it shall ensure that the members of the committees individually and collectively possess sufficient experience and knowledge to ensure the fulfilment of their functions. An institution that has not established such committees shall ensure that the supervisory board in its full composition possesses sufficient collective experience and knowledge to ensure the fulfilment of the functions of the relevant committees.

26.<sup>2</sup> An institution shall assess the possibility to ensure at least one independent member in the supervisory board of an institution who meets the criteria for determination of the status of being independent as referred to in the Suitability Assessment Regulation, and shall document the referred to assessment.

27. Supervisory and executive board members shall ensure sufficient time commitment to perform their duties (also within the scope of the committees), *inter alia*, executive board members shall ensure sufficient time commitment for ensuring risk management in an institution, but the supervisory board members - for the supervision thereof, in line with the principles referred to in the Suitability Assessment Regulation.

## **Chapter IV**

### **Identification and management of risks of the activities of an institution**

28. An institution shall develop, document and implement appropriate policies and procedures for identifying and managing material risks inherent to the activities of an institution, *inter alia*, for the measuring, assessing, controlling of risks and risk reporting. These policies and procedures shall encompass all business lines of an institution, the role and responsibilities of employees, officers and responsible structural units involved in the identification and management of risks, as well as the characteristic overall organisational structure of the group an institution belongs to on a prudential consolidating group level or sub-consolidated level.

#### ***Identification, management and control of material risks inherent to an institution***

29. When carrying out the identification of material risks inherent to the activities of an institution, an institution shall assess, on a regular basis, which risks may adversely affect the achievement of its operational objectives, *inter alia*, the achievement of the planned financial results. An institution shall ensure that appropriate quantitative and qualitative criteria are used for the identification of material risks, *inter alia*, stress testing, assessment results and conclusions are justified and documented and the assessment, taking into account the specificity of the activities of an institution, shall assess at least the following risks:

- 29.1. credit risk;
- 29.2. market risks;
- 29.3. operational risk;
- 29.3.<sup>1</sup> compliance risk;
- 29.3.<sup>2</sup> money laundering and terrorism and proliferation financing risk and sanctions risk;
- 29.3.<sup>3</sup> risk of information technologies;
- 29.4. interest rate risk in the non-trading book;
- 29.5. liquidity risk;
- 29.6. risks arising from exposure concentration;
- 29.7. residual risk – risk that the credit risk mitigation techniques applied by an institution turn out to be less efficient than initially planned;
- 29.8. risks arising from securitisation transactions, if an institution acts in such transactions as an investor, initial lender, originator or sponsor:
  - 29.8.<sup>1</sup> risk of excessive leverage;
  - 29.8.<sup>2</sup> model risk – risk that errors have been allowed for as a result of operational activities or model specificity restrictions, when developing, introducing or using an internal model for determination of the values of exposures or calculation of own funds requirement, and decisions adopted on the basis of outputs of such internal model may cause losses to an institution;
- 29.9. other risks affecting the activities of an institution (for example, country risk, reputational risk, strategy risk).

29.<sup>1</sup> An institution shall ensure the integration of money laundering and terrorism and proliferation financing risk and sanctions risk into the risk management system of an institution, as well as shall ensure the management thereof in accordance with the requirements laid down in the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing, the Law on International Sanctions and National Sanctions of the Republic of Latvia, as well as the Commission Regulation governing the management of

money laundering and terrorism and proliferation financing risk and the management of sanctions risk.

30. With respect to the risks identified by an institution as material for its activities, an institution shall develop, document and implement appropriate risk management policies and control procedures, specifying:

30.1. methods and regularity of risk measurement (for the risks that can be measured in quantitative figures, for example, credit risk, market risks) and assessment (for the risks which cannot be measured in quantitative figures, for example, reputational risk, strategy risk);

30.2. appropriate risk control procedures, *inter alia*, in accordance with the risk strategy of an institution, shall determine the restrictions and limits of maximum risk tolerance, methods for hedging of risks, control procedures for mitigating the risks which cannot be measured in quantitative figures, where the business lines, financial condition, capital base of an institution, strategic objectives of an institution and other factors relevant for an institution have been considered;

30.3. procedure under which the supervisory board, risk committee, executive board, chief risk officer and heads of the structural units receive regular information about the risks inherent to the activities of an institution, the scale and trends thereof, the impact of risks on the amount and adequacy of capital of an institution, as well as other information necessary for taking decisions;

30.4. procedure for control over the compliance of the risk management policies and control procedures, *inter alia*, the set restrictions and limits;

30.5. allocation of duties, powers and responsibility in risk management, *inter alia*, the duty of the structural units performing business functions to identify and manage the risks arising as a result of their activities (*first line of defence*), duty of the risk control function and the compliance control function to perform further in-depth, independent and comprehensive identification, measurement, assessment, analysis and monitoring of the relevant risks, to report, on a regular basis, to the supervisory board or the relevant supervisory board level committees of an institution (at the same time, ensuring that the supervisory board is always informed regarding the most relevant aspects) the assessment results and to perform the management of the relevant risks within the scope of the functions (*second line of defence*), as well as the duty of the internal audit function to independently oversee the conduct of the referred to structural units of an institution in risk management (*third line of defence*).

31. When measuring, assessing and monitoring material risks inherent to the activities of an institution, an institution shall apply appropriate analytical methods adequate for the specificity and complexity of its activities, including stress testing used by an institution to assess material risks as well as the mutual interaction thereof. An institution shall document and review, on a regular basis, the choice and essence of the analytical methods to be used, as well as the assumptions and estimates used therein. When assessing the risks, an institution may not excessively rely upon quantitative methods, incl., findings obtained during stress testing, and shall always supplement the quantitative risk measurement with the qualitative assessment, for example, critical analysis of quantitative results, expert evaluations and analysis of macroeconomic environment in the countries where an institution performs material activities.

31.<sup>1</sup> When performing stress testing, an institution shall comply with the requirements laid down in the European Banking Authority's "Guidelines on Institution Stress Testing" (EBA/GL/2018/04).

32. An institution shall, on a regular basis, however at least on an annual basis, review and improve risk identification and management policies and procedures consistently with the changes to the activities of an institution and external circumstances affecting the activities of an institution. An institution shall assess its compliance with the provisions of risk identification and management policies and procedures, the adequacy and efficiency of these policies and procedures, as well as the appropriateness and efficiency of the measures taken by an institution to eliminate the deficiencies identified in the referred to policies and procedures.

32.<sup>1</sup> An institution shall document the necessary changes in the risk strategy of an institution, taking into account the findings and conclusions obtained during the risk identification and management process.

***Policy of introduction of new financial services or material changes in the existing financial services***

33. An institution shall develop, document and implement the policy of introduction of new financial services or material changes in the existing financial services, specifying therein:

33.1. procedure and requirements to be complied with, when introducing new financial services, starting to offer the existing financial services in new markets or introducing material changes in the procedure for the provision of existing financial services;

33.2. definition of the new financial service and strategic new business provided for by an institution;

33.2.<sup>1</sup> definition or description classifying material changes in the procedure for the provision of the existing financial services;

33.3. the role of the risk control function and chief risk officer, when assessing new financial services or introducing material changes in the existing financial services, assessing the alignment thereof to the risk strategy of an institution and influence on the overall risk profile of an institution;

33.3.<sup>1</sup> procedure for assessing the influence of various scenarios on the overall risk profile, liquidity and capital adequacy of an institution;

33.4. the role of the risk control function and chief risk officer, when assessing the adequacy and conformity of the policies, procedures, restrictions and limits, risk hedging methods of an institution, preparedness of employees and resources and knowledge available to an institution for the implementation of new financial services or the introduction of material changes in the existing financial services;

33.5. the role and tasks of the compliance control functions, when assessing whether an institution, by implementing new financial services or introducing material changes in the existing financial services, would meet the compliance laws, rules and standards, considering the conclusions expressed by the risk control function and other relevant structural units.

33.<sup>1</sup> An institution shall ensure that the measures referred to Point 33.3, 33.4 and 33.5 of this Regulation are taken before the implementation of new financial services or before the offering of existing financial services in new markets, or material changes in the procedure for the provision of existing financial services.

33.<sup>2</sup> An institution, when implementing the policy of introduction of new financial services, shall additionally consider the general principles contained in the European Banking Authority's "Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services", (EBA/GL/2016/06) and "Guidelines on



product oversight and governance arrangements for retail banking products", (EBA/GL/2015/18), if they are suitable for the specificity and complexity of the activities of an institution, as well as the specificity of the relevant new financial services.

### ***Chief Risk Officer***

34. An institution shall commence an employment relationship with the chief risk officer or shall appoint him/her to the position, ensuring direct contact with the supervisory board (reporting lines). The duties of the chief risk officer may not include the duties related to the performance of the activity, incl., business functions, to be controlled. Chief risk officer should have sufficient experience, knowledge and skills for his/her official duties.

35. An institution shall develop and document the procedure for the commencement of an employment relationship with the chief risk officer or for his/her appointment to the position and for termination of the employment relationship with the chief risk officer or for his/her dismissal from the position. An institution shall ensure that information about the commencement of an employment relationship with the chief risk officer or appointment of him/her to the position and termination of an employment relationship with the chief risk officer or his/her resignation from the position is published on the internet website of an institution.

35.<sup>1</sup> An institution shall submit the Commission information about the causes of termination of an employment relationship with the chief risk officer or his/her dismissal from the position not later than within a period of five business days from the day of termination of an employment relationship with the chief risk officer or his/her resignation from the position.

35.<sup>2</sup> An institution shall ensure that the commencement of an employment relationship with the chief risk officer or appointment of him/her to the position and termination of an employment relationship with the chief risk officer or his/her dismissal from the position takes place upon written approval of the supervisory board of an institution.

36. The duties of the chief risk officer shall include:

36.1. managing the comprehensive risk control function;

36.2. establishment and supervision of the risk management system of an institution and ensuring the enhancement thereof;

36.3. regular assessment of the strategy of an institution (including types of activities), particular services (including the development of new services or introduction of changes in the services offered by an institution), structure, overall risk profile, as well as the compliance of the restrictions and limits set to the risk strategy of an institution and, in the case of irregularities, reporting them to the supervisory board, risk committee (where established), executive board and heads of the relevant structural units of an institution;

36.4. ensuring that clear and comprehensive information regarding the overall risk profile of an institution, all material risks of an institution and compliance thereof with the risk strategy is provided on a regular basis to the supervisory board, risk committee (where established), executive board and heads of the relevant structural units;

36.5. consulting and providing support to the supervisory board, risk committee (where established) and the executive board in the development of the strategy (including risk strategy) of an institution and in taking other decisions related to the risks of an institution.

37. An institution shall ensure the chief risk officer has independence, incl., from the business functions, and authority required for the effective performance of his/her duties,

appropriate position within the organisational structure of an institution and possibility to participate and express his/her opinion, within the scope of his/her competence, in taking decisions that are material for an institution.

37.<sup>1</sup> An institution shall document the role and participation of the chief risk officer in the composition of the committees established in an institution, ensuring the status of independence and authority of the chief risk officer referred to in Point 37 of this Regulation.

37.<sup>2</sup> An institution shall document each and every decision adopted by the committees established in an institution, which the chief risk officer has not supported, specifying in the minutes the main causes of such decision, as well as shall ensure that the decision concerned is forwarded for review to the senior decision-making body (supervisory or executive board of an institution).

### ***Risk committee***

38. An institution, which is significant in terms of the scale, nature, complexity and specificity of the activities thereof or having a complex organisational internal or group structure, shall establish a risk committee. The risk committee shall be responsible for:

38.1. consulting and providing support to the supervisory board with respect to the existing and future risk strategy of an institution, incl., changes thereto, considering the changes in the business line of an institution and the changes in external factors, and shall assist the supervisory board in monitoring the implementation thereof;

38.2. without prejudice to the duties of the remuneration committee, the performance of verification of whether the incentive schemes laid down in the remuneration system take into account the considerations on risk, capital, liquidity, probability of gaining profit;

38.3. performance of verification of whether, when setting prices and tariffs of the offered financial services and products for the clients of an institution, all related risks, specificity of the activities of an institution and objectives set in the strategy have been considered;

38.4. if irregularities have been identified during the verification stated in Point 38.3 herein above, preparing of the remedy (correctional) plan and submitting it to the supervisory board of an institution for review;

38.5. consulting of the supervisory board with respect to the attraction of external experts on issues related to risk management;

38.6. participating in the process of the development and analysis of various scenarios, in order to assess how different internal and external events affect the risk profile of an institution;

38.7. performing the assessment regarding the evaluation and recommendations provided by internal auditors and certified auditors with respect to risk management in an institution, as well as, where necessary, the development of the corrective measures and monitoring of the implementation thereof.

38.<sup>1</sup> An institution, considering the number of the members of its supervisory board and the scale, nature, complexity and specificity of the activities, as well as the organisational structure of an institution, may also decide not to establish the risk committee, if it is ensured that the responsibilities of the risk committee are performed by the supervisory board in full composition.

38.<sup>2</sup> Irrespective of whether or not the risk committee is established in an institution, the supervisory board in full composition shall be responsible for the supervision of risk management in an institution.

39. Only members of the supervisory board of an institution may be appointed as members of the risk committee. An institution shall ensure that the members of the risk committee possess adequate experience and knowledge for understanding the risk strategy of an institution and the supervision of its implementation.

39.<sup>1</sup> An institution shall ensure that the chairperson of the risk committee is not concurrently the chairperson of any other committee or the chairperson of the supervisory board.

39.<sup>2</sup> An institution shall ensure that the risk committee consists of at least three members.

40. Risk committee shall determine the content, volume, format and frequency of reports it receives.

40.<sup>1</sup> An institution, which is not significant in terms of the scale, nature, complexity and specificity of its activities, as well as the organisational structure, may combine the risk committee and the audit committee, where established, provided that the following conditions are met:

- 40.<sup>1</sup>1. appropriate authorisation from the Commission has been received;
- 40.<sup>1</sup>2. the members of the combined committee both individually and collectively possess sufficient knowledge, skills and experience to perform their duties related to both - the risk committee and audit committee.

#### ***Nomination committee***

40.<sup>2</sup> An institution, which is significant in terms of the scale, nature, complexity and specificity of the activities, as well as the organisational structure thereof, shall establish a nomination committee. The responsibilities of the nomination committee shall include:

40.<sup>2</sup>1. selecting candidates for the position of a supervisory or executive board member and recommending them for approval in the supervisory board or the shareholders' meeting of an institution, taking into account the collective knowledge, skills, experience and diversity of the supervisory board and executive board as applicable during the selection;

40.<sup>2</sup>2. when performing the selection laid down in Point 40.<sup>2</sup>1. herein above, preparing the description of the official tasks and the necessary qualifications of the particular position, and assessing the time commitment for the duties thereof;

40.<sup>2</sup>3. taking a decision on the objective to be achieved for the representation of an insufficiently represented gender in the executive and supervisory board of an institution and developing a policy on the achievement of this objective, as well as ensuring the disclosure of the objective, policy and information about the implementation thereof in accordance with Article 435(2)(c) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012;

40.<sup>2</sup>4. performing a periodic (at least annual) assessment of the organisational structure, size, composition and effectiveness of operation of the supervisory and executive board, reporting the results thereof to the supervisory board of an institution and informing the executive board about the part of the assessment relating to the executive board;

40.<sup>25</sup>. performing the individual and collective assessment of the supervisory and executive board members in accordance with the procedure laid down in the Suitability Assessment Regulation, performing a periodic (at least annual) assessment of the collective knowledge, skills and experience of the supervisory and executive board members, considering the collective suitability referred to in Point 25 of this Regulation, as well as informing the supervisory board of an institution about the results obtained;

40.<sup>26</sup>. periodic review of the policy on the selection and appointment of the senior management and reporting the necessary improvements to the supervisory board.

40.<sup>3</sup> An institution, considering the number of the members of its supervisory board and the scale, nature, complexity and specificity of the activities, as well as the organisational structure of an institution, may also decide not to establish the nomination committee, if it is ensured that the responsibilities of the nomination committee are performed by the supervisory board in full composition.

40.<sup>4</sup> When performing its duties, the nomination committee shall take into account the necessity, to the extent possible, to constantly ensure that the supervisory and executive board's decision making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interests of an institution as a whole;

40.<sup>5</sup> Only members of the supervisory board of an institution may be appointed as members of the nomination committee. An institution shall provide the nomination committee with sufficient resources for performing its functions.

40.<sup>6</sup> An institution shall ensure that the nomination committee consists of at least three members.

40.<sup>7</sup> An institution may combine the nomination committee and the remuneration committee, where established, provided that the following conditions are met:

40.<sup>71</sup>. the members of the combined committee can fully provide the functions of the nomination committee referred to in this Regulation, as well as the functions of the remuneration committee referred to in the Remuneration Regulation;

40.<sup>72</sup>. the members of the combined committee collectively possess sufficient knowledge, skills and experience for their duties related to both - the remuneration committee and the nomination committee.

40.<sup>8</sup> An institution shall ensure that both the risk committee and the nomination committee or the supervisory board of an institution, where the relevant committees are not established:

40.<sup>81</sup>. have access to all information necessary for the operation thereof;

40.<sup>82</sup>. receive reports and information necessary for ensuring the functions thereof, provided, on a regular basis or upon request thereof, by the employees and officers of an institution;

40.<sup>83</sup>. when necessary, have the possibility to attract persons performing internal control functions, as well as other experts, for example, human resources manager or expert, to promote the exchange of opinion, consulting and provision of support to the members of the relevant committee.

40.<sup>9</sup> An institution, taking into account the number of its supervisory board members, as far as possible shall ensure that the risk committee, nomination committee and remuneration committee are not comprised of the same supervisory board members of an institution.

40.<sup>10</sup> An institution shall assess the possibility of ensuring the participation of an independent supervisory board member of an institution in the risk committee and nomination committee.

40.<sup>11</sup> An institution, which is significant in terms of the scale, nature, complexity and specificity of its activities, as well as the organisational structure thereof, in addition to that which is referred to in Point 40.<sup>10</sup> of this Regulation, shall assess the possibility of ensuring the participation of an independent supervisory board member of an institution in the risk committee and nomination committee as the chairperson of those committees.

## **Chapter V**

### **Capital adequacy assessment process**

41. The objective of the capital adequacy assessment process is to ensure that the capital of an institution in terms of its amount, elements and share is adequate and sufficient for covering the inherent and possible risks to the current and planned activities of an institution. The capital adequacy assessment process shall entail setting of the amount of own funds required for covering material inherent risks arising from the current and planned activities of an institution, planning of own funds and ongoing maintenance of the amount of the own funds sufficient for covering the risks.

42. An institution shall develop, document and implement effective and justified policy and procedures for the capital adequacy assessment process, specifying therein:

42.1. definition of the capital, including elements, structure and procedure for calculation of the capital, in line with the requirements of the legal framework;

42.2. methods applied by an institution to calculate the capital requirement for each material risk and the total capital requirement for all material risks in an institution as a whole (hereinafter, the total capital requirement);

42.3. methods applied by an institution to maintain the adequate capital requirement for risks on an ongoing basis and to comply with the objectives of capital adequacy laid down in the capital adequacy maintenance strategy of an institution;

42.4. procedure for, frequency of an assumptions used in the performance of analysis of the scenarios and stress testing, as well as the role and duties of the risk committee in implementing the relevant measures;

42.5. allocation of duties, powers and responsibilities, when performing the capital adequacy assessment process;

42.6. procedure for reporting results of the capital adequacy assessment process, which shall ensure that the supervisory and executive board of an institution receive, on a regular basis, information enabling them to assess the adequacy of the capital of an institution, justification of the key assumptions applied in the capital adequacy assessment process and their impact on the results of the capital adequacy assessment process, the necessary capital requirement for the risks inherent to the current and planned activities, as well as other information necessary for taking decisions;

42.7. frequency of the capital adequacy assessment process.

43. An institution shall on a regular basis, but at least annually, review and enhance the policy of and procedures for the capital adequacy assessment process in accordance with the changes in the activities of an institution and in external factors affecting the activities of an institution.

45. An institution shall determine, on a regular basis, the capital requirement for the material risks inherent to its current and planned activities, assessing the amount of possible losses associated with such risks. An institution shall ensure that the results and conclusions of the assessment of the capital requirement are justified and documented.

46. When determining the capital requirement for covering risks, an institution shall assess all material risks inherent to its activities, including risks subject to own funds requirements in accordance with Regulation No. 575/2013 (credit risk, market risks, credit valuation adjustment risk and operational risk) and risks not subject to own funds requirements in accordance with Regulation No. 575/2013 (for example, interest rate risk in the non-trading book, reputational risk), and shall assess the possible impact of external factors on the activities of an institution.

47. For the determination of the capital requirement necessary for covering risks subject to own funds requirements in accordance with Regulation No. 575/2013, an institution shall assess whether the compliance with the relevant own funds requirements ensures that the capital of an institution is adequate for covering possible losses associated with such risks. To this effect, an institution shall assess, in accordance with the specificity of its activities, the following:

47.1. credit risk, *inter alia*, an institution shall analyse how the amount of the credit risk is affected by:

47.1.1. concentration of exposures (to this effect, an institution shall, for example, analyse exposures to a single client, including to central counterparties, exposures to one group of connected clients, exposures to clients whose activities are related to one economic sector or geographical region, exposures secured by the same type of collateral, and other possible concentrations);

47.1.2. residual risk when applying credit risk mitigating methods (to this effect, an institution analyses situations such as the inability of an institution to take over or sell the pledged collateral in due time; in cases when the mitigation of the credit risk of the transaction arises out of the commitment of the third party to repay the debt in the case where the debtor defaults on its liabilities - refusal or inability of such third party to settle its liabilities; other possible situations where the credit risk mitigation techniques applied by an institution may turn out to be less effective than initially planned);

47.1.3. risks associated with securitisation transactions, if an institution participates in securitisation transactions as an investor, originator, initial lender or sponsor (to this effect, an institution shall analyse, for example, risks arising out of incomplete transfer of credit risk, risks arising out of the securitisation of renewable exposures, which entail an early amortisation condition);

47.1.<sup>1</sup> credit valuation adjustment risk (hereinafter - the CVA risk), *inter alia*, shall analyse, for example, the materiality of the security financing transactions in its portfolio, the materiality of the over-the-counter derivatives (hereinafter - the OTC derivatives), which are not included in the calculation of the CVA risk own funds requirement in accordance with the exemptions laid down in Regulation No. 575/2013, in the portfolio of the OTC derivatives of an institution;

47.2. market risks, *inter alia*, shall analyse how the market risks are affected by the concentration of exposures and how the market risks of an institution could be affected by changes in the financial instruments' market liquidity in extraordinary market conditions;

47.3. operational risk, *inter alia*, shall assess whether the operational risk own funds requirements calculated by an institution objectively reflect the amount of the operational risk of an institution (to this effect, for example, a comparison with other institutions similar in terms of the scale and nature of activities is feasible);

47.4. other possible risk factors, for example, if an institution applies internal models for the calculation of capital requirements, it shall analyse the results of stress testing, restrictions of these models and the impact of the assumptions applied in the models on the results of the calculation of capital requirements.

48. For the determination of the capital requirement necessary for covering risks not subject to own funds requirements in accordance with Regulation No. 575/2013, an institution shall determine possible losses which might arise as a result of such material risks, *inter alia*, shall assess possible losses triggered by risks which cannot be identified in quantitative figures. To this end, an institution, in accordance with the specificity of the activities thereof, shall analyse:

48.1. interest rate risk in the non-trading book, incl., in accordance with the procedure prescribed by Commission Regulation No. 34 of 7 March 2008 "Regulation of interest rate risk governance, calculation of reduction of economic value and preparation of the term-structure report of the interest rate risk";

48.2. other risks relevant to the activities of an institution (for example, country risk, liquidity risk, risk of excessive leverage, model risk, reputational risk, strategy risk).

49. To determine the necessary capital requirement for possible losses of an institution which might occur as a result of external factors, an institution, in accordance with the specificity of its activities, shall analyse the changes in compliance laws, rules and standards, political, economic and other circumstances in the countries where an institution carries out or plans to carry out its activities, in the sectors affecting the activities of an institution, technological achievements, actions of competitors and other external factors which might cause losses to an institution.

50. To determine the necessary capital requirement for risks inherent to the activities of an institution and possible risks, in addition to the own funds requirements in accordance with Regulation No. 575/2013, an institution may apply scenario analysis, including stress testing, enabling one to identify such possible events or possible changes in market conditions which might have an adverse effect on the amount of capital of an institution.

51. To determine the total capital requirement, an institution shall aggregate the results of the determination of the capital requirement for covering individual risks. If an institution, when calculating the capital requirement for various risks, applies different assumptions (for example, different plausibility intervals, different holding periods), an institution, when calculating the overall capital requirement, shall ensure the comparability of the obtained results. An institution shall ensure that the results of the calculation of the overall capital requirement are documented.

52. An institution shall set the overall capital requirement, by assessing the capital requirement for covering the inherent and possible risks to its current and planned activities and by shaping the capital adequacy maintenance plan, and shall ensure that the capital requirement at its disposal is, on an ongoing basis, equal to or larger than the overall capital requirement.

## **Chapter VI**

### **Organisation of accounting**

53. An institution shall establish an accounting system, taking into account the laws and other legal acts governing the organisation of accounting of an institution, by developing and

documenting the accounting policy (specifying how various transactions are reflected in accounting) and procedures for the recording, control and assessment of reporting.

54. An institution shall ensure that all transactions are processed on a daily basis and the closing balance is prepared at the end of each business day.

## **Chapter VII**

### **Management information system**

55. An institution shall develop a management information system, which permits the users to understand and assess the financial standing of an institution on a timely basis, to effectively take decisions and to assess the consequences thereof, as well as to discover the failure to comply with control procedures on a timely basis. The supervisory board, executive board, committees, heads of structural units and responsible employees of an institution must have timely access to accurate and appropriate information necessary for the performance of their official duties and decision taking, both under normal operational conditions and in a crisis situation.

56. Management information system shall at least entail:

56.1. current standing and performance results of an institution in comparison with the previous periods and indicators of the operational plan;

56.2. analysis of the assets, liabilities and off-balance items, specifying how they are measured;

56.3. analysis of income and expenses, including the dependence thereof upon various classes of assets, liabilities and off-balance items;

56.4. compliance of the actual quantitative risks to the risk strategy of an institution and comparison with the prescribed restrictions and limits;

56.5. listing and analysis of cases of non-compliance with the adopted policies and procedures.

57. Information system shall ensure the provision of timely, accurate, complete, credible and appropriate information to external users (the Commission, the Bank of Latvia, etc.) in accordance with the requirements of the applicable legal acts, both under normal operational conditions and in a crisis situation, within the term specified in the relevant legal act and upon request.

57.<sup>1</sup> An institution shall ensure adequate resources for aggregating information related to risk management and the preparation and provision of management information and information to external users.

## **Chapter VIII**

### **Safeguarding of assets and information systems**

58. An institution shall develop and document the safeguarding procedures, which shall:

58.1. ensure the preservation of the tangible and financial assets of an institution;

58.2. ensure the preservation of tangible and financial assets held on behalf of the clients;

58.3. prevent unauthorised direct or indirect (via documents) access of third parties to the assets, accounting, electronic communication system and other data of an institution;



58.4. ensure safe and sound functioning of information systems and the preservation of information (including restoration of information in extraordinary situations).

## Chapter IX

### Functions of the supervisory board in the field of the internal control system

59. The supervisory board of an institution shall supervise how the executive board of an institution ensures the establishment and effective functioning of the internal control system. When carrying out the supervision of the internal control system, the supervisory board of an institution shall:

59.1. determine the distribution of duties among the supervisory board members and committees, where established, and procedure for information exchange among the supervisory and executive board, *inter alia*, shall critically assess the content of information submitted by the executive board;

59.1.<sup>1</sup> ensure that the agenda and the most relevant issues and conclusions of the supervisory board level committee, where established, are documented;

59.2. set the duties and remuneration of the executive board members and procedure for the assessment of individual and collective performance results of the executive board;

59.3. set the development strategy of an institution, including objectives of the activities, risk strategy and capital adequacy maintenance strategy, as well as shall supervise the implementation of those strategies;

59.3.<sup>1</sup> supervise the establishment of the organisational structure and the compliance thereof with the internal and external legal framework, as well as the compliance thereof with the specificity of the activities and risk strategy of an institution;

59.3.<sup>2</sup> approve the outsourcing, as well as, at least on an annual basis, review it in accordance with the changes in the activities of an institution and external circumstances policy of an institution and oversee the implementation thereof;

59.4. set the corporate values and standards of professional conduct and ethics of an institution, approve the policy on the governance of conflict of interest situations and the policy of ensuring diversity in the composition of the supervisory and executive board of an institution;

59.4.<sup>1</sup> monitor ensuring the risk culture of an institution in accordance with Point 23 of this Regulation;

59.5. supervise risk management in an institution, *inter alia*, approve policies on the identification and management of risks, request and receive information about the size and management of material risks inherent to the activities of an institution (including risks related to macroeconomic factors and the economic cycle), shall ensure that an institution allocates sufficient resources for risk management, as well as shall annually assess the effectiveness of risk management;

59.6. supervise the valuation of assets related to the material risks inherent to the activities of an institution, application of ratings granted by the credit rating agencies and use of internal models;

59.7. set guidelines for the capital adequacy assessment process, including, methods to be applied and objectives, shall approve the policy on the capital adequacy assessment process;

59.8. supervise compliance risk management in an institution, *inter alia*, shall approve the policy on compliance risk management, shall at least annually assess the effectiveness of compliance risk management;

59.9. supervise the functioning of an effective management information system, information disclosure and communication;

59.10. supervise, whether the risk control function, compliance control function and internal audit control function is clearly defined, whether these functions have an appropriate position in the organisational structure of an institution and a particular role in the governance of an institution, whether qualified staff is provided thereto and whether they operate effectively;

59.11. supervise the periodic enhancement of the internal control system in accordance with the changes in the activities of an institution and external factors affecting the activities of an institution;

59.12. review the opinions and recommendations of the internal audit function, certified auditors, as well as of the Commission and other authorities for enhancement of the activities of an institution and shall control the prevention of the detected weaknesses;

59.13. approve the policy on introducing new financial services;

59.14. determine the content, volume, format and frequency of reports it receives, as well as shall critically assess and, if necessary, dispute the truthfulness of such information;

59.15. ensure that, on a regular basis, by means of internal or external resources, the assessment of the performance of the supervisory board is performed, assessing the collective effectiveness of the supervisory board and individual effectiveness of its members, the established committees and internal rules of procedure and procedures of the supervisory board and executive board;

59.16. ensure that, based on the results of assessment of the performance of the supervisory board, deficiencies in the work of the supervisory board are identified and appropriate preventive measures are taken;

59.17. in full composition, perform the duties of the risk committee, nomination committee and remuneration committee, where no such committees are established, taking into account the requirements laid down in this Regulation and Remuneration Regulation with respect to the establishment of such committees;

59.18. at least on an annual basis, determine and approve the action plan of the internal audit functions in accordance with that which is prescribed in Point 78 of this Regulation, ensuring that the risk committee and audit committee, where established, are involved in the development of such plan.

## **Chapter X**

### **Functions of the executive board in the field of the internal control system**

60. The executive board of an institution shall be responsible for the establishment of the comprehensive internal control system, its implementation, management and enhancement. In the field of the internal control system, the executive board shall:

60.1. set qualitative and quantitative objectives for each field of activity of an institution in accordance with Point 59.3 of this Regulation regarding the development strategy set by the supervisory board, as well as shall, on a regular basis, report to the supervisory board on the achievement and suitability of such objectives;

60.2. establish the organisational structure of an institution;

60.2.<sup>1</sup> ensure the introduction of the outsourcing policy approved by the supervisory board and approve the relevant procedures (where an institution uses outsourced services);

60.3. ensure the appropriate qualification and sufficient experience of the employees of an institution (inter alia, with respect to the key function holders), ensure the implementation of the standards of professional conduct and ethics set by the supervisory board, ensure the implementation of the policy on the governance of conflict of interest situations set by the supervisory board and approve the relevant procedures;

60.3.<sup>1</sup> determine and ensure the implementation of the risk culture in an institution, in line with Point 23 of this Regulation;

60.4. ensure the identification and management of risks arising from the activities of an institution, including measurement, control and risk reporting, implementing policies on risk identification and management set by the supervisory board, and approve the relevant procedures, as well as shall ensure the review and enhancement of such policies and procedures in accordance with that which is referred to in Point 32 of this Regulation;

60.5. ensure a regular capital adequacy assessment and maintenance of adequate capital in accordance with the policy on the capital adequacy assessment process set by the supervisory board and approve the relevant procedures;

60.6. ensure compliance risk management, implementing the policy on compliance risk management set by the supervisory board, and approve the relevant procedures;

60.7. set the principles for accounting and valuation of the assets, liabilities, off-balance claims and obligations, income and expenses;

60.8. implement and manage the management information system, covering all activities of an institution, and shall ensure information disclosure and communication;

60.9. ensure the safeguarding of assets and information systems of an institution;

60.10. ensure that measures are taken for the prevention of weaknesses in the internal control system, identified by the internal audit function, certified auditors, the Commission or other authorities;

60.11. shall at least annually submit the report to the supervisory board of an institution on the functioning of the internal control system, by assessing its effectiveness and, if necessary, initiating the changes for enhancing its effectiveness, taking into account the changes in the activities of an institution and in the external factors affecting the activities of an institution;

60.11.<sup>1</sup> in addition to that which is stated in Point 60.11 of this Regulation, shall immediately report any material changes in the activities of an institution to the supervisory board of an institution, where material derogations from the objectives set in the operational strategy are detected;

60.12. implement the policy of the introduction of new financial services or introduction of material changes in the existing financial services set by the supervisory board and approve the relevant procedures;

60.13. determine the content, volume, format and frequency of reports it receives, as well as shall critically assess and, if necessary, dispute the truthfulness of such information.

## **Chapter XI**

### **Internal control functions**

61. To facilitate the establishment of an effective and comprehensive internal control system in all areas of the activities of an institution; an institution in accordance with the specificity of its activities shall ensure the performance of at least the following three internal control functions – risk control function, compliance function and internal audit function.

62. An institution shall ensure that the internal control functions are independent from the activities they assess (hereinafter – the assessed activities). The internal control functions shall be considered independent from the activity to be controlled, if the following conditions are met:

62.1. the duties of the employees performing the internal control functions do not include the duties related to the performance of the activity to be controlled;

62.2. the internal control functions, in terms of organisation, are segregated from the activity to be controlled, and the head of the structural unit performing the internal control functions, in terms of organisation, is subordinated to a person, who does not simultaneously supervise the structural unit performing the activity to be controlled;

62.3. the head of the structural unit performing the internal control functions is accountable to the supervisory board of an institution, but, in a separate case, the relevant supervisory board committees (where established) or the executive board, ensuring due independence of the internal control functions from the activity to be controlled;

62.4. remuneration of the employees performing the internal control functions does not depend upon the results of the activity to be controlled.

63. An institution shall ensure that the internal control functions, in terms of the organisation thereof, are segregated from each other.

64. Derogation from the principles listed in Points 62 and 63 of this Regulation with respect to combining the risk control function and compliance control function shall be allowed, if an institution develops and implements control procedures that ensure the prevention of existing or potential conflict of interest situations, and if it is compatible with the size, specificity and complexity of the activities of an institution, as well as the organisational structure thereof.

64.<sup>1</sup> An institution shall ensure that the internal audit function is independent from the risk control function and compliance control function.

64.<sup>2</sup> In an institution, which is not significant in terms of the scale, nature, complexity and specificity of its activities, and which does not have a complex organisational structure, the executive board member or the member of the senior management body may simultaneously be responsible for the performance of the risk control function or compliance control function in an institution or the performance of both of these functions, if it is ensured that the person concerned does not perform any other material duties, which would affect the independent operation of the internal control functions.

65. For the effective functioning of the internal control functions, an institution shall:

65.1. clearly define and document the powers of structural units performing the internal control functions;

65.2. segregate internal control functions from the functions of the performance of everyday transactions and other control functions;

65.3. provide the structural units carrying out the internal audit function with free access to all documents, information and employees;

65.3.<sup>1</sup> ensure that the structural units carrying out the internal audit function mutually exchange information necessary for ensuring the operation of the functions;

65.4. grant the structural units carrying out the internal control functions the powers to control such activities of an institution, for the provision whereof the services of outsourced service providers are also used;

65.5. provide the structural units carrying out the internal audit functions with sufficient resources for the effective performance of functions, including a sufficient number of employees with adequate education and professional experience, so that there are grounds to consider that they are able to carry out their duties professionally, as well as shall provide them with continuous training and appropriate information technology systems and support functions;

65.6. provide the structural units carrying out the internal control functions with direct contacts with the supervisory and executive board of an institution.

65.<sup>1</sup> An institution shall ensure that with respect to the head of the internal audit function and the person in charge of compliance control, the procedure is developed and

documented for commencing the employment relationship with them or appointing them to the position and for terminating the employment relationship with them or dismissing them from the position.

65.<sup>2</sup> An institution, no later than within the period of five business days following the day of termination of the employment relationship with the head of the internal audit function and the person in charge of the compliance control or dismissal of the persons concerned from the position, shall submit the Commission information regarding the reasons for the termination of the employment relationship or dismissal of the persons from the position.

### ***Risk control function***

66. The key task of the risk control function is the establishment of the management system of all risks of an institution, including development of the relevant risk management policies and procedures and ensuring their implementation.

67. An institution shall organise the performance of the risk control function in accordance with the size and specificity of its activities, by assigning the risk control function to one or several structural units (each separately or all together hereinafter referred to as the risk control structural unit) and ensuring that the duties and role of the risk control structural unit are documented and an institution has appointed employees in charge of risk control.

68. The duties of the risk control structural unit shall include:

68.1. identification and measurement of all material risks inherent to the activities of an institution and their mutual interaction, and development of policies and procedures for the management of those risks, as well as active participation in the development of the risk strategy of an institution and taking material decisions related to risk management;

68.2. control over compliance with the risk management policies and procedures, *inter alia*, set limits and restrictions;

68.3. regular review and enhancement of the risk management policies and procedures to ensure that they are up-to-date and correspond to the changes in the activities of an institution and in external factors affecting the activities of an institution.

69. The risk control structural unit shall submit regular reports to the supervisory board, executive board, risk committee and heads of the relevant structural units of an institution, including information about the risks inherent to the activities of an institution and compliance thereof with the strategy of an institution, enabling the supervisory board, executive board, risk committee and heads of the relevant structural units of an institution to assess, on an ongoing basis, the risks affecting the ability of an institution to achieve its objectives and, if necessary, take decisions on appropriate corrective measures.

### ***Compliance control function***

70. The key task of the compliance control function is to identify, assess and manage the compliance risk. For the purposes of this Regulation, the compliance risk shall refer to the risk that an institution might incur losses or there might be legal obligations imposed on an institution or sanctions applied against an institution, or its reputation might deteriorate, if an institution fails to comply with or violates the compliance laws, rules and standards.

71. An institution shall organise the performance of the compliance control function in accordance with the size and specificity of its activities, by entrusting the compliance control

function to one or several structural units (each separately or all together hereinafter referred to as the compliance control structural unit) and ensuring that the duties and role of the compliance control structural unit are documented and an institution has appointed employees in charge of compliance control.

72. The executive board of an institution, in cooperation with the compliance control structural unit, shall:

72.1. at least annually, identify and assess the most important compliance problems and shall develop plans for the prevention thereof;

72.2. at least annually, submit a report to the supervisory board of an institution on the compliance risk, including therein information enabling the supervisory board of an institution to assess the effectiveness of compliance risk management;

72.3. immediately report all material compliance problems to the supervisory board, due to which an institution might incur losses or there might be legal obligations imposed on it, or sanctions applied against it, or its reputation might deteriorate.

73. The duties of the compliance control structural unit shall include:

73.1. identification, documentation and assessment of compliance risk, *inter alia*, by ensuring that prior to the commencement of new activities (including prior to the introduction of new financial services or introduction of material changes in the existing financial services, introduction of procedures, approval of new clients or cooperation partners) the compliance risk associated with the relevant activity is identified and it is assessed, whether when performing the relevant activity, an institution observes the compliance laws, rules and standards;

73.2. development and documentation of compliance risk management policy and procedures, including development of the relevant procedures ensuring that all employees of an institution observe the compliance laws, rules and standards;

73.3. control over observance of the risk management policy and procedures;

73.4. regular review and enhancement of compliance risk management policy and procedures, to ensure that they are up-to-date and correspond to the changes in the activities of an institution and in external factors affecting the activities of an institution;

73.5. informing the supervisory and executive board, as well as the heads of the relevant structural units of an institution, on a regular basis, about the compliance risk of an institution, compliance problems that might affect the ability of an institution to achieve its objectives, desirable measures and measures taken for the prevention of these problems, compliance laws, rules and standards and changes therein;

73.6. assessment of the impact of possible changes in compliance laws, rules and standards on the activities of an institution;

73.7. providing consultations and support to the employees of an institution, in order to ensure that they observe compliance laws, rules and standards when performing their official duties.

74. The compliance control structural unit shall carry out its activities in accordance with the operational plan approved by the supervisory or executive board, which shall reflect the activities to be performed during the reporting period.

### ***Internal audit function***

75. The key task of the internal audit function is to carry out independent supervision of the internal control system, as well as the assessment of the adequacy and effectiveness

thereof, in order to assist the supervisory board, executive board and heads of structural units of an institution to be more effective in performing their functions.

75.<sup>1</sup> An institution shall organise the performance of the internal audit function in accordance with the size and specificity of the activities thereof, ensuring the documentation of the duties and role of the internal audit are documented. An institution shall ensure the appointment of the employees in charge of the performance of the internal audit functions.

75.<sup>2</sup> An institution shall ensure that the internal audit function is independent from the activities, the assessment of effectiveness and results whereof is included in its duties.

76. The duties of the internal audit function shall include:

76.1. assessment of effectiveness and results of the activities of an institution;

76.2. assessment of compliance of all types or activities and operation of the structural units, including the outsourced functions, of an institution to the strategy, plans, policies and procedures, *inter alia*, in the field of management of the risks of the activities of an institution, taking into account the assessment provided by the risk control function and the risk committee, where established, regarding the actual compliance of the risks with the risk appetite of an institution;

76.2.<sup>1</sup> verification of the compliance of policies and procedures existing in an institution with the regulatory and other requirements of the legal framework, risk strategy of an institution and operational strategy of an institution, as well as the relevant decisions of the supervisory and executive board of an institution;

76.3. verification of the capital adequacy assessment process of an institution, including the assessment of effectiveness, completeness and conformity thereof to the activities of an institution;

76.4. assessment of effectiveness of the risk control function and compliance control function, including the assessment of methods applied in the operation of these functions and the assessment of adequacy of the achieved results;

76.5. verification of the accounting system;

76.6. evaluation of information systems;

76.7. verification of functioning of the internal control procedures;

76.8. verification of credibility and completeness of financial information, as well as the verification of the means, by which such information is identified, measured, classified and disclosed;

76.9. carrying out special verifications and investigations.

77. The procedure for the appointment to and dismissal from the position of the head of internal audit function shall ensure that the head of internal audit function is independent from the executive board of an institution in taking decisions and his/her conduct and his/her duties, powers and reporting procedure are clearly stated.

78. The internal audit function shall operate in accordance with the annual action plan set by the supervisory board, which shall reflect:

78.1. areas of the activities to be verified during the reporting period, regularity of verifications and resources necessary for the performance of verifications;

78.2. risk identification and assessment methods for the activity areas to be verified, as well as the criteria for assessing risk control procedures, *inter alia*, shall specify that the risk-based approach is used;

78.3. requirements for documentation of the results of verifications;

78.4. the procedure under which the results of the verifications are communicated to the supervisory and executive board, and the procedure for verifying the implementation of recommendations.

79. The internal audit function shall prepare reports on facts discovered as a result of each performed verification and weaknesses in the internal control system, violations of policies and procedures, insufficiently identified or managed risks, and shall submit recommendations for solving the problems discovered. The internal audit function shall ensure discussion of the facts discovered, opinions and recommendations detected and prepared as a result of each performed verification at the relevant level of management, as well as shall perform the follow-up checks of the implementation of the recommendations made. The internal audit function shall, at least on an annual basis, prepare the report on performed verifications and main problems discovered, expressing its view on the effectiveness of the internal control system.

## **Chapter XII Final provisions**

80. The Regulation is recommended for application by insurance brokerage companies, private pension funds, regulated market organisers and central securities depositories, insofar as this Regulation refers to their activities.

81. Upon the coming into effect of this Regulation, Commission Regulation No. 63 of 2 May 2007 "Regulation on Establishment of the Internal Control Framework" shall become null and void.

82. An institution shall ensure that the requirements of Points 11.3, 12, 21.3, 21.4, 24, 25, 26, 27, 29, 30.2, 30.3, 31, 33, 34, 35, 36, 37, 38, 39, 40, 55, 56.4, 59.3, 59.5, 59.6, 59.13, 59.14, 59.15, 59.16, 60.12, 60.13, 65.5, 68.1, 69 and 76.2 are introduced on 1 January 2013 at the latest.

83. The Commission, by 1 January 2015, shall review Point 25 of this Regulation and shall resolve upon the necessity to set additional requirements.

84. An institution shall ensure that the requirements of this Regulation are introduced on 30 June 2020 at the latest.

### **Informative reference to the directives of the European Union Directives and other international documents**

The Regulation contains legal provisions arising from:

- 1) Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions;
- 2) Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions;
- 3) Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments;
- 4) Commission Directive 2006/73/EK implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive;



5) Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast);

6) Document of the European Banking Authority "EBA Guidelines on internal governance" (EBA/GL/2017/11);

7) The Basel Committee on Banking Supervision document "Corporate governance principles for banks", July 2015;

8) Document of the European Banking Authority "EBA Guidelines on institutions' stress testing" (EBA/GL/2018/04);

9) Document of the European Banking Authority "EBA Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services" (EBA/GL/2016/06);

10) Document of the European Banking Authority "EBA Guidelines on product oversight and governance arrangements for retail banking products" (EBA/GL/2015/18).

Chairperson of  
the Financial and Capital Market Commission

K. Zakulis