The pulse of FinTech industry in Latvia

A look at the state of the country's FinTech ecosystem, sharing key growth metrics and emerging trends

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The pulse of FinTech in Latvia 2022

FinTech as a technology sector has an overarching mission to make financial services more accessible for both consumers and businesses. Its adoption has grown faster than most other digital services, and more than two-thirds of the world's population are using FinTech in their day-to-day lives.

FinTech had a great year in 2021, attracting record investment and experiencing significant growth due to the positive trajectory of e-commerce and payments, as well as significant interest in developing verticals such as cryptocurrencies. Investment in FinTech companies in the EMEA region tripled in 2021 due to an upward trend in eCommerce, payments, and crypto. While this year is defined by significant market challenges and global investments in FinTech experienced a downward trend globally in the first half of 2022, Europe's FinTech funding, however, keeps growing in the face of uncertainty.

The same upward trend holds true for Latvia, which has long been a strong regional hub for startups in finance. FinTech companies make up an astounding 1/4th of all startups in the country, among them some of the most successful and fastest growing FinTech companies in Europe. The trend shows a growing increase, and FinTechs are also among the startup sectors receiving the most investment, talent, and interest. This is due to several beneficial factors, such as a traditionally strong finance sector in Riga; state-of-the-art local digital infrastructure; lack of legacy banking infrastructure as well as openness and ease of adoption of digital services in the tech-friendly Baltic societies.

Most recent data from the Financial and Capital Market Commission doubles down on the thriving industry and especially highlights the fact that adoption of tech is growing across the financial industry in Latvia. Market participants planning to develop and implement new and innovative processes and technological application innovation group FinTech solutions in coming years have increased by 143% over the year, including directions such as artificial intelligence, biometric data, and crypto-assets.

The Pulse of FinTech in Latvia report was created by the FinTech Latvia Association and Helve, in close collaboration with market participants and ecosystem partners. We are sure it will be a handy guide to the current landscape of the Latvian FinTech ecosystem, including the top FinTech trends, regulations, support mechanisms, capital availability, and infrastructure, as well as a showcase of the successful companies and services operating in the field. We hope it will be useful to market participants, investors, and interested parties and deliver valuable insights.

We greatly appreciate the support provided by the FinTechs who participated in the survey or agreed to be interviewed. And we would like to thank all the ecosystem partners - Financial and Capital Market Commission, Consumer Rights Protection Centre, Investment and Development Agency of Latvia, Ministry of Finance, Nasdaq, Association of Latvian Payment Services and Electronic Money Institutions, Venture Faculty, KPMG, BDO Latvia and Sorainen for their contribution in developing a significant part of the content for this report.

We would like to thank Greta Schulte (European FinTech Association) and Maria Staszkiewicz (European Digital Finance Association) for taking the time to share their highly valued outlook for the FinTech future development in Europe. We appreciate the great contribution to the report by Marine Krasovska, Director of Financial Innovation Department of Financial and Capital Market Commission.

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Tīna Lūse
General Manager of FinTech Latvia Association

While the government of Latvia is still taking the last steps to finalise a formalised FinTech strategy for Latvia, we all have witnessed the speedy development of Latvian FinTech sector players both locally and globally and have felt its strong presence in the market for some time already.

With this report we are aiming to create a "one stop shop" tool for investors, regulators, policy makers and the market players themselves to have access to information with the latest data, regulatory framework and tax regime, feedback from the market participants, success and experience stories, insights from the regulators, and market expectations for what is coming next for the FinTech landscape of Latvia. Having said that, we would like to welcome anyone who wants to participate in creating the next report and collaboratively shape the Latvian FinTech environment, to reach out and work together with us in the future.

Looking at the data, we can see that in comparison with the peak year of 2017 there has been a declining tendency in the numbers of newly incorporated FinTechs over 2018-2021. This data partly reflects the impact of the crisis brought by the Covid-19 pandemic followed by the war initiated by Russia against Ukraine. It also reflects a global trend that the FinTech sector has always developed in a sectoral manner driven by innovation and regulation - each development phase or boost is backed up by a regulatory framework and the market is therefore filtered, leaving only the strongest and most trustworthy players in the game. However, if we look at the market participants survey on what to expect next, the outlook is positive and indicates further growth.

Latvian FinTech sector is regulated by two regulators - CPRC that has accumulated significant experience with licensing and supervising consumer lending service providers, and FCMC for the rest of the market participants. The latter has undergone a visible transformation to be able to meet the market demand for having more and more new FinTech players in game, and this transformation has received a very positive feedback from the industry. To quote CrowdedHeroe who received the first Europe-wide crowdfunding licence in Latvia (and 4th in Europe) in an astounding 3 months' term after filing the application "working with the Regulator was like working with another FinTech, just from the public sector".

Another feature that Latvia can be proud of is its Employees' Stock Option regulation that has been characterised as one of the best regimes in the world by the market players and has been recognised as a great tool for attraction of high level professionals in their teams by a line of startups both from financial and other sectors. Such instruments as Regulatory Sandbox for innovative services, pre-licensing evaluation, as well as Securities Sandbox for those market participants that are preparing for joining stock exchange are very great tools created by FCMC to help FinTechs and beyond.

In terms of funding attracted, much of the information is not publicly available. While VC's and banks are slow to provide the financing to FinTechs for the reasons of them being too high risk profile or for the reputational reasons, we have seen our FinTechs being able to attract substantial funds via bonds issue, as well as more mature market participants even being able to successfully undergo an IPO. Some of the FinTechs have very successfully managed to fund their growth via crowdfunding received from their own customer base. Meanwhile some of our FinTechs have attracted attention of global FinTech players and are continuing their growth through acquisition.

Overall, while there still are some opportunities (easy access to banking payment infrastructure, strengthened cooperation with banks, digital currencies) that Latvia as a country must harvest to foster further growth of FinTech and reap the benefits of that growth, the overall feedback from the industry is that Latvia is a great place to launch your next responsible worldwide FinTech startup and that the pulse of Latvian FinTech is very much alive!

We hope you will enjoy reading this outlook!

Greta Schulte
Secretary General of the
European FinTech Association

What is next for European fintech, you ask? As we move toward a post-pandemic economy, heavily influenced by geopolitical developments on the macro level, it is obvious that things will never be the same - or will they?

There are some important developments we are observing, which will be of particular interest for Europe:

A wallet-first economy: With some regions on the global level, such as the Middle East and Southeast Africa, already having adopted a wallet-first approach, the development is bound to reach Europe eventually. The main question is whether the European Union will present a European solution for electronic identification in time - or whether big techs will step in.

Central banks are going digital (on currency): Within 3 years, 5 of the world's 10 largest economies will have adopted Central Bank Digital Currencies (CBDCs), most notably in Asia, the Middle East, and Latin America. Meanwhile, the European Central Bank just announced it will analyze how a digital euro can be designed and distributed to retailers and the public, setting October 2023 as a deadline for this initial investigative phase.

Decentralizing finance: At the same time, multiple private, stabilized cryptocurrencies (aka stablecoins) have emerged outside of state-sponsored channels, as part of efforts designed to enhance liquidity and simplify settlement across the growing crypto ecosystem. They are a crucial facilitator of decentralized finance (DeFi) – financial services performed by applications on a permissionless blockchain.

Banking in the cloud: Within the next 3 years, banking tech stacks are expected to be predominantly cloud-based, with significant elements of core processing being open-source based within 5 years. The desire for a European solution competitive with services offered globally has been longstanding, however, the attempted solution in the form of Gaia-X has yet to become a feasible reality.

Open Finance: By opening up access to customer data with user consent, fintech will build services that are more intuitive to consumers. Behavior-based innovation will continue to create a service experience that mirrors consumers' changing needs and lifestyles. Proving that some things will remain the same:

"FinTech's main strength early on has been its unique ability to target consumers' pain points and frustrations with existing financial services by delivering comprehensive, innovative and understandable financial service products for all Europeans."

The European FinTech Association believes that this has become even more relevant in times of crisis: We need to empower European consumers to become more confident in their financial decision-making to be more resilient. European consumers have been historically underserved with regard to fairer and more accessible financial services - and FinTech is needed more than ever to support.

Maria Staszkiewicz
President of the European Digital Finance Association

Political push for the introduction of industrial policies, inflation, the end of cheap money, and new European regulation will paradoxically help financial technology companies. A period of blood, sweat, and tears awaits us, yet it will open up new business opportunities and motivate entrepreneurs to improve business models.

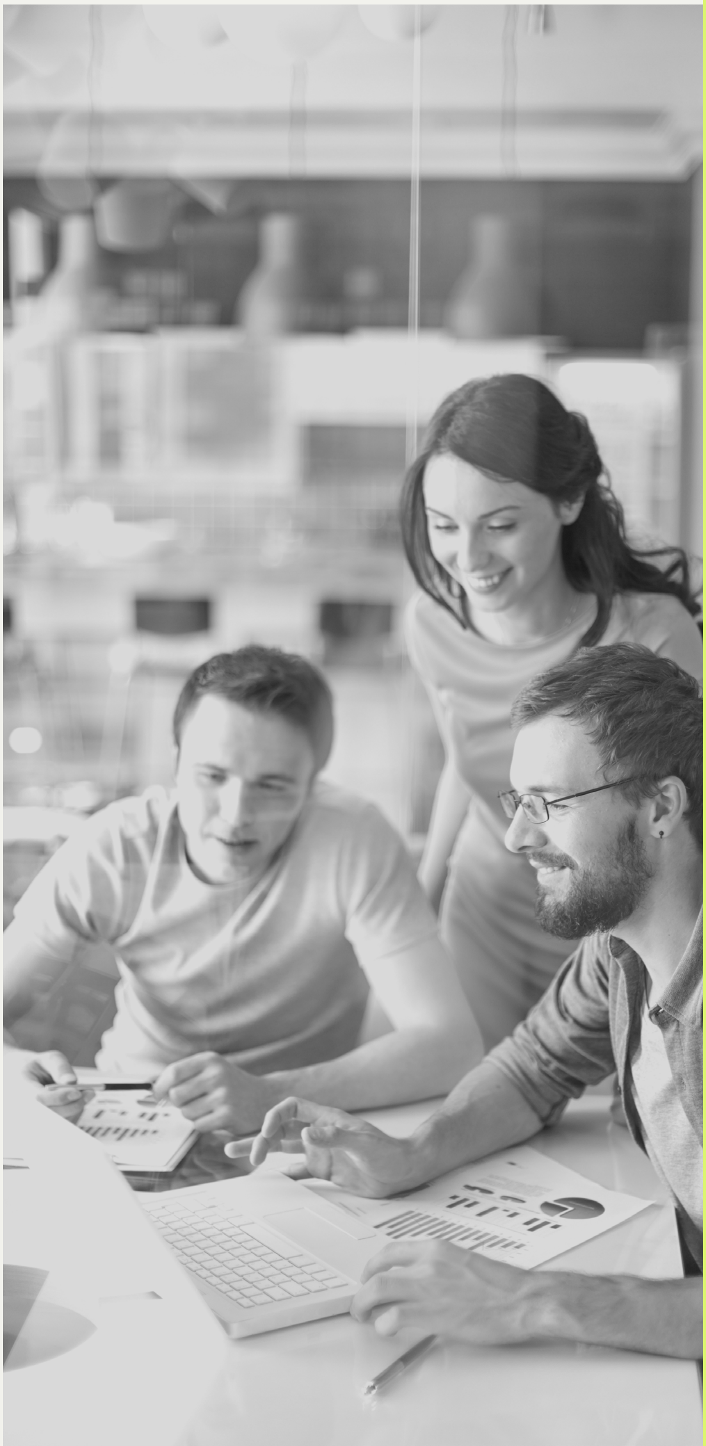
The geopolitical situation, caused not only by the situation in Ukraine but also by the long-term confrontation of the USA and Europe with China will strengthen the partnership between the public and the private sector. The war will bring an increase in public spending on R&D, and government programs to protect technology beyond the defense sector. Finance and financial infrastructure are strategic areas where FinTech companies can contribute not only in the field of cyber security and automation but also through their solutions for less wealthy consumers or by opening new sources of financing for companies.

In the case of FinTech companies, **the task of the state should primarily be to support innovation through special testing environments for new technologies (sandboxes, experimentation clauses, etc.) and a reasonable regulatory environment.**

After all, the EU member states already issued a special statement about their importance almost two years ago.

New European regulation of digital finance discussed in the corridors of Brussels administrative buildings will be another test for FinTech companies. It is also up to them what the final legal wording of the European Data Strategy, Consumer Credit Directive 2, or MiCA2 will be. Companies, themselves or through their proxy associations, must engage in regulatory lobbying so that regulation brings more opportunities than harm.

The biggest task ahead is probably the revision of PSD2, the directive that implemented the idea of open banking. In the context of current global challenges and the need for more resilient financial services, a fresh debate on regulating access to financial and non-financial data for European companies will define their competitiveness for years to come. The European Commission is now evaluating the deficient implementation of PSD2 and will soon decide what regulatory steps to take next. Frictionless and safe access to data is the prerequisite for robust services that will strengthen European economies. FinTech companies must repeat it loudly not only in Brussels.



The Shift in Public Policy

Aija Zitcere
Director of Financial Market Policy at the Ministry of Finance of the Republic of Latvia

Digitalisation and access to innovative services is one of the financial market policy priorities set out in the Financial Sector Development Plan for the period 2021-2023.

As a driver of innovation and competition, FinTech companies play an important role in the financial services market. They create innovative services in payments, insurance, regulatory technology, investment, cybersecurity, and other areas. Crypto and blockchain technology solutions are also increasingly evolving and attracting investment. The development and application of technology in financial services have become a necessity for the creation of competitive products. We need to promote the development and integration of AI, big data, cloud solutions, and other technologies in financial services.

Latvia has a dynamic and open FinTech ecosystem: entrepreneurs, institutions, investors, specialists, as well as the public sector. To further strengthen it, constant communication between the parties involved is essential. A functioning ecosystem is one of the prerequisites for the development of FinTech.

It is important to create an environment in which new FinTech companies can develop. Some of the directions are regulation - clear rules for financial service providers, developed financial market infrastructure, and access to capital. We also cannot forget the development of high-quality communication both in Latvia and, especially, outside it, in order to promote the interest of investors and the recognition of Latvia as an innovation/FinTech centre.

The information report on the FinTech sector development strategy submitted to the Cabinet of Ministers lays out priority actions for the creation of a supportive environment and ecosystem for FinTech, as well as communication activities to be undertaken by ecosystem participants.

Concrete actions are divided into three blocks.

Supportive environment:

- Support new and existing FinTech companies by implementing regulations on crypto and digital operational resilience;
- Support the creation of regtech companies;
- Increase availability of open data;
- Review of the licensing process by a financial sector supervisor to make it more transparent and understandable.

Strengthening the FinTech ecosystem:

- Making information regarding various forms of support readily available;
- Expand cooperation between FinTech and universities;
- Develop innovation centre capacity and reduce administrative obstacles.

Promotion and accessibility of information:

- Increase investor activity through communication activities;
- Ensure regular stakeholder communication.

Financial service providers must seize the potential of innovative technologies and the EU's single market to scale new financial services. Together with other Baltic states, Latvia can become a centre of innovation and activity thanks to favorable conditions for FinTech companies.

About this Report

The Pulse of FinTech in Latvia 2022 is a comprehensive report on the financial technology ecosystem. You will find the latest market data, regulation, and infrastructure landscape, information on state support and case studies of market leaders, as well as their review of current and future industry trends. The authors would like to thank the market-leading companies and state institutions for active participation in a collaborative initiative to promote further growth and cooperation, and together foster Latvia's thriving FinTech ecosystem even further.

Report authors recognize the challenges of identifying and separating FinTech companies from both traditional finance institutions offering innovative solutions to their customers, as well as other startups and companies offering finance-focused products within their scope. As Latvian founders and leading companies can easily be characterized by a global outset from the start, selected companies registered elsewhere are included in the report, with the precondition that a significant majority of their operations are held in Latvia. That being said, we would urge any Latvian FinTechs not included in this report to let us know of their existence, so they can provide input for future reports and outlooks.

Research for this report consisted of a collaborative approach to ensure the best and most accurate possible results. For the section on the **Landscape of the Latvian FinTech ecosystem,** we surveyed a comprehensive list of individual operational FinTech companies in Latvia, supplemented by available financial data from most market participants for the analysis of general industry tendencies.The survey questions focused on gaining insights into the companies' operations in Latvia, talent dynamics, revenue and funding, client pool, and strategic partnerships. Looking ahead, the survey also included questions on the anticipated future business development and technological innovations in the company, as well as anticipated challenges and opportunities.

This data analysis is followed by a **Key Industry trends** section with insights and case studies from several leading market participants in Latvia, showcasing their business model, success stories, and their views on current trends.

For a deep dive look into the ecosystem benefits and challenges, the report offers a comprehensive overview of the market **Regulation and Supervision** specifics and what to expect from the regulatory framework, including success and experience stories from two licensed FinTech enterprises. This is followed by an overview of available **Support Mechanisms** from the state bodies and community partners, with subsequent sections focused on financing options from the stock exchange to venture funding in the section on **Capital Availability,** as well as a look into the current Infrastructure of the financial technology market and key factors to take note of.

Last but not least, looking forward to the future, we invited market leaders to share their own ambitions and opportunities in FinTech they see in the near future, in the section What to expect in 2023?

Landscape of Latvian FinTech ecosystem

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A total of 146 FinTech companies can be identified as having either a legal entity or operating in Latvia at the end of 2022. This number comprises more than one-fifth of the overall number of Latvian startups and proves without further doubt that FinTech is a clear cornerstone of innovation in the heart of the Baltics. FinTech companies in Latvia encompass a wide scope of sectors, from payments and lending to crypto and crowdfunding. Beyond analyzing data, we can assume that the density and scope of startups are further evidence that collaboration, not a competition between innovators, together with a beneficial infrastructure and regulatory framework, work as positive factors in facilitating the growth of innovative companies and furthering the image of Latvia as an established FinTech hub.

Methodology

The survey questions focused on gaining insights into the companies' operations in Latvia, talent dynamics, revenue and funding, client pool, and strategic partnerships. Looking ahead, the survey also included questions on the anticipated future business development and technological innovations in the company, as well as anticipated challenges and opportunities. In all, 25 companies submitted their responses, representing around 17% of the FinTech market.

An additional overview of the FinTech financial performance was added in collaboration with Lursoft. Data retrieved on the financial metrics such as turnover, profit, and loss, was retrieved in addition to an overview of total industry tax payments and the number of employees. In total data on 123 FinTech companies was retrieved from Lursoft. Data is presented in an aggregated manner to present the total industry trends and tendencies.

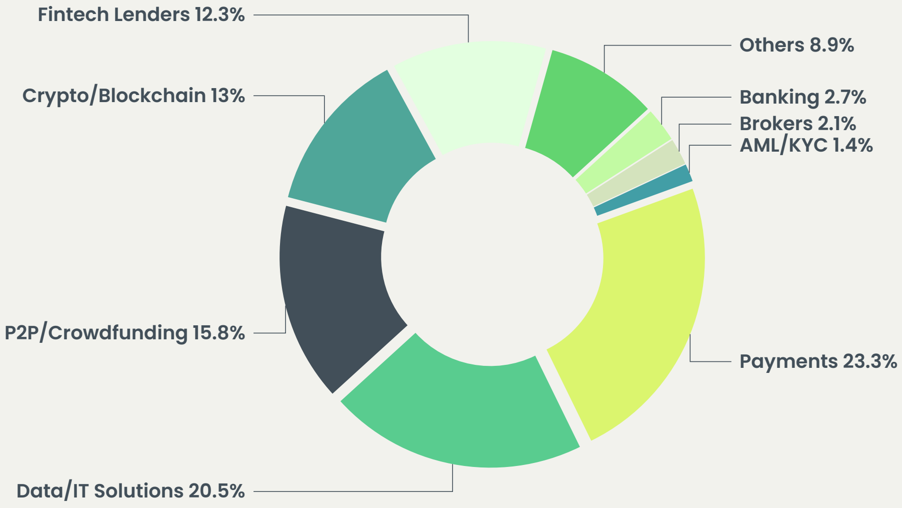
There are numerous definitions of FinTech but no consensus about which is the most appropriate definition of a FinTech company. For the purposes of this report, we rely on the definition by the European Banking Authority (EBA) (2017)[1] "technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services". This means that this report covers both startups and established firms involved in or supporting the provision of financial services. To be included in the report, the FinTech companies had to be incorporated in Latvia meaning that we are omitting all branches and the companies established by Latvian founders abroad. A more detailed split of the FinTech companies is included in page 12 of the report.

* based on Dealroom data collected by Venture Faculty[2].

Categories

Companies currently included in the Landscape are categorized in the following categories: AML/KYC, Banking, Brokers, Crypto/Blockchain, Data/IT Solutions, FinTech Lenders, Payments, P2P/Crowdfunding, and an uncategorized group - Others. Currently, there are more than 146 companies that are included in the landscape, which in the context of startups accounts for slightly more than 20% of total Latvian startups.

[1] European Banking Authority: Glossary for Financial Innovation (2017)
[2] Landscape is constantly being updated and cannot claim to be complete. The reason why the database might be incomplete is that the data are based on Venture Faculty's own research which was complemented by crowdsourced data, while at the same time the dataset is constantly being updated about two times a year, it still might have a few inaccuracies. All the data are publicly available and every person has a chance to give suggestions for potential improvements.



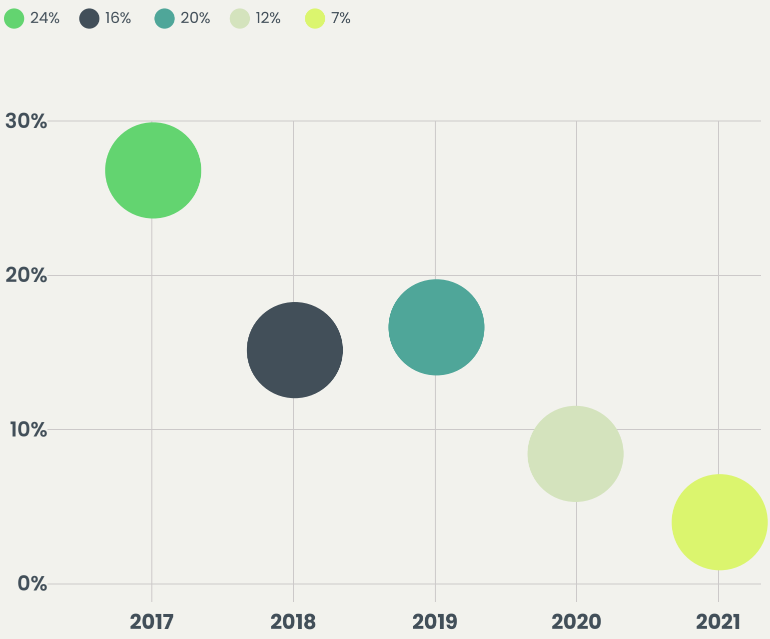
Currently, the data shows that the most saturated segment in Latvian FinTech is the Payments segment, with 34 companies listed. Not far behind in terms of total numbers are the Data/IT Solutions and P2P/Crowdfunding categories, which have 30 and 23 companies respectively. The Crypto/Blockchain category is also starting to catch up, with 19 FinTech companies listed, followed by FinTech Lenders, a category with a proven track record in Latvia consisting of 18 companies. At the end of the list are Banking, Brokers, and AML/KYC categories with 4, 3, and 2 FinTechs respectively. This leaves us with the final category, where we included companies that do not fit into a particular category. There are 13 individual companies in this category.

Growth

During the timeframe of 2017 to 2019 the total number of FinTech companies almost doubled. These three years were some of the best in terms of newly founded companies with skyrocketing growth percentages: over 25% growth in 2017 and about 15% in 2018 and 2019. What we are seeing now is that the numbers have been decreasing over the past two years. 2020 saw 12 newly founded FinTech companies (growth at about 9%), while 2021 saw just 7 (3,5% growth).

As for location, lately Latvian founders are showing a tendency to choose Latvia as the location for their headquarters, instead of the UK, Estonia, Lithuania, or the Netherlands as was common in previous years. From the data, it is apparent that in 2020 and 2021, by the available data, only one Latvian-rooted company was established outside our borders, while the rest have headquarters in Latvia.

Growth % and Total newly funded

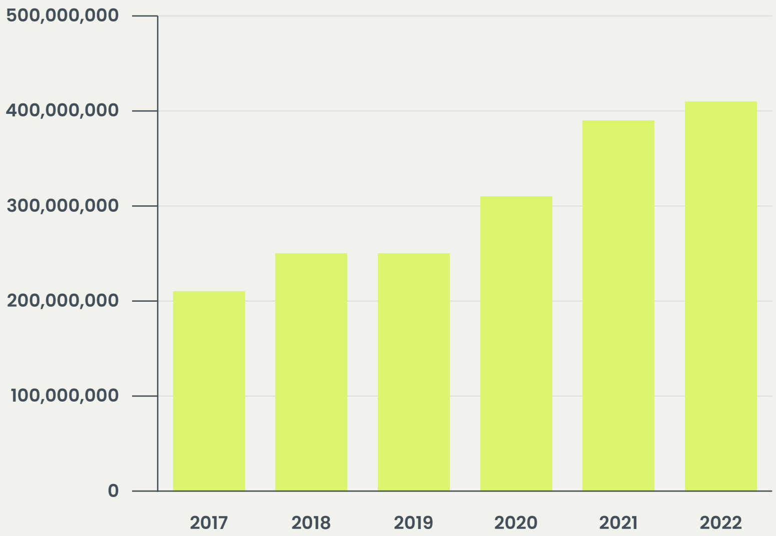


Funding

In terms of funding attracted, much of the information is not publicly available. At the same time, debt financing is not accounted for and is not always publicly declared by the companies, nevertheless it makes up a big proportion of funding in some sectors for example lending. Funding data for the Latvian FinTech sector should therefore not be considered complete, although we can see the broader trends.

Latvian FinTechs raised about €66 million and €74 million during 2020 and 2021 respectively, with total cumulative funding reaching €307 million and €381 million respectively. Looking at the cumulative data, we can see that the positive trend should continue over the next few years. Even though this year is still ongoing, received funding has passed the €30 million benchmark, reaffirming the continuous growth.

Total Funding (EUR)



Latvian FinTech Landscape based on Dealroom data:

Data/IT solutions

Fintelligence, Maxaa, TradersAlloy, Welfio, PointBiDA, Tammy.lv, AgroPlatforma.co, Niit Solutions, Notakey, Fino, Sorsera, INFIR, Forex Team, LOVAT, FinanceFlow, Nordigen, FIS.solutions, UVS Group, TapBox, X Infotech, Typbot, DataCom, Wandoo, Graphdo, BillMe, Global Future Solutions, Knowledgeprice

Brokers

Iizi, Altero, Jeff

Others

Lendiscore, Alpha Visum, INDEXO, Kora App, Snapio, PayTraq, MyCalorieBank, UXDA, VincitPats, Garanteer

AML/KYC

Finchecker, Huntli

* *Dealroom: Latvian Fintech landscape.* Landscape is constantly being updated and cannot claim to be complete. The reason why the database might be incomplete is that the data are based on Venture Faculty's own research which was complemented by crowdsourced data, while at the same time the dataset is constantly being updated about two times a year, it still might have a few inaccuracies. All the data are publicly available and every person has a chance to give suggestions for potential improvements.

P2P/Crowdfunding

Bulkestate, Crowdedhero, DoFinance, EstateGuru, Swaper, Crowdestate, Crowdestor, Debitum Network, Sneakypeer, Tradebacking.com, Crowdestate, Esketit, Mintos, PeerBerry, Factris, ViVentor, tfgcrowd, ViaInvest, Robocash, Lenndy, Boldyield, Credon, Lande

Payments

OurSpell, Multipass.co, Abillio, Paynt, Moneliq, MoneyExpress, ZELF, RoyalPay, Mobilly, Ecommpay, Securita, Gerlionti, NEXPAY, Coinfide, SPARQ, Joompay, DECTA, LatCard, SmartVend, Klix.app, Dali Dali, UniversePAY, Xpate, Monea, VIALET, Transact Pro, 3s money, MeaWallet, TBF Finance, Walleto, OctopusPays, MakeCommerce, InBudget, Velvet Platform

Banking

How2Bank, A-Heads, Crassula, WestStein

Fintech Lenders

NordCard, SOLUT, Erst Finance, Finamba, Dynatech, Eleving Group, Alfa Finance, 4finance, Finitera, FLEXIDEA, ViaSMS, Sun Finance, Fintera, Creditea, Direct Mortgage Capital, Moni365, Delfin Group, Factris

Crypto/blockchain

LendaBit, Gravityteam, Point-X, Striga, Fintelum, WunderTrading, BITLEVEX, Globitex, Axioma, Hodl Hodl, Dexopay, Powermining, Ayzd, BitFury, PayBis, BlockVis, BTCBIT

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* *Dealroom: Latvian Fintech landscape.* Landscape is constantly being updated and cannot claim to be complete. The reason why the database might be incomplete is that the data are based on Venture Faculty's own research which was complemented by crowdsourced data, while at the same time the dataset is constantly being updated about two times a year, it still might have a few inaccuracies. All the data are publicly available and every person has a chance to give suggestions for potential improvements.

Survey and market data analysis

In collaboration with FinTech industry stakeholders and representatives, a comprehensive survey was conducted to understand past performance, current FinTech endeavors, and future outlook. The survey was carried out to gain an understanding of issues such as talent availability in Latvia, companies' motivation to set up operations in Latvia as their base country, financial performance, as well as a sense of currently available support mechanisms and potential future opportunities and challenges.

In addition to the direct approach in the form of questionnaires, thorough insights into the companies' financial performance were retrieved from the Lursoft database. The data has been presented in the industry aggregated manner, in essence showing the general industry tendencies.

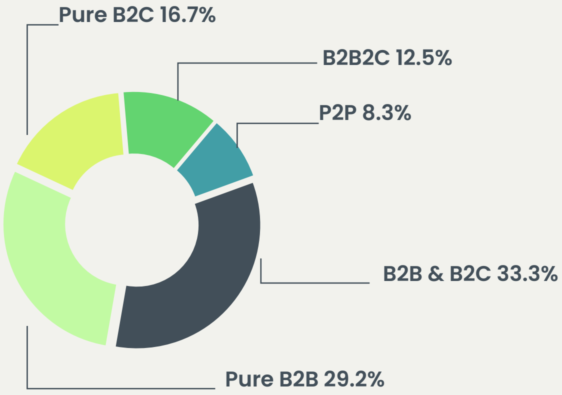
The data retrieved from FinTech industry participants are grouped in the following manner:

- Business model overview and sources of revenue/funding
- Target market
- Talent pool availability
- Analysis of FinTech enterprise financial performance (data retrieved from Lursoft)

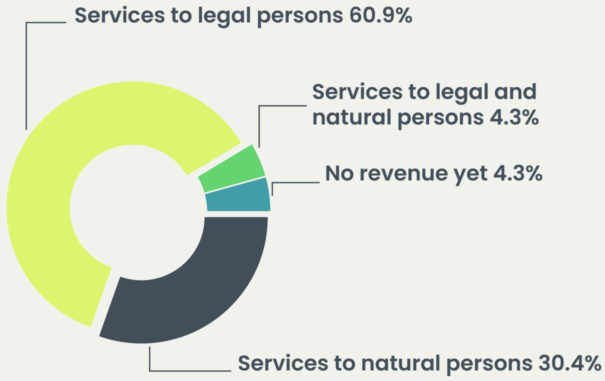
Analysis of FinTech enterprises

Major part of the industry representatives operate with the business to the business model. Services to legal persons also make up most of the revenue streams of the surveyed FinTech entities.

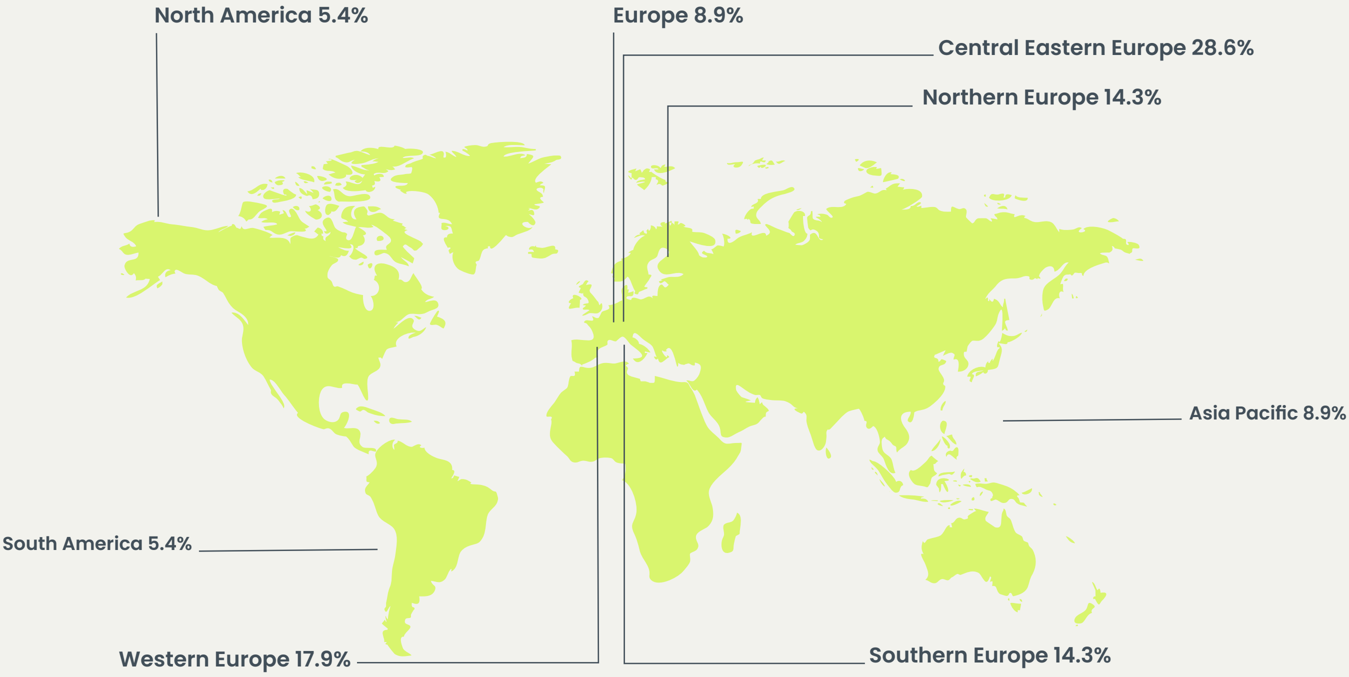
Current business model



Main source of revenue

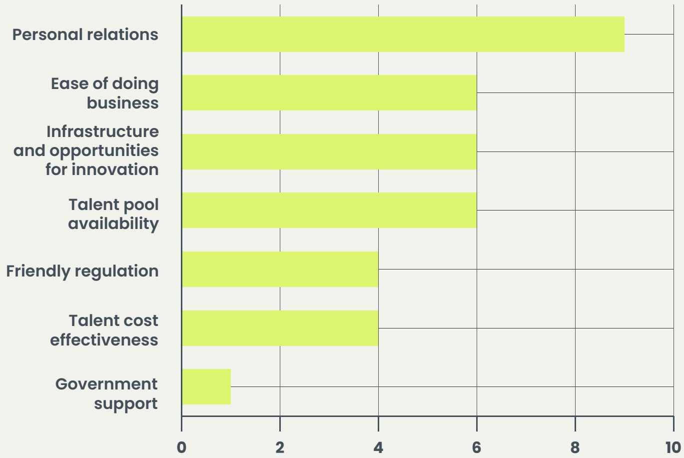


Key target markets

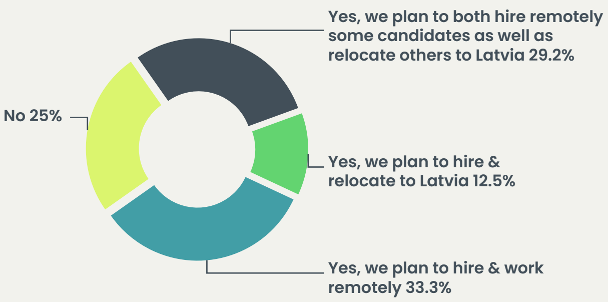


The absolute majority of FinTech companies look towards international markets from the outset, and rarely if ever plan to focus on the local market, even in the short term. The most significant target markets for Latvian FinTech companies still remain in Europe, especially the part of Central Eastern Europe, Western, and Northern European markets. Very few FinTechs surveyed choose to target the North American and Asian-Pacific regions for the short to medium term.

Why choose Latvia?



Do you plan to recruit & work remotely or relocate to Latvia?



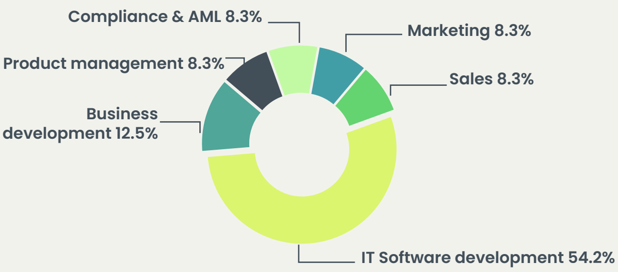
Available infrastructure and talent pool

Ease of doing business, as well as the infrastructure availability and opportunities for innovation are among the most critical factors for the FinTech enterprises to choose Latvia to set up their main operations.

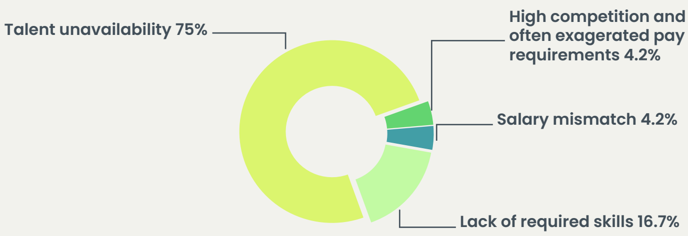
Talent pool quality and availability is a defining challenge for most innovative companies globally, FinTechs are no exception. Talent is mentioned as one of the most important factors for why FinTech companies choose Latvia for their HQ location. Latvia's FinTech ecosystem has an especially high growth potential taking into account the strong banking and financial industry roots & talent density in Riga, the largest city in the Baltics.

An additional positive tendency of FinTech enterprises is to plan to either hire and relocate to Latvia or hire specialists and work remotely. A major part of the respondents - 75% - plan on doing either one of the activities.

What specialists are the most difficult to recruit in Latvia?

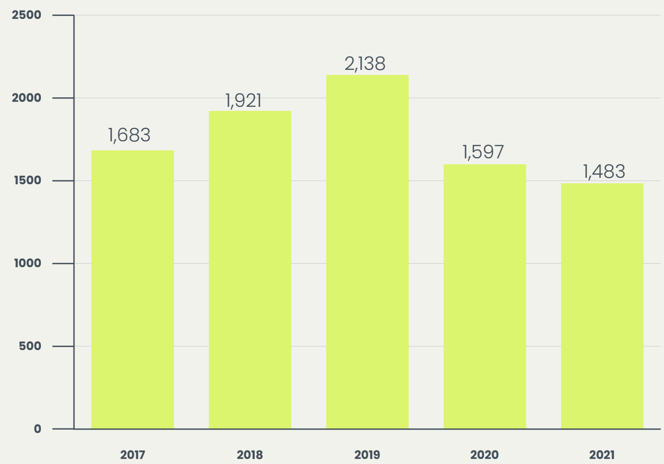


What is the main reason behind this difficulty?



Without surprise, companies in the survey carried out by the FinTech Latvia Association also mention that the most significant challenge in the market is engineering recruitment, as companies point to talent scarcities, with IT and software development resources among the most desirable to recruit. We can expect to see this in relation to increasing focus on hybrid and remote workforce, as well as companies expanding their hiring efforts within an ever wider regional scope and offering relocation packages for key talent.

Employees, industry total



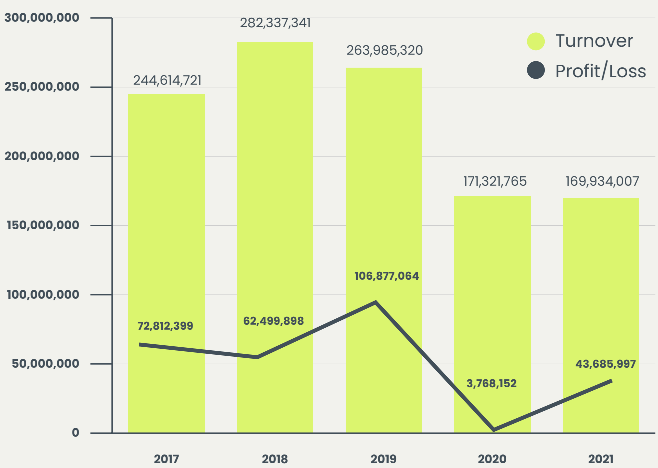
Data retrieved from Lursoft

Data further elaborated are retrieved from Lursoft. If we take a closer look at the data of employees employed in the industry an interesting trendline appears. In 2020 there was a significant decrease in the total number of employees employed in the industry, possibly due to Covid-19 pandemic related market struggles.

Industry financial performance

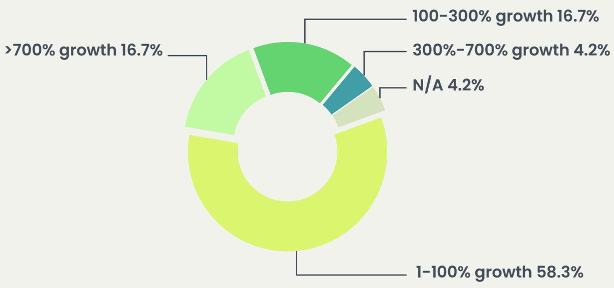
Taking into consideration the total industry turnover of analyzed FinTech enterprises, the general trend is positive, showing an increase in turnover till 2019. Possibly due to the Covid-19 pandemic, a significant drop in the total turnover was experienced. The Covid-19 pandemic has impacted the profitability of the industry players, leaving the majority of the enterprises with decreasing profits in 2020. In 2021, figures started to trend upwards, potentially signaling the industry's slow recovery after the global crisis.

Industry total turnover and profit/loss (EUR)



Data retrieved from Lursoft

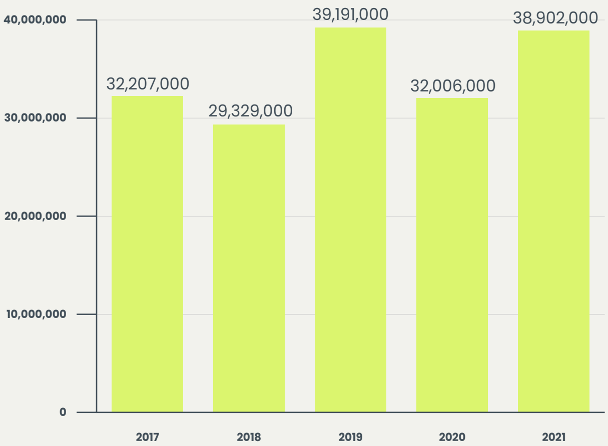
What is your expected revenue growth in 2022?



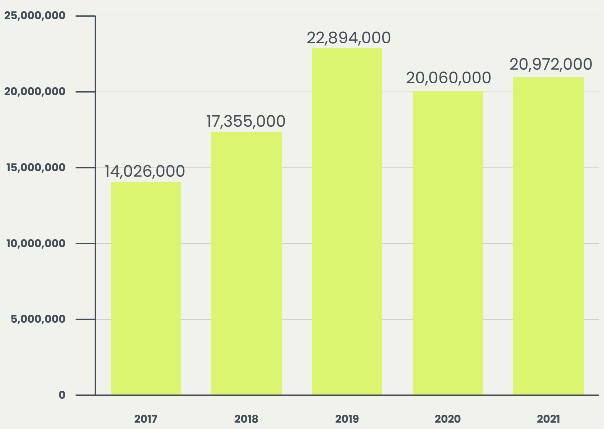
However, FinTech companies' future outlook shines on a rather positive note. According to the market participants' answers, the majority of respondents expect revenue growth of around 1-100% in 2022, whereas 16.7% of respondents claim a potential revenue growth rate of either 100-300% or 300-700%.

Another important aspect is the total contribution to the state in the form of tax payments. Although, as reflected in other financial data, the pandemic has left its mark on the performance of FinTech companies, there is a positive tendency for the total industry tax payments to increase throughout the years. Methodology against which the data has been visualized is based on the paid and State Revenue Service administered sum of the total tax payments[3].

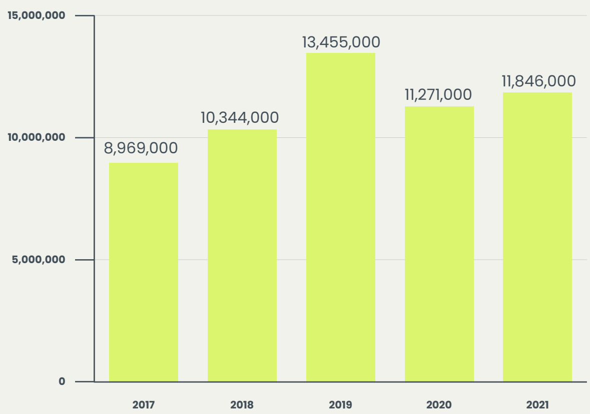
Tax payments, industry total (EUR)



VSAA, industry total (EUR)



IIN, industry total (EUR)



Data retrieved from Lursoft

[3] All data retrieved from Lursoft on the total tax payments are visualised as the difference between the actual payments made to the state and the sum expected to be paid by the enterprise. In addition, in 2018 tax reform took place and from 2020 till 2021 ended the deadline for diverse norm period, thereof on a yearly basis the raw data retrieved may not be equivalent

Latvian FinTech Environment and Trends

The FinTech sector globally has slowed down after a significant growth boost during the pandemic era, especially in eCommerce and payments. From the data retrieved by both the Venture Faculty, Lursoft, and other sources, we can conclude that overall a similar trend of new FinTech establishments has slowed down this year. However, several data points and market sentiment points toward increasing growth in the near future and a positive outlook in the near-term timeline.

The successful acquisitions of A-Heads by Meawallet and Nordigen by GoCardless are evidence of the trend of Latvian startups being on the radar of significant FinTech giants.

Apart from these acquisitions, we also have seen a couple of Initial Public Offerings, notably by DelfinGroup in 2021 with a significant number of investors having participated - in total 5,927. Following this, the 2022 Indexo IPO was oversubscribed by €2.5 million. Two IPOs in two years is a significant number for the Latvian FinTech environment, showing that there are companies capable of reaching such landmarks.

The FinTech sector has always developed in a sectoral manner, driven by innovation and regulation. Initially, online lending boomed until the regulation was put into place. Afterward, a big boost was seen in payment services, which were bolstered by SEPA payments and EU-wide regulation. More recently, the P2P and crowdfunding segment grew in popularity until a regulatory framework was put in place, and the segment has now become more mature and filtered. Currently, new trends include recent developments in crypto/blockchain services, even if this area is relatively less developed in Latvia than other FinTech verticals.

The sector in Latvia is defined by several well-established companies with an international customer base and several financial product offerings. When surveying market leaders on the current trends, we can see repeating an interest in expanding into new business directions, exploring avenues of consumer interest, and investing in new technology with future business potential.

FinTech has become a full-fledged industry with offerings in areas well beyond standard FinTech services, from cars to personal habits to sustainability and data analysis. We see more and more examples of FinTech collaborations and expanding services, ensuring an increasing offering to customers.

Industry scope broadening well beyond its early definition

FinTech, in general, is transformed from a disruptive approach that defined itself by contrasting with and competing against the traditional banking sector, into a more collaborative and multifaceted offering focused on working alongside and providing a seamless experience to customers.

Krišjānis Znotiņš
Eleving Group Business Manager in Latvia

Eleving Group in Latvia operates with three companies offering vehicle financing and car subscription services. The company expanded across the Baltics within its first year in business and today operates in the vehicle and consumer finance segments in 13 countries across three continents, providing financial inclusion and disrupting financial services.

Since its inception, our focus has been on providing mobility solutions through accessible financing for car purchases. The next addition to mobility solutions was launched at the end of 2018 when the new company and brand Renti was developed in Latvia. Renti started to offer used car long-term rental services. The product was designed with ultimate flexibility in mind so that customers could choose their desired vehicle with the peace of mind that they are not locked into a financial contract. Customers are able to return cars after the minimum rental term, without the burden of outstanding financial liabilities.

More development came in 2019, with the launch of a new brand Primero with the help of a joint venture between Eleving Group and Signet bank. This was the first collaboration in Latvia between a FinTech and a commercial bank for car financing solutions. Primero started with traditional car leasing, adding car loans, eco-leasing (for the purchase of an electric car), and leasing for legal entities.

On a European level, the number of people using the Car-as-a-Service model is growing by 5% every year. Flexibility is appreciated by customers, and traditional car ownership models are starting to lose popularity.

The main takeaways from the Eleving Group mobility story:

- Keep setting a strategy – in our case, focusing on mobility is our “golden ticket to the chocolate factory”, so find your niche and hold the course;
- Monitor global trends and customer demand to provide timely offers to customers;
- Search for opportunities and try new forms of cooperation (such as joint ventures with the local bank) to serve customer demand.

ESG-focused FinTechs will have a large growth trajectory

Given the growing prioritization of ESG happening more broadly, there will likely be increasing interest in FinTechs with ESG capabilities, including companies focused on climate change, decarbonization, and the circular economy. Sustainability is a key concern, relevant for both companies and consumers, and growing in relevance. The FinTech industry is no exception, and we see a trend of sustainable product offerings, which also include changing customer habits.

Ieva Kustova
ESG & Sustainability Consulting Lead, KPMG Baltics

ESG is an abbreviation that has been at the forefront of our minds lately. It creates a framework for companies worldwide to acknowledge and manage aspects related to their environmental impact (mostly impact on climate change and biodiversity), social impact (including their own workforce and human rights in their supply chains), and governance practices (covering, among other things, anti-corruption and anti-bribery policies, transparency of business models and operations and other aspects).

Since 2018, the European Union has introduced a list of regulations and requirements aimed at facilitating businesses' interest in investing in ESG and helping them consider these aspects alongside their core development strategy. One of the strategic directions the EU wants to facilitate is access to finance. Taking into account that most businesses need external financing sooner or later, the EU has begun establishing a framework to facilitate access to finance for sustainable investments and restrict it for businesses that are not sustainable enough.

There are several regulations that are worth looking at. These are not specifically defined for FinTech, however, they outline the overall approach to sustainable transformation.

First, there has been an ongoing debate on how to identify which projects or financing needs are sustainable or "green" enough and which ones are not. In order to clarify that, the EU recently adopted the EU Taxonomy Regulation and its delegated acts that define certain investments in specific economic sectors as green. For example, if you want to purchase a car it will have to be low-emission or, within a few years, zero-emission in order to be considered a "green" purchase. If you want to install an energy production facility, solar panels will be considered green, use of biomass for energy production will be considered green up to a certain amount of CO_2 emissions per 1 kWh, but a coal-powered plant will not be green regardless of any measurements or additional considerations.

The requirements outlined by this Regulation will be applied by commercial banks, investment funds, and asset managers in their decision-making on certain financing decisions.

Second, financial institutions have their own obligations. Again, these are not primarily related to FinTech, however, they outline the general requirements for the financial sector. Several regulations issued by the European Commission, as well as the European Central Bank and the European Banking Authority, require financial sector participants to assess their clients' ESG risks and incorporate this assessment into their overall credit risk methodology. Again, this means that a more sustainable business has a higher probability of gaining a better credit rating and better conditions for financing.

Last but not least, the European Commission is currently in the process of adopting the Corporate Sustainability Reporting Directive which will set common grounds for companies reporting on their sustainability as well as significantly expand the scope of companies for whom reporting will be mandatory. The current edition of the draft Directive foresees that all large enterprises (250+ employees and €40 million turnover and/or €20 million asset value), as well as small and medium-sized enterprises who are willing to go for IPO or are already listed, will have to report on their sustainability efforts annually.

How does all of the above affect FinTech? Taking into account that FinTech companies need to attract financing for their operations, this means in practical terms that a FinTech looking for money might need to disclose information to its potential investors on the portfolio it lends to, its lending assessment policies, and how ESG factors are incorporated in this assessment, what their priority lending areas are, etc.

Taking into account that investors need to be treated equally, that might also require that the FinTechs start reporting publicly on their efforts in the ESG area. In that case, they would need to cover three practical steps - conduct a materiality assessment in order to define what to report on, undertake data stocktaking based on the identified material aspects, and prepare the report itself.

Changes in Business Thinking and People's habits

Didzis Ādmīdiņš
CEO of DelfinGroup

Climate change is one of the most significant challenges of the 21st century, receiving increasing attention from international organizations and national policymakers. The long-term goal of DelfinGroup is to develop Banknote pawn shops as a comprehensive network for extending the life cycle of pre-owned goods and ensuring the purchase and sale of pre-owned goods throughout Latvia. In addition to the circulation of pre-owned goods, DelfinGroup also provides inclusive financial services to customers in Latvia – loans to individuals, including loans specifically designed for people of retirement age, credit lines up to €10,000, and pawn loans.

The Banknote network sells goods sold by private individuals and home appliance retailers, including online stores, which do not maintain a secondary circular system for returned pre-owned goods. It is expected that the European Green Deal policy will encourage the introduction of such systems or co-operation with companies that already provide re-use services, thus reducing the need to produce new goods. It means less use of resources, less waste, and a more environmentally friendly policy.

DelfinGroup also operates according to similar principles, creating its business in such a way that it would be beneficial for people to act according to circular economy principles. Convenience, cost-effectiveness, and green thinking are combined. The Banknote pawn shop network is currently being actively developed, and infrastructure is being created so that people throughout Latvia become comfortable selling and buying pre-owned goods.

Financial Technologies Go Mainstream

Financial technologies used to be a novelty – a new trend of innovation that disrupted the traditional banking markets. It is still about innovation and disruption, but we have entered a new phase of market development – acceptance and maturity of FinTech.

Edgars Kalniņš
IPF Digital Country Manager for Latvia

The key aspect of this new market reality is that consumers can solve all their daily financing needs via a new breed of financial solutions. **FinTech is no longer a fancy addition to traditional banking, it can be and is an independent solution for all daily requirements.**

We see that our digital customers are looking for an affordable, end-to-end digital service from a speedy application and decision for credit, to being able to manage their finances online at any time. They generally have medium incomes and an existing credit history which enables them to borrow remotely.

Customers can choose from a range of innovative products, from open-ended revolving credit lines to our mobile wallet which features online payment transactions and value-added services offering a competitive advantage within our customer segment.

Last year we saw consistent signs of regrowth in demand and a resurgence of consumer optimism after the darkest days of the pandemic. Short-term demand and consumer confidence correlated with pandemic restrictions being imposed and lifted. The pandemic accelerated online shopping trends and consumers' desire for remote lending.

The consumer finance sector remained very competitive last year and continues to be fiercely contested with customers expecting ever greater personalization of their financial solutions and a frictionless customer experience. We note a significantly improved GDP outlook post the Covid-19 crisis. However, the cost of living crisis with its inflationary pressure could disrupt economic activity as consumers grow more concerned about their daily finances.

Jānis Diedišķis
SME Finance Country Manager for Latvia

The whole financing sector is stepping into an open finance era right now. We can already see the early signs, and in the next ten years, FinTech will become invisible as it moves to the background. Every FinTech may attempt to create super apps, where all financial services and products are available on one single platform. Now we are all talking about trends such as open banking, API integrations, Buy Now Pay Later (BNPL) models, Revenue-based financing (RBF), and open finance. Thus, trends in open finance and data are leading to the integration of all financial services ecosystems. Open banking and open finance ecosystems are becoming the core of the world's digital financial infrastructure.

Even though regulations are evolving, **more and more sectors enable embedded finance: payments, banking, lending, wealth management, insurance, even payroll verticals, etc.**

SME Finance as a FinTech pays a lot of attention to making financial products and services more accessible to customers. We invest a lot in digitalization, Artificial Intelligence, and optimization. We create partnerships with other FinTech companies in order to be able to offer a wide range of services on a single platform.

SME Finance offers a number of different financing services on a single platform, which includes: business loans (both short-term and long-term), credit lines, loans with varying types of financing (investment loans, seasonal loans, working capital loans, bridge loans, refinancing and recapitalization loans), and invoice financing (factoring), including classic, reverse, undisclosed, supply chain, and leasing.

In early 2022, the company launched Smart Loan - a new type of loan where the main goal is to simplify and accelerate the credit checking process for companies seeking to borrow up to €30,000.

The main difference between Smart Loan and an ordinary business loan is the credit underwriting process. With Smart Loan, the credit decision is based on the applicant business's bank statements for the previous 24 months (or the period the company has been operating). Once bank statements have been submitted, an advanced AI system is used to analyze the underlying data and assess creditworthiness. This new type of loan is superior to other market players because it brings more flexibility, is faster, and is also more relevant for client groups who might be otherwise deemed ineligible for funding using the conventional credit checking processes.

Additionally, SME Finance's delivery method innovates by providing all financing solutions on a single, AI-powered platform where SMEs can access all their essential lending and payment products in one place.

This digital platform brings a number of value-adds for SMEs:

- Digital, fast and frictionless cross-border customer onboarding;
- Financing on demand - 24/7 credit applications and money disbursement with AI-driven credit checking;
- Banking payments and cards are available on-demand on the same platform;
- Insights and analytics powered by OB (Opening Balance) - real-time cash flow data and forecasts;
- Marketplace - a hub for all SME financial service needs as a single marketplace with best-in-class partners.

SME Finance is also innovating new services:

- A new RBF (revenue-based financing) solution with a predefined limit, AI credit scoring, and BNPL (buy-now, pay-later);
- Embedded finance solutions aimed at new client segments (e-shops, SaaS companies, and digital businesses).

SME Finance's main customers are small and medium enterprises and entrepreneurs who are perceived as higher-risk clients to traditional banks. SMEs are the backbone of our economy, and that is why we need to make financial services more reachable for them. Our goal is to make finance easy: at SME Finance, all processes are automated and fast, from becoming a customer to AI-assisted application processes, everything is online, and easy for business owners to understand and apply.

I believe that there is plenty of room to improve digital transformation and the digital customer journey. It is obvious that customers need fully digital, integrated, and flexible services. That's why one-stop-shop solutions are winning, and I'm sure that those who will adopt the changes first will beat the market.

The non-bank lending industry of tomorrow

Lending being one of the leading FinTech verticals in the region, we see both increasing competition with traditional banks, as well as amongst FinTech companies themselves. The increasing selection is a benefit to consumers, as they can compare and choose the most preferable option among many.

Gvido Endlers
Country Manager of 4Finance Latvia

Fiercest competition with traditional banks

Alternative lenders have the ability to leverage a broad set of data and the latest technologies, allowing them to reach further into the lending market than incumbent banks. The presence of alternative lenders and digitally advanced nonbanks is continuing to grow in the banking industry.

According to Oracle's Digital Demand in Retail Banking study of 5,200 consumers from 13 countries, over 40% of customers surveyed think non-banks can better assist them with personal money management and investment needs.

Services safer than ever before

Different technological solutions are used for the remote identification of customers, the effective assessment of their solvency, and the safe issuing of credit.

4finance has introduced an additional preventive measure - biometric and identification data verification or automatic identification by comparing a facial image with a personal identification document. The most advanced providers of alternative financial services use similar technological solutions on a daily basis. The high accuracy of our technology allows us to exclude potentially risky customers or lending for inappropriate purposes, making our services safer than ever before.

Automation – the key to the future of lending

In a new era of competition marked by technology-first entrants and evolving customer expectations, top-performing credit providers have learned to employ these new technologies effectively to address the evolving needs and demands of their customers. Automation has shown its potential to positively serve every stage of the loan lifecycle, from identification and pre-screening of applicants to customer onboarding, contract management, and credit underwriting.

High social responsibility

It is important to select customers carefully and work only with those who will be able to repay the loan in full and on time. To ensure this, non-bank lenders set very high solvency requirements for which a very small percentage of new customers can qualify.

4finance refuses 90% of new customers because they do not qualify for the company's high solvency requirements. However, thanks to its highly accurate multi-stage solvency assessment system, 4finance is able to select and work only with highly responsible clients – 84% of our clients are able to repay their loans within 30 days. In the period up to 90 days, we recover around 2.5% of the loans issued and 95% overall in the longer period.

Asset-backed securities. New opportunities for retail investors

In the past decade, the world of finance has faced a rise in innovations regarding the possibility of investing as a private individual. Nowadays, almost everyone has access to investment marketplaces such as crowdlending - P2P, P2B, real estate platforms, and others. All of these newcomers are still babies compared to traditional investment opportunities that have been around for a while and have been mainly available to institutional investors only. Luckily, these changes are leading to the start of a new era for retail investors. As a result, the rise of many platforms has been followed by changes in regulations and the necessity to be licensed by governmental institutions.

Henrijs Jansons
CEO at Debitum Network

The P2P and P2B sector is shifting into an investment marketplace sector that will provide licensed and regulated financial instruments to the retail market. Europe is the first to regulate platforms that sell claim rights. FCMC announced that selling claim rights should be replaced with regulated financial products, and came up with proper regulation in 2019. This transition is aimed at making investments in such marketplaces more transparent and secure, thereby increasing protection for investors. As a result, investors in licensed platforms are guaranteed up to €20,000 in deposit recovery from the state of Latvia if the platform misuses the funds.

Furthermore, regulation has made it possible to issue financial instruments instead of claim rights and offer them to retail investors. The outcome of this regulation plays a significant role in changing the industry, as financial instruments were previously only accessible to institutional investors. Latvia is the first country in Europe to do so.

In March 2022, Debitum Network, licensed in September 2021, was the first platform in Europe to launch Asset-Backed Securities and make them available to the retail market. Debitum has therefore become the pioneer in introducing this innovation to the investment market.

Asset-backed securities (ABS) are derived from a pool of underlying assets. The assets are the same loans we previously offered individually for assigning claim rights – business loans and factoring loans. By pooling them together through a securitization process monitored by the FCMC, financial institutions such as Debitum can offer investors opportunities for investments that have diversified risk profiles, thus minimizing the risk of default.

To make it clear, this is a huge deal. These financial instruments were previously only available to institutional investors, and the retail market was not previously regulated. Let us not forget that institutional investors must have at least €100 000 to invest in products like this, but at Debitum we place no restrictions on the investment amount.

Therefore, Debitum and other licensed platforms can be compared to European companies that offer their products to institutional investors, such as Crosslend and i2 group. Although neither is regulated, they offer well-structured financial instruments for institutional investors, such as Asset-Backed Securities.

At Debitum we are doing the same, but we are regulated and offer well-structured financial instruments for **everybody.**

Regulation and Supervision

The FinTech sector is mainly licenced and supervised by FCMC in Latvia with an exception of the consumer lending leg of FinTech that is being licenced and supervised by the Consumer Rights protection centre.

If we are speaking of FCMC, it must be noted that the licensing and general regulatory framework for FinTech startups and the industry overall has been significantly improved in recent years, aiming to offer a fair balance between a secure and transparent financial sector and regulations that benefit innovation. FCMC is both the regulator and a key partner for FinTechs aiming for a licence, with positive feedback from several market players of a smooth and effective partnership and support from the state side. An initiative to applaud is the Regulatory Sandbox, a concept to allow ease of testing innovative ideas and business models and their legal viability in the context of Latvian and European financial regulations.

However, there's no doubt that several areas are yet to be improved upon, such as a state-level FinTech strategy still in process and improved regulations to promote cryptocurrency and blockchain-based innovations that currently lack a comprehensive state approach. As such, the recent geopolitical developments and regulatory sanctions on Russia and Belarus due to the invasion of Ukraine will no doubt have long-term effects on local FinTechs with ties to the region, with the full consequences on the industry yet to be seen.

Marine Krasovska
Director of Financial Innovation Department of Financial and Capital Market Commission

The Latvian FinTech landscape is diverse, and although the Latvian FinTech market is at an early stage of development, the sector is characterised by good quality development. Currently, there are more than 100 active FinTech companies in Latvia in various business segments, such as payment services, lending, investment platforms and crowdfunding platforms, as well as regulatory technology (RegTech) and data analytics services.

FinTech Regulation in Latvia

In 2018, the European Commission adopted the FinTech Action Plan to more Competitive and Innovative Financial Sector in Europe. The main aim of the plan is to increase supervisory convergence about technological innovation and to prepare the EU financial sector to benefit from new technologies.

All new EU legislation must be based on the "innovation principle". The European Parliament emphasizes that, in order to prevent regulatory arbitrage, legislation and supervision in the Member States must be based on the following principles:

- Same services and risks: the same rules should apply regardless of the type or location of the legal entity concerned in the EU;
- Technology neutrality;
- A risk-based approach, considering the proportionality of the regulatory and supervisory activities to the risks and the materiality of the risks.

Regulators around the world are trying to find the optimal balance between rules that provide adequate safeguards and growth and innovation in the financial sector. This balance is affected by several elements, such as:

- The growing number of financial technology companies is likely to increase competition in the banking supply chain; in turn, the fragmentation of banking services ma y increase operational risks in the business model;
- The use of cloud computing could increase the efficiency of financial system participants' systems, but also increase systemic risk. Particularly at risk in the event of a cyber attack, if several banks outsource the same services;
- The automation of new customer acquisition processes (the "know your customer" requirement) and the use of RegTech technologies can expand the availability of financial services while increasing data protection risks;
- Algorithm-based credit rating methods based on data sources are likely to reduce the human resources required but also pose risks to privacy and data leakage;
- Virtual currencies could reduce the cost of cross-border payments, but at the same time pose significant AML risks.

Depending on the business model and types of financial services, FinTech companies are regulated and supervised by the FCMC, CRPC (consumer lending), and the State Revenue Service (virtual currency transactions). A common European approach to the regulation of payment service providers strengthens competitiveness, market development, and a level playing field in both the EU and Latvia. FinTech companies currently have the opportunity to obtain licenses from FCMC for the provision of payment and e-money services, the operation of investment platforms, crowdfunding services, and other areas depending on the structure of the business model and the planned innovation.

Edvīns Draba
Senior Associate

Agneta Rumpa
Associate Sorainen ZAB SIA

Most FinTech entities qualify as obliged entities for the purpose of AML regulation which have experienced a significant make-over as part of the thorough renovation of Latvian finance sector in recent years. While this aspect did make the Latvian FinTech market less business-friendly than in the neighboring countries, there is hope that now it might actually be well-placed to be one of the most competitive ones. As the regulators everywhere else in Europe are toughening their rules, Latvian entities are adapted to managing difficult regulations and strict supervision, whilst the FCMC is publicly acclaiming the readiness to accommodate and cooperate with the market participants and entrants.

Financial and Capital Market Commission

Payment and electronic money institutions

The activities of payment and electronic money institutions are regulated by the Law on Payment Services and Electronic Money, which specifies the payment services that a company that has received a license from the FCMC is entitled to provide, as well as cases where it is not necessary to obtain a license.

The FCMC makes a decision on the issuance of a license within three months after receipt of all necessary documents. The existing regulation in the field of payments is common in Europe, which in turn enables local FinTechs to operate throughout the EU, receiving a license in Latvia.

Open banking: If a licensed payment institution only provides an account information service, it is not required to have initial capital, while ensuring that the institution's equity is not negative. In order to provide an account information service and/or a payment initiation service, a payment institution needs to ensure its professional liability.

Comparison of service providers and requirements:

	Payment institution		E-money institution	
	Registration	Licence	Registration	Licence
Payment services	Money remittance Issue of payment instrument EUR 3 000 000 (maximum monthly payments)	✓	Money remittance Issue of payment instrument EUR 3 000 000 (maximum monthly payments)	✓
E-money issue	✗	✗	Closed loop only EUR 2 000 000 (maximum average amount of e-money in circulation)	✓
Area of the provision of services	In Latvia only Customers related to Latvia	EEA	In Latvia only Customers related to Latvia	EEA
Involving representatives	✓	✓	✓	✓
Own funds	The total sum of the items of the balance sheet section "Own the funds" is not negative	EUR 350 000	The total sum of the items of the balance sheet section "Own the funds" is not negative	EUR 20 000 - EUR 125 000 Insurance policy (if account information service or payment initiation service is provided)
Assessment of the acquisition of qualifying holding	Assessed at a reduced level i.e., there must be good repute	✓	Assessed at a reduced level i.e., there must be good repute	✓
Assesment of officials	✓	✓	✓	✓
Application of anti-money laundering requirements	✓	✓	✓	✓
Fee for examination of application	EUR 2500 EUR 450 if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level	EUR 5000 EUR 450 if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level	EUR 2500 EUR 450 if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level	EUR 5000 EUR 450 if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level
Fee for supervision (annual)	Not more than EUR 100 000 EUR 1000 + up to 1.4% (inclusive) of gross revenue related to the provision of services EUR 1000 for the first three years, if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level	Not more than EUR 100 000 EUR 7000 + up to 1.4% (inclusive) of gross revenue related to the provision of payment services EUR 3000 + up to 1.4% (inclusive) of gross revenue related to the provision of payment services (if only account information services or payment initiation services are provided (or both)) EUR 1000 for the first three years, if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level	Not more than EUR 100 000 EUR 1000 + up to 1.4% (inclusive) of gross revenue related to the provision of the e-money institution services EUR 1000 for the first three years, if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level	Not more than EUR 100 000 EUR 7000 + up to 1.4% (inclusive) of gross revenue related to the provision of the e-money institution services EUR 3000 + up to 1.4% (inclusive) of gross revenue related to the provision of e-money services (if only account information services or payment initiation services are provided (or both)) EUR 1000 for the first three years, if it is planned to provide an innovative service, i.e., a new or substantially improved payment service at Latvia's level
Period of examination of application*	1 month	3 months	1 month	3 months

Prepared by FCMC

Payment institution licensing guide:

Preparatory stage

- **A person** presents the planned business model (services, customers, countries)
- Provides information on the enterprise's shareholders and officials
- Provides general information on the origin of funds

- **The FCMC** informs about completing and submitting of documents
- Informs on the process of handling the application

- **The FCMC** carries out an initial assessment of the project to verify its possible complance with regulatory requirements and the possibility of continuing the process of obtaining authorisation

Submission of applicaton and its pre-examination

- **A person** submits a complete application and all necessary documents

10 working days
- The FCMC performs an examination of the completeness of the application:
- Whether it has been completed correctly
- Whether all documents and information have been submitted (by list) to start their examination in substance

- **A person** addresses shortcomings identified, if applicable
- Resubmission of an application and documents for verification of their completeness

- **The FCMC's** letter regarding the initiation of assesment of the application

Assesment of application

- **The FCMC** assesses the documents submitted
- If deficiencies are identified or additional information is needed, The FCMC organises the meeting and draws up a letter

- **A person** makes the necessary corrections and submits the missing information and documents

- **The FCMC** continues the assessment of the application
- If necessary, meetings are organised and a letter is drawn up on the remaining shortcomings

- **A person** makes the necessary corrections and submits the missing information and documents

Decision-making

- **The FCMC** finalises the examination of the application and prepares a draft decision

- The Board of **the FCMC** takes a decision on the issue of authorisation (with or without conditions) or refusal to issue authorisation

- **A person** receives authorisation and commences the provision of services

Prepared by FCMC

The E-money institution licensing guide comprises several steps:

Preparatory stage

- **A person** presents the planned business model (services, customers, countries)
- Provides information on the enterprise's shareholders and officials
- Provides general information on the origin of funds

- **The FCMC** informs about completing and submitting of documents
- Informs on the process of handling the application

- **The FCMC** carries out an initial assessment of the project to verify its possible complance with regulatory requirements and the possibility of continuing the process of obtaining authorisation

Submission of applicaton and its pre-examination

- **A person** submits a complete application and all necessary documents

10 working days
- The FCMC performs an examination of the completeness of the application:
- Whether it has been completed correctly
- Whether all documents and information have been submitted (by list) to start their examination in substance

- **A person** addresses shortcomings identified, if applicable
- Resubmission of an application and documents for verification of their completeness

- **The FCMC's** letter regarding the initiation of assesment of the application

Assesment of application

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Prepared by FCMC

Edvīns Draba
Senior Associate

Agneta Rumpa
Associate Sorainen ZAB SIA

The development of the local payment and electronic money market segment has been affected by the overhaul of the Latvian financial system that took place in the previous years, which is reflected in its current structure and future perspectives.

Over the course of the last several years, the local payment services market has shrunk in terms of the number of market participants, as a number of payment service providers gave up their licenses. The reasons might be various, however, it is obvious that a higher level of scrutiny applied by credit institutions with respect to payment service providers that are holding correspondent accounts with these credit institutions, along with stricter, more detailed legal, AML-related regulation pursuant to which credit institutions must supervise such payment service providers, have played its role in this process.

Nonetheless, the volume and total amount of transactions have stabilized and remained roughly the same for the last two years.

Currently, there are three electronic money institutions holding full licenses, whilst another three are registered electronic money institutions, i.e. they have received limited licenses allowing them to operate domestically, with restrictions on the volume of their operations and the types of services they are entitled to provide. There are five licensed payment institutions, whereas there are no registered payment institutions, i.e. holding a limited license.

Most of the institutions have obtained a license to service their own business needs or the business needs of their group entities, e.g. to ensure payment flow on an online marketplace platform operated by a related company without the necessity of engaging a third-party payment service provider.

Six licenses for the novel open banking categories of services - account information service and payment initiation service - have been issued so far. Although one of the goals of the introduction of these categories was to unlock an additional segment for non-bank entities within the payments market, licenses for these new types of services have mostly been issued to credit institutions, with only one non-bank entity among the licensees in Latvia.

There are indications that the licensing process has become smoother and faster in recent years, and the regulator is, even more, accommodating towards new institutions willing to enter the market. This, as well as initiatives such as the Regulatory Sandbox, are welcome signs that the regulator aims to take an active role in helping to develop a booming FinTech market, including the payment services market in Latvia.

Financial and Capital Market Commission

Regulation of crowdfunding services

Based on the EU crowdfunding regulation no. 2020/1503 In accordance with the national Law on Collective Financing, the FCMC has been designated as the competent authority for the registration and supervision of the activities of providers of collective financing services.

FCMC experts, together with colleagues from other EU regulatory authorities and the European Securities Markets Authority (ESMA), as well as the European Banking Authority (EBA), are working on Regulation and technical standards (RTS and ITS). The new framework essentially sets out the requirements and key principles of regulation, while RTS and ITS already set out more detailed requirements for complaint handling, conflicts of interest, business continuity plan measures, and procedures, licensing, default calculation, investor protection, and loss simulation, requirements to key investment information sheet and reporting, as well as notification to ESMA of national rules on marketing requirements. Crowdfunding services to be provided by a legal person who has obtained authorization granted by the FCMC.

Qualification requirements for the crowdfunding service provider:

- Persons involved in the management have adequate education and experience to manage the crowdfunding services;
- Persons involved in the management and in the case of shareholders holding 20% or more of their share capital or voting rights with good repute and no criminal record in accordance with the requirements of paragraph 3 of Article 12 of Regulation No 2020/1503;
- Provision of own funds of at least 25 000 euro or capital requirement (a quarter of fixed overheads in the previous year), if it is more than 25 000 euro, or insurance policy or a combination of own funds and insurance policy.

"From our first meeting, representatives of the regulator surprised us with their accommodating attitude, and to a certain extent, they felt interested in our business model and a desire to understand all the nuances of the crowdfunding business. When planning began, all possible resources were used for developing processes, policies, and documents. Step by step, we created drafts and blueprints for our procedure and policy. During this process, we learned a lot and created our business model to adapt as closely as possible to our vision. Our regular online meetings with the FCMC working group were extremely productive and allowed us to discuss conflicting procedures and details of the process. These discussions enabled us to quickly adapt our procedures and documentation to legal requirements. It was like working with another FinTech just from the public sector.

Work progressed quickly, and when we submitted our license application on May 16th, 2022, the CrowdedHero team also submitted our entire documentation package and the wait began. Even during this period, we had prompt discussions with FCMC representatives to resolve issues that were not fully finalized in the pre-check phase. Again, I must once again praise the FCMC's professional work. We know of many precedents in Europe where the registration process for a similar business takes nine months. In our case, it was only three months before we heard the long-awaited news: "The FCMC issues Latvia's first EU-wide crowdfunding service provider permit to SIA CrowdedHero"."

Jānis Blaževičs
CEO and co-founder of Crowdedhero

Process of obtaining authorisation:

Preparatory stage	Submission of applicaton and its pre-examination	Assesment of application	Decision-making
• **A person** presents the planned business model (services, customers, countries) • Provides information on the enterprise's shareholders and officials • Provides general information on the origin of funds	• **A person** submits a complete application and all necessary documents	• **The FCMC** assesses the documents submitted • If deficiencies are identified or additional information is needed, The FCMC organises the meeting and draws up a letter	• **The FCMC** finalises the examination of the application and prepares a draft decision
• **The FCMC** informs about completing and submitting of documents • Informs on the process of handling the application	**25 working days** • The FCMC performs an examination of the completeness of the application: • Whether it has been completed correctly • Whether all documents and information have been submitted (by list) to start their examination in substance	• **A person** makes the necessary corrections and submits the missing information and documents	• The Board of **the FCMC** takes a decision on the issue of authorisation (with or without conditions) or refusal to issue authorisation
• **The FCMC** carries out an initial assessment of the project to verify its possible complance with regulatory requirements and the possibility of continuing the process of obtaining authorisation	• **A person** addresses shortcomings identified, if applicable • Resubmission of an application and documents for verification of their completeness	• **The FCMC** continues the assessment of the application • If necessary, meetings are organised and a letter is drawn up on the remaining shortcomings	• **A person** receives authorisation and commences the provision of services
	• **The FCMC's** letter regarding the initiation of assesment of the application	• **A person** makes the necessary corrections and submits the missing information and documents	

Prepared by FCMC

Regulation of investment platforms

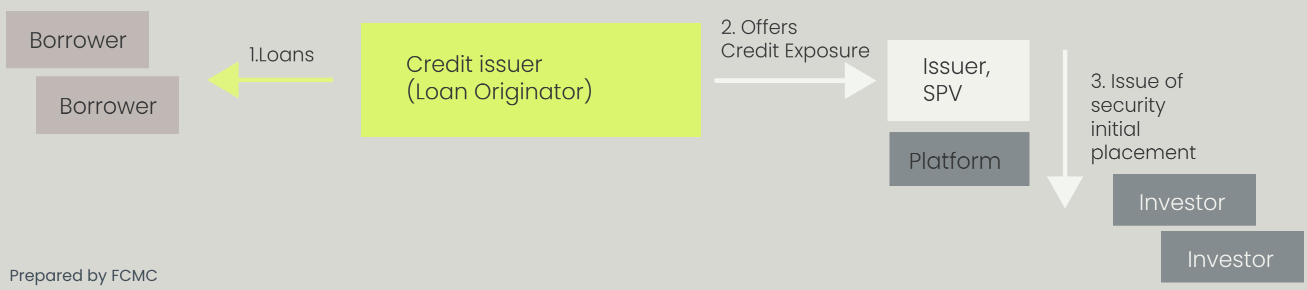
An investment brokerage company that provides investment services shall comply with the Financial Instruments Market Law, the enactments of the FCMC-issued administrative acts, as well as internal policies and procedures.

An investment brokerage company that provides investment services with financial instruments listed on a regulated market shall also comply with the rules of the relevant market operator. The minimum initial capital of an investment brokerage company is from 50,000 to 730,000 euros, depending on the chosen types of investment services. The FCMC shall make a decision regarding the issuance of a license within six months after all the documents required for making a decision specified by law have been duly executed and received.

Investment platforms offer to place money in loan instruments. The investment platform model that is common in Latvia differs from the traditional peer-to-peer lending platforms because of the marketing of the right of action to previously issued loans.

Consequently, in order to enable business activity on the investment platform where such debt securities are offered to investors, credit issuers and online platform providers have to obtain a license to operate a credit institution or investment firm in accordance with the Credit Institution Law or Financial Instruments Market Law.

The FCMC issues licenses and supervises the functioning of this segment, thereby supporting and monitoring the functioning of understandable and transparent investment platforms.



Prepared by FCMC

License for provision of investment management services

1 Prior to obtaining a licence

The meeting of a market participant with the FCMC during which the market participant presents information on the platform business model and the FCMC assesses the possibility of granting a licence.

2 Submission of application

The market participant prepares and submits the necessary documents for examination to the FCMC.

3 Assesment of application

The FCMC assesses the application and the market participant makes adjustments, if necessary. Time limit for examining the application - six months.

4 Receipt of application

The meeting of a market participant with the FCMC during which the market participant presents information on the platform business model and the FCMC assesses the possibility of granting a licence.

Prepared by FCMC

Sorainen ZAB SIA

Latvian investment platforms have evolved over time. Initially, they positioned themselves as peer-to-peer lending platforms and operated outside the conventional financial services legal framework, while now they have become fairly traditional financial market participants – investment brokerage companies.

The investment platforms have been operating by offering their clients to invest in loans issued to third parties like companies or consumers. This has usually worked by a trilateral assignment agreement between the lender, the client, or the investor and the platform. The investor was entitled to the proceeds of the loan or a fraction of it. Pursuant to the position of the FCMC, this type of activity was not specifically regulated until 2017. Now, depending on the specifics of the business model, peer-to-peer lending platforms fall within the investment services provision regulation.

This is a fairly complex undertaking as it requires observing a range of regulatory requirements. In 2021 and 2022, five investment platforms obtained investment brokerage company licenses, taking the next step both in terms of services provided and regulatory requirements. These companies have switched or are in the process of transition from the mentioned assignment model to the model of the financial instrument, where the clients-investors invest not in the loan itself, but in notes issued on the basis of the loan or package of loans. This model offers broader security for the clients who as investors within the meaning of financial instruments and investment services regulations are entitled to compensation (up to EUR 20,000) in case of the investment platform's insolvency or inability to fulfill its obligations. Whereas for the market participants themselves this means additional administrative and financial burden, which makes this type of financial services area suitable for more mature investment platforms as has also been proven in practice. The platform operators which have taken the next step and have become fully-regulated investment brokerage companies have a sound reason for doing so: the licensed status allows for a broader scope of services that the firms may provide and thus more market potential. Investment platforms are also fully fitted with the "tech" part of the FinTech sector as evidenced by the user-friendly platforms that they are operating as well as innovative types of investment instruments.

Financial and Capital Market Commission

Crypto-asset service regulation

In Latvia, there is no specific national framework for obtaining authorization for crypto-asset transactions. Depending on the business model, the possibilities for using crypto-assets, and classification, issuers and/or service providers are subject to the legislation existing in Latvia, which determines that the issuers and service providers are subject to certain financial sector regulations and requirements for the licensing process. In order to provide virtual currency services: its issuance, holding, and settlement, a special permit is not required, at the same time the service provider must register with the SRS and comply with the requirements of the Law on the Prevention of Money Laundering and Terrorist and Proliferation Financing. In case the virtual currency assets management company intends to perform activities comparable to the regulated market in Latvia, it must obtain one of the operating permits in the area of competence. For more detailed information, see the explanation issued by the FCMC on the possibilities of using virtual assets and the initial supply of virtual currency (hereinafter also ICO) and the applicable regulation. The explanation provides information on the use and application of the ICO, the applicable ICO regulation, and information for ICO organizers and investors.

On 24 September 2020, the European Commission (EC) published a proposal on the regulation on crypto-assets or MiCA (Regulation on Markets in Crypto Assets), in December 2021, the European Union (EU) Council adopted a compromise text on the Regulation. Following the entry into force of the MiCA framework in Latvia, depending on the classification of crypto-assets, two-way regulation will be applied, namely the new MiCA framework and existing legislation at the EU level (e.g., MiFIDII and PSD2) and at the Latvian level (e.g., Financial Instruments Market Law).

The MiCA regulation will apply to legal and natural persons and businesses involved in crypto-asset issuance, offers to the public, admission to trading or providing services related to crypto-assets in the EU, and any transactions or activities related to crypto-assets.

The aim of the MiCA framework is to create a completely new and unitary crypto-asset regulatory regime in all EU Member States, to promote innovation development and wider use of DLT while maintaining financial stability and protecting investors against risks. The implementation of these MiCA objectives will allow, in a safe regulated environment, for the development and expansion of the number of companies working in the fast-growing crypto-asset sector in Latvia.

The MiCA regulation applies to all types of crypto-assets which are not covered by any of the existing EU national legislation governing financial services, including asset-referenced tokens, e-money tokens, and other crypto-assets other than asset-referenced or e-money tokens.

Asset-referenced tokens

This type of crypto-assets that is not an e-money token and its purpose is to maintain a stable value by reference to any other value or rights or a combination thereof, including one or several official currencies. An example of this type of crypto-asset is a relatively new type of crypto-assets, stablecoins. They may be pegged to a specific currency (such as the US dollar, or the euro) or a basket of currencies, or to other types of crypto-assets or their basket, with a view to reducing price volatility.

E-money tokens

This is a type of crypto-asset that purports to maintain a stable value by reference to the value of an official currency of one country and, like electronic money, is used for settlement or for the purpose of maintaining a stable value.

Other crypto-assets, other than asset-referenced or e-money tokens

This crypto-asset group covers a wide range of crypto-assets, including utility tokens, which provide digital access to a good or a service supplied by the issuer of this token.

The MiCA Regulation does not apply to crypto-assets that are unique and non-fungible by other crypto-assets, as well as crypto-assets classified as:

- financial instruments governed by Directive No 2014/65/ES on financial instruments markets (MiFID II);
- deposits, including structured deposits;

- funds not classified as e-money tokens governed by Directive (EU) No 2015/2366 on payment services in the internal market (PSD2);
- others (e.g., life and non-life insurance products, pension products).

The MiCA Regulation does not apply to the European Central Bank or EU national banks. The MiCA Regulation will provide legal clarity and certainty for crypto-asset issuers and crypto-asset service providers, by defining:

- transparency and disclosure requirements for crypto-asset issuance, offers to the public, and admission to trading (admission to trading);
- the procedures for the authorization of crypto-asset issuers and service providers and their subsequent monitoring;
- the activities, organization, and management requirements of crypto-asset issuers and service providers.

The MiCA Regulation will allow passporting operators authorized in one EU Member State to provide their financial services in all EU countries. The MiCA Regulation covers certain requirements and measures that will provide protection for crypto-asset holders and clients of service providers (capital requirements, asset storage, mandatory complaint storage procedures available to investors, and investor rights against the issuer).

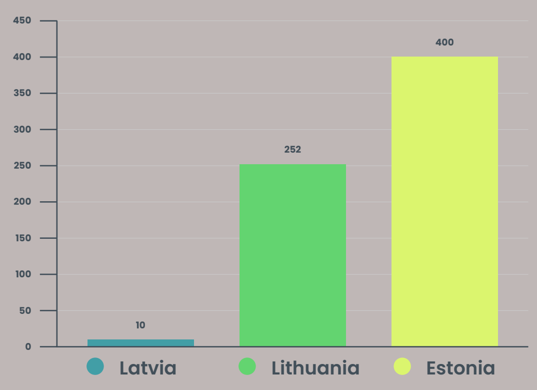
Sorainen ZAB SIA

There are only 10 registered virtual currency services providers in Latvia, while the numbers in the neighboring countries Lithuania and Estonia are far higher.

Several factors have hindered the growth of the Latvian crypto space in the past. First, as mentioned, there is no sector-specific regulation or licensing mechanism, at least until the MiCA Regulation gets adopted. Market participants have stressed that this is a major obstacle to developing a mature market for crypto services. Second, crypto-related businesses have been considered to pose a higher AML risk level, so considering this as well as an overall tendency to decrease AML risks in the past years in the Latvian market, traditional financial markets participants like credit institutions have been reluctant to cooperate with cryptocurrency services providers, which has to lead the crypto businesses to seek for banking services outside Latvia. Finally, there is a lack of understanding of the crypto area from both regulators and traditional financial services providers.

Meanwhile, there is a potential for the development of the crypto market in Latvia that legal advisory services providers are aware of. First, there are known crypto ventures based in Latvia that are not registered with the SRS as they provide no services within Latvia and thus are not required to. Second, businesses operating in the crypto sphere show interest to enter the crypto services market in Latvia. Also, Latvian fintech market participants originally provide

Number of virtual currency services providers in the Baltic States



their services in traditional currencies every now and then consider introducing some elements of blockchain or cryptocurrency in their operations. So, there seems to be sufficient willingness from the potential market participants to grow the crypto-services market in Latvia.

Considering the new planned EU-wide MiCA regulation, the mentioned market potential in Latvia in respect of crypto, as well as the arguably superior ability to navigate AML rules by both the regulators and financial sector participants, **Latvia is well-placed to become a crypto powerhouse.**

Martins Benkitis
CEO and co-founder of Gravity Team

It is important to understand that crypto companies are very flexible in terms of their location. Usually, the entire business is virtual, remote work is the norm and the services provided tend to serve a global audience. So crypto companies can be quite picky and actually shop for the best jurisdiction to incorporate their business, custody of the funds, and hire the best talent. Every government that wants to attract crypto money (the market cap is roughly 1.09 trillion dollars as we speak) should embrace the fact that governments are competing for companies and not the other way around. So I would propose the following:

Enable crypto tax payments. This is great for many reasons:

a) The strongest and shortest signal to show that the government welcomes crypto businesses.

b) Would make headlines all around the world and be a great marketing tool to get heard. This would be an actual innovation that no other country has done in full capacity.

c) Would ease up the convenience of doing business with crypto massively and would pave the way for a completely self-custodial financial system.

Enable a simple, client-focused licensing process for MiCA. MiCA is coming in 2024, and most crypto businesses in Europe will have to abide by it. This presents an opportunity for governments to attract successful businesses and build awareness and understanding of crypto among other financial institutions, especially banks. Right now banks in Latvia have no or very low-risk tolerance for crypto businesses. In reality, there is a massive opportunity given the proper risk assessment and tailoring AML practices to crypto.

IT Security risk management framework

Financial and Capital Market Commission

IT security in the financial sector regulated by the FCMC is determined by the FCMC Regulations "Information Technology and Security Risk Management act" Nr 150. The aim of the rules is to reduce to an acceptable level the risks of information technology used for the operation of market participants and the provision of customer services and to improve IT and security management, generally aiming at a prudent level of risk management (risk appetite), as well as common structured IT and security management requirements for market participants. The Regulations are binding on all financial and capital market participants supervised by the FCMC.

In September 2020, the European Commission published a draft Digital Operational Resilience Act (DORA). DORA is part of the European Commission's digital finance strategy, which aims to support the development of digital finance while reducing the associated risks. The legislative proposal builds on existing IT risk management requirements already developed by other EU institutions and links together a number of recent EU initiatives on IT incident reporting, security testing, and third-party service management to create a harmonized approach across the EU financial services industry.

DORA will cover a very wide range of financial institutions, including credit institutions, payment institutions, electronic money institutions, investment and investment brokerage firms, virtual asset service providers, alternative investment fund managers, insurance and reinsurance companies, insurance intermediaries, and crowdfunding service providers. Importantly, DORA will establish a number of additional requirements for incident reporting, security testing, and third-party service management. The implementation of DORA will also bring critical IT third-party service providers, including cloud service providers, under the supervision of the European Supervisory Authorities for the first time, including the possibility for EU institutions to take administrative action and sanction an IT service provider for non-compliance.

DORA requirements can be divided into four basic directions:

- **IT risk management.** This includes harmonizing the requirements of IT risk management legislation based on common guidelines, such as the IT and security risk guidelines issued by EBA.
- **IT incident reporting.** This direction aims to harmonize the incident reporting framework, including incident classification and reporting requirements. This will give financial institutions and regulators a better idea of new risks, threats, and the ability to exchange information.
- **Risk management of third-party ICT service providers.** This direction also requires third-party critical IT service providers to be subject to regulatory requirements.
- **Operational durability testing.** This includes harmonizing and standardizing digital operational resilience testing requirements - with a risk-based approach, companies should implement assessment, testing, methodologies, solutions, and tools that are appropriate to the size, business, and risk profile of the organization.

The DORA framework is currently being examined through the EU legislative procedure, and there are likely to be minor changes to the DORA framework before the new framework is finalized and enters into force. The final version of DORA is expected in the next 18 months. Companies in the financial sector need to start assessing today how the new regulation will affect their IT risk management system and plan the necessary measures to comply with the DORA regulation.

Consumer crediting

Sorainen ZAB SIA

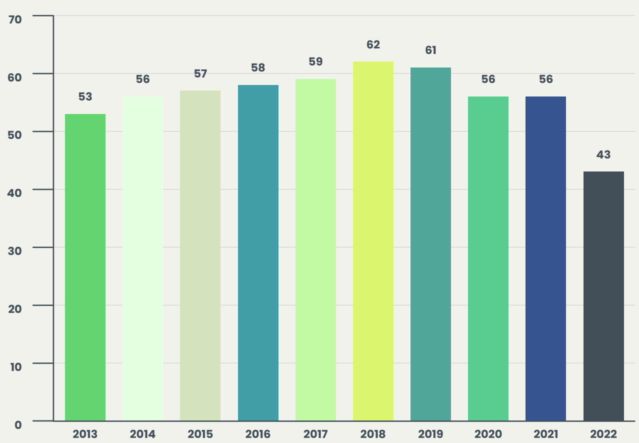
Consumer crediting sector has had a long and remarkable history in Latvia. It is also a particular FinTech sector due to the fact that the supervision of the area of consumer finance is performed by the Consumer Rights Protection Centre, unlike other financial services which are within the purview of the FCMC. Initially, it was little regulated, namely, by one, a brief article in the Consumer Rights Protection Law and by accompanying regulations. Apart from traditional credit institutions, there were numerous consumer crediting market participants (above 60 non-bank lenders at the peak), diverse in their size and the provided services – short-term consumer lending, distance consumer crediting, credit in exchange for a pledged movable asset or a mortgage, leasing services. Services such as short-term unsecured loans were easily accessible and prominent in the media.

Now, the sector is highly regulated, and the various requirements and restrictions have changed the regulatory playing field. This has led to changes in the offered products, with more focus on longer-term loans and lines of revolving credit as opposed to short-term consumer loans which were the consumer credit providers' bread and butter initially. While the market was very vocal and active in opposing the legislative changes, for now, these restrictions are in effect and the consumer credit providers are adapting to the new situation.

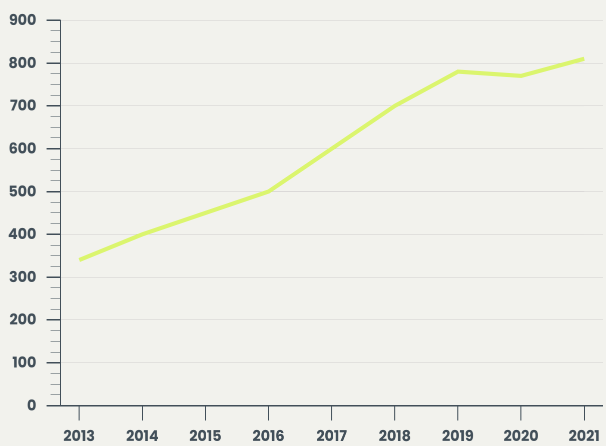
As the result, there has been a consolidation of consumer credit market participants (currently there are 39 non-bank lenders) and arguably, this has also led to less competition that favors the larger non-bank creditors and traditional credit institutions that also provide consumer credit services. Also, while the provided scope of services is the same as during the prime years of consumer crediting, for specific services there are only a few companies still specializing in providing them, such as credit in exchange for a pledge on movable asset.

The sector predates the notion of FinTech, however, the inclusion of non-bank lending in the FinTech sector is quite logical. Certain consumer credit providers were innovators in the finance sector when it came to providing much simpler, user-friendly web-based platforms as compared to the i-banking systems of some of the traditional credit institutions in Latvia during the time. Possibly, focusing on the tech aspects of the financing business may provide the needed competitive advantage to the business that is more challenging to come by these days, as has been indicated by FinTech Latvia Association. Yet, even during challenging times, the consumer credit business is still a notable one and expanding, as evidenced by the numbers – 2021 was the record-setting year as the total value of credit portfolio for all consumer credit services providers combined exceeded 800 million EUR.

Number of non-bank consumer credting services providers in Latvia



Total credit portfolio of non-bank consumer credit services providers (mEUR)



FinTech and Startup Business Taxation Overview

BDO Latvia

Corporate income tax (CIT):

Taxation of profit distribution
CIT is levied on dividend distribution or other events that are considered profit distribution. CIT rate is 20% of the taxable base, which is the amount of profit distribution or deemed profit distribution. Prior to the application of the CIT rate, the taxable base is to be divided by a 0.8 coefficient.

Excessive interest expenses
If the received loan amount exceeds a sum that is equal to the amount of equity capital (share capital, reserves, and accrued profits) multiplied by 4, the interest calculated on the exceeding part of the loan is considered to be excessive and is subject to CIT.

Losses on debtors
The CIT taxable base includes the amount which has been created as a provision for doubtful debts and later included as a loss in the profit and loss statement, and the debt has not been recovered within 36 months from the day of the creation of the provision, or if the amount was initially included in the losses.

Related-party loans
Issuing loans to related companies may be subject to CIT:

- Loans issued to related persons are considered conditional distribution of profits in certain circumstances and are therefore considered objects to include in the taxable base for CIT purposes
- The provision does not apply to loans issued to subsidiaries or companies in which the lender has as low as 1% participation in the share capital of the borrower
- The issued loans are not included in the taxable base if they are issued by a licensed credit institution on general credit terms (not favorable to the related person in comparison to other clients), or if the issue of these loans follows the legislative acts regulating the operations of credit institutions.

Value added tax (VAT):

Financial services exempt from VAT
Services that are related to crediting, payment operations, and investments in equity, financial instruments, and securities, except the management of assets, are exempt from VAT and thus the input tax cannot be deducted by such businesses.

Provision of IT and other services required for FinTech and startups are within the scope of VAT creating input tax for the acquirers of such services.

If the company provides both taxable and exempt services, input tax can be deducted if separate records of acquired goods and services are kept or a revenue ratio for input tax purposes is used for the purposes of taxable and exempt transactions.

If services supplied abroad are considered to be electronically supplied, there may be an obligation for the supplier of the services to register for VAT purposes in the country where these services are provided.

State support and tax relief programs for start-ups:

Exemption of salary income for start-up employees

If a company takes part in either the fixed payment or highly qualified employee attraction aid program, or both, for the duration of their participation in the aid program an employee of the start-up company is exempt from personal income tax if a fixed payment has been made for the income amounting to two minimum salaries subject to a payroll tax obtained from employment in the start-up company.

Employee Stock Options:

Issuing shares under employee stock options is generally subject to personal income tax as a fringe benefit of employment, however, by meeting certain criteria such income may be subject to an exemption. The criteria are:

1. Minimum holding period of these stock options must be at least 12 months;
2. The employee has been in employment with the enterprise issuing the stock option for the whole 12-month period;
3. Options are implemented no longer than 6 months from the day when employment relations are terminated;
4. The employer who has issued stock options to the employee has not issued a loan to the respective employee;
5. The company has submitted information about the stock options to the tax authorities.

The emergence of start-ups, especially in the Financial Technology industry, has made it important for the new companies to be aware of the taxation aspects specific to the industry. This information includes the summaries of different taxation aspects that FinTech companies may face particularly at the start of their operations in Latvia and while attracting investments. The data does not cover payroll taxation aspects since there are no substantial differences from other businesses.

Corporate Income Tax

A 2018 tax reform changed the principles of application and calculation of the corporate income tax. Unlike the previous model, as of 1st January 2018, corporate income tax is now payable at the events of the distribution or conditional distribution of profits, among other changes. The corporate income tax rate is 20% of the taxable base, however, prior to the application of the corporate income tax rate, the taxable base is to be divided by a coefficient of 0.8.

Apart from several obvious taxable items such as dividends (including intermediary dividends), a capital decrease from capitalized profits, etc., certain aspects of applying corporate income tax may not be that straightforward and could bring surprises at the end of the financial year as the final corporate income tax return for the year is drawn and filed to the tax authorities.

Some of the most important aspects of the application of the deemed profit distribution concept in Latvia for corporate income tax purposes are summarised in this article.

Corporate Income Tax on excessive interest expenses

In certain circumstances, interest expenses for received loans may be subject to corporate income tax for Latvian taxpayers. This is due to limitations on excessive interest expenses, or the so-called thin capitalization limitations. The rules under the previous corporate income tax system have disallowed the deduction of excessive interest payments as an expense for corporate income tax purposes. Under the current system, however, such excessive interest payments become simply taxable and corporate income tax is to be paid on the portion of interest payments that exceed specified limits.

The most common option to fund startup operations is to receive loans in exchange for interest. However, according to the Corporate Income Tax Law, if the received loan amount exceeds a sum that is equal to the amount of equity capital (share capital, reserves plus accrued profits) multiplied by 4, the interest calculated on such an excessive part of the loan is considered to be excessive and is subject to corporate income tax. This does not apply to the loans received from banks or other licensed financial institutions.

An important feature of the equity calculation for the above purposes is that it is measured not at the end of the year when the interest is calculated and/or paid, but rather on the 31 December of the preceding financial year. In most cases, new businesses have a minimum share capital and generate losses in the first periods of their operations.

Therefore, if a startup company (or other new business in Latvia) obtains loan funding that exceeds end equity for its previous year, this will already result in a corporate income tax payment at the beginning of operations on the amounts that are essentially business expenses from an economic standpoint.

1 mil. attracted funding	1/5 equity investments (an increase of share capital)
	4/5 in loans or debt instruments

- Proposed solution: if, for example, a company aims to obtain €1 million in investments, it would be wise to consider that 1/5 of the total investment or €200,000 would be invested in the share capital, letting investors receive dividends in return, whereas the remaining 4/5 of the total investments, or €800,000, are provided in the form of loans. In response to the Covid-19 pandemic, an exception with the application of the limitation on excessive interest payments was made. The Law on the Suppression of Consequences of the Spread of Covid-19 Infection stipulated that corporate income taxpayers shall not apply the provisions of the Corporate Income Tax Law relating to the limitations of the excessive interest payments made in the reporting year which starts in 2021 and 2022, therefore effectively not including the excessive interest for these loans in the taxable base for the corporate income tax for the respective years. It is not expected that a similar exemption will be provided for 2023 and subsequent years.
- A substantial proportion of Latvian FinTech businesses represent different forms of consumer lending peer-to-peer platforms, often operating a large number of issued loans, and loan assignments and often transferring substantial amounts of interest payments to individual investors. It would be interesting to consider whether these interest payments also fall under the limitations of excessive interest payments.

In conclusion, when it comes to corporate income tax regarding excessive interest payments, new FinTech companies have to pay attention to the fact that the equity/debt ratio for them is typically lower (and often the equity is even zero or negative), potentially giving rise to limitations on excessive interest payments. Both new and established FinTech companies should evaluate the number of necessary funds for their activity as it may be more efficient to ask investors to invest part of the investments into share capital, especially if the business is new.

Writing off bad debts

- FinTech companies, especially the companies that operate in the credit industry, can find themselves in a position where they have issued loans to many debtors, some of which may be considered doubtful debts for which provisions are made in the balance sheet, or appear to be bad debts that are written-off as losses.
- The taxable base includes the amount which has been created as a provision for doubtful debts and later included as a loss in the profit and loss statement, with the debt not recovered within 36 months of the day the provision was created, or if the amount was included in the losses initially.
- This, however, does not apply to the following:
  - The provisions for debtors created by credit institutions and savings and loan associations or the write-off thereof directly in losses that have been established in accordance with the requirements of the International Financial Reporting Standards or the procedures for creating provisions laid down in the regulatory provisions of the FCMC;
  - The provisions for debts of debtors created by the development finance institution, including the guarantees issued in respect of these provisions (including export credit guarantees), investments in risk capital funds and loans issued in respect of the provisions by implementing support and development programs.

Loans to Related Persons and Affiliates

If the company is established as part of a group, it is likely that the company will not just receive loans from related persons, but may also issue loans to other companies in the group in order to optimize cash flow within the group. Thus, it is important to note the situations in which issued loans may also be included in the taxable base, and in which cases the tax is not applicable.

- Loans issued to related persons are considered conditional distribution of profits and are therefore considered objects to include in the taxable base for corporate income tax purposes, provided the duration of such loans exceeds 12 months and the lender has undistributed profits in the previous financial year.
- The provision does not, however, apply to the loans issued to subsidiaries or companies in which the lender has as little as a 1% participation in the share capital of the borrower.
- The loans are also not included in the taxable base if they are issued by a licensed credit institution on general credit terms (not favorable to the related person in comparison to other clients), or if the issue of these loans follows the legislative acts regulating the operations of credit institutions.

Value Added Tax (VAT)

FinTech companies, although generally operating in the same financial and technology sector, provide a large array of products and services, some of which are exempt from VAT, while others are subject to VAT.

For FinTech companies, when it comes to value-added tax, it first needs to be clarified whether the provided service is subject to or exempt from VAT, as this determines whether the FinTech company will charge VAT on its services and whether it can deduct any input tax that the company has incurred. It is often difficult to define the provided services for VAT purposes. Often, FinTech companies have financial and payment institutions as clients, who in turn mostly provide exempt services, and their rights to deduct input tax are limited, generating additional cost in the form of a non-deductible input VAT.

For example, services that are related to crediting, payment operations, and investments in equity, financial instruments, and securities, except asset management, are exempt from VAT and thus the input tax cannot be deducted by such businesses. However, the provision of IT services is within the scope of VAT and therefore input tax can be deducted with respect to these services.

If the company provides both taxable and exempt services, input tax may be deducted if separate records of acquired goods and services are kept or a revenue ratio for input tax purposes is used for the purposes of taxable and exempt transactions.

When determining whether a service is subject to or exempt from VAT, it is presumed that VAT is applicable to any services that the VAT payer provides in return for remuneration, and any exemption requires a specific reason. Exemptions are therefore determined not just for how the service is provided or what legal terms and conditions apply to the service, but also by examining the essence of the service.

If a transaction includes several services, it is important to understand whether the bundle forms a single service or whether they are separate transactions. If the services can be considered within the bundle of services as separate, independent services, each of these services can have a different VAT application, based on their nature.

In cross-border transactions involving various jurisdictions, the location where the services are provided for VAT purposes might not coincide with the place where the service provider is registered. In cases where the services are provided remotely to non-VAT payers (for example, individual consumers), special rules on the provision of electronically-supplied services may apply.

State Aid and Tax Relief Programs for Startups

Many FinTech companies qualify as start-ups, having started their operations fairly recently with limited resources. The State of Latvia provides assistance for the development of start-ups through programs managed by the Latvian Investment and Development Agency (LIAA).

The Law on Aid for the Activities of Start-up Companies sets out two main aid programs for start-up companies: an aid program for fixed payments and an aid program for attracting highly-qualified employees.

The law also lists criteria for participation in these programs. The criteria include:

- a qualified venture capital investor who is not a person related to the start-up company (a qualified venture capital investor who repeatedly makes an investment in one and the same start-up company shall not be regarded as a related person) has, within 24 months of the day when the application for participation in an aid program was submitted, made an early stage venture capital investment of at least €30,000 for the implementation of the submitted business idea or an investment of at least €15,000:

  - in a start-up company;

  - in a parent undertaking or a subsidiary of a start-up company which meets the criteria laid down in Paragraph two of this Section;

- the tax debt of the start-up company does not exceed €150;
- insolvency proceedings have not been initiated for the start-up company.

For the duration of their participation in the aid program, if a company is part of one or both of the previously mentioned aid programs, an employee of the start-up company is exempt from personal income tax if a fixed payment has been made for their income subject to a payroll tax obtained by the start-up company.

However, if an employee does not pay personal income tax for the income subject to a payroll tax obtained by the start-up company during the taxation period in which he or she has been an employee of the start-up company, then this employee is not eligible for the annual non-taxable minimum (this may be applied to a pension income only) and a relief for dependent persons, and they themselves may not be a dependent person in accordance with the Law On Personal Income Tax. An employee of a start-up company who earns other income subject to personal income tax is not entitled to include State Social Insurance payments and solidarity tax payments from earned income from a start-up company, as well as eligible taxation year expenditure, in eligible expenditure.

Employee Stock Options

With more startup companies using employee stock options as a way to attract a highly qualified workforce to their company, it is vital to take into account the taxation aspects regarding the issuance of stock options to employees.

Stock options for employees of FinTech companies are available if the FinTech company is established as either a joint stock company or a limited liability company. In general, the stock options are subjected to personal income tax and corporate income tax as distributed profits and personal income. However, if certain criteria are met, these stock options are exempt from taxation, therefore allowing the companies to consider the issuance of stock options without worrying about additional taxation expenses.

In order to apply for the tax exemption on stock options, a plan for the implementation of the stock purchase option must first be created and submitted to the State Revenue Service (SRS) (including in the event of a change in the stock option plan). Additionally, several criteria must be fulfilled for the exemption from taxation to be applicable.

Criteria for the application of a tax exemption

1) Minimum holding period of these stock options must be at least 12 months;

2) During the minimum period for holding the stock purchase option the employee is in an employment relationship with a capital company which has granted the stock purchase option to the payer or a person related thereto within the meaning of the law On Taxes and Fees has granted the stock purchase option to the payer;

3) The employer has submitted the information regarding the plan for the implementation of the stock purchase option to the SRS;

4) The stock purchase option is implemented not later than within six months from the day when an employment relationship has been terminated between the payer and the employer (a capital company which has granted the stock purchase option to the payer or which is a person related to the employer within the meaning of the law On Taxes and Fees);

5) A capital company which has granted the stock purchase option to the payer or a person related thereto within the meaning of the law On Taxes and Fees has failed to grant a loan to the payer which has not been repaid by the moment of implementation of the stock purchase option, except for loans which are granted by a:

- credit institution,
- Development Financial Institution,
- savings and loan company, or
- capital company which has received a special permit (licence) for the provision of consumer crediting services,

unless the specific loans are granted for the purchase of the stock of the lender itself in implementing the stock purchase option.

Regarding the time when income is earned, it is important to note that the obligation to withhold the personal income tax applies to the employer according to the Law on Personal Income Tax. It is presumed that income is earned on the day the stock option is implemented. If according to the stock option implementation plan, the employee alienates the stock option, the employer calculates the employee's labor tax and subsequently withholds it on the day the stock option is implemented, regardless of which person implements the stock option.

Conclusion

FinTech companies operating as lending intermediaries or launching a startup in Latvia may face certain limitations on the way the investments are attracted and the business is run stemming from existing tax regulations in Latvia.
Among other CIT-related aspects, structuring the company's debt-to-equity ratio is one important aspect to consider, since it impacts the company's tax position, particularly when the company is thinly capitalized and attracts substantial debt financing.

Application of a VAT exemption on financial services raises the issue of input VAT deduction for businesses that are engaged fully or partially in the provision of financial services, as input VAT creates costs for the customers and businesses.

At the same time, the regulations in place stipulate benefits for companies qualifying for the start-up support program as well as for companies issuing employee stock options. The benefits provide a substantial exemption on personal income tax on salary income and income in form of shares under the employee stock option program.

Rolands Mesters
co-founder and CEO of Nordigen

We started Nordigen as an analytics company in 2016 and it has certainly been an experience to be part of the Baltic startup community. There are countless reasons why Latvia is a fantastic place to start your journey as an entrepreneur and grow your business, with one of these being an unparalleled employee share option program that Latvian startups are able to offer to their employees.

Recruiting and retaining a team of highly-skilled and talented individuals is always a priority when trying to reach new business heights and build a lasting company. Share options enable us to make employees stakeholders in the company's success and ensure our employees feel deeply ingrained in the culture and foundation of the company.

Share option rules differ across various countries, with Latvia having the most beneficial regulations in the world according to recent findings by Index Ventures. In 2021, amendments were put forth that made the program attractive to employees. The most notable benefit of the Latvian share option law is the fact that the minimum vesting cliff can be 12 months after the option grant, which is super friendly to employees.

While share option plans were previously only available to large organizations with connections abroad, Latvian startups now have full capabilities to offer these sorts of plans as well, and with little effort.

These recent amendments to option law made share options incredibly attractive to both employers and employees, and for us, it helped to create lasting working relationships between the company and our employees. More broadly, share options are a fantastic way to help employees feel a sense of ownership, motivate them to build their careers with us, and stay for longer periods of time. Over the last few years, we have been successfully growing our teams and bringing new, brilliant people on board who are helping shape our company and improve our customer offering.

Andis Priedītis
Deputy Director of Consumer Rights Surveillance Department at the Consumer Rights Protection Centre

Latvia has taken a similar path to other Northern European countries when it comes to developing financial technology. The development of computers and software brought momentum to the creation of new solutions and services, and Latvia was one of the first to develop alternative consumer financing. Like other new services, the path from idea to successful implementation was not easy, and some of the initial mistakes that were made became the basis for bringing the sector under specific regulation. This ensured a high level of consumer rights protection in an honest, transparent, and competitive market and became an efficient mechanism for monitoring consumer loan service providers.

Fourteen years have passed since we first heard of the need for regulation in 2008, and enormous progress has been made during this time, with initial goals having been accomplished. Over these years, we have not just specified a clear group of institutions that are allowed to operate consumer lending. We have also expanded legislation to stipulate strict regulation of solvency evaluation; debt history, credit information and statistics databases; advertisements; remote identification; and others. The most recent update was to implement full prevention of money laundering and terrorism and proliferation financing and international and national sanctions requirements regulation for the loan industry.
As an institution that monitors consumer lenders, including any FinTech services which offer this service to consumers, the Consumer Rights Protection Centre has worked not just as an industry overseer, but also as a source of advice and experience, giving recommendations on updating and developing the best practices. If the CRPC was initially viewed as an institution of power that got in the way of business, it later became a place where business owners often came for consultations on adhering to legislation and ensuring best practices.

As time went on, some of these businesses joined forces to create a specialized association, where they exchanged information and developed the sector together. The CRPC is pleased about this overall constructive collaboration, which has created a new, secure, and ordered sector and has encouraged other market players to develop and new services to emerge. That is, the initial uncontrolled, chaotic consumer loan environment created a large wave of debtors and was a catalyst for creating a licensed, regulated, effective, and monitored debt collection sector outside of the court system. Furthermore, the swift implementation of technological solutions in the consumer loan sector helped to update the services offered by credit institutions, who invested more resources in customer-friendly technology and software, and was the impetus for the creation of new services in Latvia, such as investment platforms or automated credit worthiness tools.

The CRPC is currently working on its existing priorities, such as evaluating creditworthiness and achieving honest commercial practice, in parallel ensuring that market players do not include unfair terms in their agreements, create advertisements that promote reckless borrowing, breach loan cost limits, or break any other regulations. We collaborate on expanding legislation in Latvia and Europe, such as with the new EU Consumer Credit Directive project and EU directives on the distance selling of consumer finance services, as well as on, for example, the Financial Sector Development Plan (2021-2023) and the National Strategy for Financial Literacy in Latvia (2021-2027), as well as offering commentary on the upcoming FinTech strategy (2022-2023), etc. Alongside its traditional task of ensuring a high level of consumer rights protection, the CRPC therefore also works on expanding regulation and requirements by implementing various strategies and normative objectives.

The CRPC expects the sector to keep evolving and invest in new solutions, the development of financial technology to create new challenges regarding funds gained on the global market, information and creditworthiness evaluation technologies to improve, and the use of more blockchain solutions in attracting financing and issuing loans.

We, therefore, expect new challenges in the consumer loan sector and hope that the CRPC and association will be two irreplaceable foundational elements of an orderly system that collaborate actively to ensure both industry growth and a high level of consumer rights protection, thus bringing about sustainable development in the FinTech sector.

Anastasija Oļeiņika
TWINO Investments Board Member

TWINO Investments is a regulated global investment and trading marketplace and the leading peer-to-peer lending platform in continental Europe. TWINO serves nearly 50,000 retail investors from 30 countries, enabling them to invest in consumer loans through the company's subsidiaries in Poland, Russia, Latvia, Vietnam, and elsewhere.

On August 31, TWINO received its license to provide investment services from the FCMC. This was a big day for TWINO, and here I share the path that took us there.

Latvia – the perfect launchpad for founding a FinTech business

Thirteen years ago, when Armands Broks started TWINO, it consisted of a small team of enthusiasts with little experience, enormous ambition, and a few Excel sheets to track the issued loans. Today, we are a global FinTech player. We are thankful for having been able to realize all of our earnest ideas in a supportive and tech-savvy environment.

A rapidly growing FinTech company such as TWINO can only thrive in an open startup ecosystem that welcomes and supports us when necessary. We have benefited greatly from access to local mentors and advanced tech knowledge, as well as events and incentives that support tech innovation.

Equally important, Latvia has quality tech talent and a moderate political and economic situation without instability or severe conflict risk that could be dangerous to businesses.

Last but not least, we are lucky to have an understanding and forthcoming regulator for the FinTech industry. During almost 2 years of cooperation with the FCMC, we have found them to be a supportive advisory institution.

Choosing a regulatory jurisdiction

Before starting the licensing process, we analyzed several potential markets, including our Baltic neighbors. At a first glance, it seemed that other Baltic countries had simpler requirements; for example, Lithuania advertised the opportunity to receive a digital banking license quickly and easily.

But with time, we found that Latvia's approach had subtly become much more flexible and open to innovation and cooperation. We were glad to see that the FCMC is open to seeking creative solutions in unprecedented situations, which is crucial for new industries that are often trailblazers in their niche – like innovative FinTech.

We support the Latvian regulator's approach of focusing on a clear and transparent business model when issuing licenses and monitoring market participants. Unlike regulators in many other countries without a single framework for the peer-to-peer market segment or where companies in this niche are allowed to operate unregulated, the FCMC's priority has been an effective, risk-based, and development-oriented monitoring of Latvia's financial sector. We are also convinced that this path gives our users greater protection.

FCMC license opening doors to more diverse and transparent operations

On August 31, 2021, TWINO received a license for the provision of investment services and investment ancillary services. This was a big day for us as becoming a regulated investment platform opened many doors for growth and development and made our business more credible in the eyes of our users and investors.

For more than a year, TWINO collaborated actively with the FCMC to secure this license, drafting the required procedures and making adjustments to how the platform operates. In this process, we received professional guidance and a forthcoming attitude.

The day we were finally granted our license for the provision of investment services and investment ancillary services was a day of great celebration and pride. The license will allow us to supplement our product offering with additional financial instrument trading such as stocks, bonds, CFDs, ETFs, and many more.

Moreover, licensing is a major step in promoting transparency in the entire industry. Investors will choose licensed companies over unregulated ones – in fact, we can already see a growing investor interest, thanks to the greater security and reimbursement guarantees that a regulated environment provides.

Mārtiņš Valters
COO/CFO and Co-Founder at Mintos

As part of its growth and development, Mintos decided to apply for licenses from the Latvian regulator to expand and improve its service offering. We decided to apply for two licenses — the Investment Firm (IF) license and the Electronic Money Institution (EMI) license — and submitted both at the end of March 2020, just at the start of the Covid-19 outbreak.

Pre-licencing

Even though submission of the license application is an important milestone, the work actually starts long before. Given our experience with a previous licensing process in 2015-2016 when we had just started operations, the key takeaway was that, even if you do receive external help from consultants or lawyers, you need to manage the whole process in-house and be on top of the things you put in the application and how it fits together. Therefore, we had a dedicated person for each license application this time, as well as a number of people both internally and externally helping to prepare the necessary documentation. Time-wise, the preparation took around 4-6 months for the EMI license and more than 6 months for the IF license, given the larger scope and greater number of unknowns due to our business model. After any larger project, we reflect internally on what has gone well and what could have been improved, and we did the same for the pre-license submission stage. Having clear ownership of the project was definitely one of the key success factors. In terms of what could be improved and advice for future applicants, I would first say to involve more of your team in this process, which diminishes the number of questions from the regulator during the licensing process. Second, I advise contacting people that have gone through the process recently (although, in our case, this was limited due to no recent licensing in the IF area).

Licencing process

We received both licenses in August 2021, 15 months after our application. For a high-growth start-up, this seems longer than expected. But is this really so? First, as we applied for two licenses, with some overlapping issues that were among the last to be resolved, it was obvious that we received both licenses at the same time. Having said that, resolving the questions raised and adjusting the application took significantly more time for the IF license given the specifics of our business, the model we proposed that was the first of its kind in Europe, and other factors. Thus, had the EMI license been a standalone project, I am very confident that it would have taken much less than 15 months. Second, when you look at the public information about the length of licensing processes in Europe — with a few exceptions for the EMI license which could be done in a very short period of time (although perhaps not anymore) — 15 months does not seem so excessive, especially for licenses like the IF.

Third, and this should be particularly encouraging for further applicants, I believe it can be done faster in the future. One factor mentioned above is that it involved a very specific business model, which took more time for us to explain and more time for the regulator to understand. Another factor is that the FCMC has processed a number of licenses over the last 2 years, increasing their knowledge of the process. I really appreciated that, after our licensing process was done, we were invited to a number of interviews to review the process and understand how to further improve it in terms of systems used to facilitate the process, the type of information requested, the way discussions are held, etc. This shows the regulator's determination to improve.

Cooperation with regulatory bodies

Post licensing

Of course, the story does not end at the moment when the license is received. This is merely the beginning, as things that have not yet been implemented must be brought into action to operate as a licensed entity.

Final remarks

Is licensing for a startup a big deal, and will startups change due to this? The question is probably broader than one initially thinks (involving more than just the license, submitting documentation, and then business as usual), but smaller than some wish to portray it as (with excess bureaucracy). If you have either of these extreme expectations, you will either underestimate what it takes to get a license or over complicate your thoughts on how to implement licensed operations.

New products

Even though licensing did take a significant part of our effort and focus, we were also looking into the future and how to expand our services. As a company working with retail investors and with a vision of building a multi-asset investment platform for European retail investors who want to build long-term wealth via passive investing, we were actively exploring ways to offer other investment opportunities besides loans. We ended up with a plan to offer easy, automated investing in ETFs. In this regard, the license comes in handy, as we are able to use the same license to provide this service to our customers without the need to look for a 3rd party intermediary or white label solution.

As Latvia is part of the European Union, it also means that we can passport our license across the EU without the need to set up any physical presence in other countries. We are going through this process in the coming quarters, and expect to be able to offer our services throughout Europe very soon.

Support Mechanisms

Easy access to the European market, availability of skilled IT talent, and affordable cost of living are just a few of the benefits enjoyed by startups operating in Latvia4. Latvia benefits from a number of initiatives that make the location attractive, including supportive startup regulations such as the Startup Law tax incentives, one of the most favorable stock option regulations in the world, and the recently introduced Nomad Visa, among other incentives.

The Investment and Development Agency of Latvia offers a wide array of support packages for startups in general, including support both for companies founded in Latvia, as well as relocation or investment support for companies considering relocating or opening a branch in Latvia. State support is supplemented by an extensive and active local startup community, offering knowledge sharing and networking opportunities, including meeting other participants and investors at one of many startup and FinTech events over the year. In 2022 FCMC and LIAA organized its first ever "FinTech Forum Latvia 2022". Which has been a big success to restart the FinTech industry. Visit our startuplatvia.eu website to know more about new events and open calls for FinTechs.

Support program overview

program: / facts:	Startup Law	Innovation Voucher	Promotion of International Competitiveness	Magnetic Latvia Business Incubators
How much money is available:	Up to 200 000 EUR*	Up to 25 000 EUR*, with 85% support intensity	Up to 40 000 EUR*, with 50% intensity	Up to 10 000 EUR*, with 50% intensity
Keywords for support program:	• State support for startup companies • Social and Income tax relief • Support for highly qualified employees	• Aid to merchants for the development of new products or technologies • Feasibility study • Certification and testing	• Manufacture aid • Export aid • Support for foreign exhibitions and more	• Business support for beginners • Development of business idea
Main criteria:	• Production manufacturing or development of an innovative idea • No more than 150 EUR tax debt • No ongoing bankruptcy	• New or updated product has proven demand or end result has proven advantages for business growth • Product has development plan until the final production	• Export potential • Signed agreement with LIAA • Compliance accoring to de minimis rule	• Company isn't more than 3 years old • Company applying for incubation cannot be a member of any other ongoing acceleration program
End date for program:	31st of October 2023 (support for highly qualified employees)	31st of October 2023	31st of October 2023	31st of October 2023

*Per one company

Anna Elsa Karika
Head of Startup Support at the Innovation and Technology Department Investment and Development Agency of Latvia

As the FinTech sector is booming globally and in the spotlight on the European stage, Latvia has approached the FinTech vertical strategically and opened room for discussion to tackle the challenge for all stakeholders to improve the regulatory framework and expand the necessary

[4] https://www.startupblink.com/startupecosystemreport

infrastructure. It is important to highlight the windows of opportunity where FinTech companies can take advantage of broader support mechanisms that are not necessarily industry specific but would increase national innovation levels and economic growth. The Investment and Development Agency of Latvia (LIAA) is working on improving state support mechanisms and collaborating with the other public and private sector players to ensure stable growth within the industry environment. An example practice that aims to bring together professionals with extensive industry experience and cultivate international collaborations is the first Latvia FinTech Forum in September 2022, co-hosted by the FCMC and the Investment and Development Agency of Latvia (LIAA).

LIAA support mechanisms for FinTech

Promoting international competitiveness (entrepreneurship)

Support program is for external marketing, export promotion activities.

Supported activities:

- Conformity assessment or certification of production sites and products- aid intensity 90%;
- Participation in trade missions and visits abroad of high Latvian state officials organized by LIAA- aid intensity 80%; Participation in national stands organized by LIAA- aid intensity 100%;
- Application for export support operations for export support operations planned for a calendar year (aid intensity 80%, total funding in calendar year 60 000 euro).

Knowledge sharing training to boost export capacity

Entrepreneurs have the opportunity to apply for support in the employee training activity "Knowledge sharing training to boost export capacity". Within the framework of this activity, based on the needs of merchants, training may be provided either by a partner company, or the merchant himself engages the training provider in compliance with the regulatory enactments in the feld of procurement procedure. Aid intensity from 50% to 100%. Funding is available up to € 75,000 per merchant.

LIAA export services

Within the framework of the LIAA an entrepreneur has the opportunity to receive information and consultations on foreign markets, as well as to request for possible selection of contacts of cooperation partners abroad. At present we have 20 foreign economic representations in 18 of the most promising markets for goods and services of Latvia. In cooperation with foreign representatives of the LIAA we organize the participation of companies in national stands in international exhibitions, trade missions, visits of public officials abroad, as well as provide support for individual visits to potential cooperation partners. In its turn within the framework of Latvian days, which is a wide-ranging marketing event covering business, tourism and culture abroad, we present products of Latvian companies in trade networks.

The Idea Cup

It is an opportunity to undergo professional training under the guidance of experienced entrepreneurs, gain valuable contacts for the further development of your business and finally compete for impressive cash prizes to get the first capital to realize the idea.

An entrepreneur can be anyone starting from the pupils who are of the age of 18 to the old age. The main criterion for assessment will be your enthusiasm and willingness to take on a new challenge in your life – start a business with an unprecedented business idea on a Latvian or global scale.

The LIAA invites the authors of ideas to apply with the team, because good teamwork is the basis of any success story. However, if the team is still in the development phase, it is also possible to submit individual applications.

Agnese Veckalne
Chairwoman of the Board at the Latvian Startup Association

In the last couple of years Latvia has started to take significant steps to support its startups.

The stock options regulation, enacted in early 2021, has been recognized as the most startup-friendly regulation in the world.

Enabling startups to effectively set stock option plans makes them much more attractive to potential talent, as well as adds legitimacy in the eyes of investors.

The Startup Law support mechanism allows new startups to significantly decrease their costs on employees and thus extend their runway, which can be crucial for their survival, especially in the early years. Both regulations play a large role in making Latvian startups more competitive on the international stage.

Nevertheless, we are still in dire need of making the process of relocating international talent to Latvia simpler. Instead of months, it should take only a couple of weeks. If we don't make the necessary changes, we will continue to see top talent relocating to our neighboring countries.

FCMC support instruments for FinTech

FCMC continuously develop the FinTech environment by expanding its support instruments – the **Innovation Hub and the Regulatory Sandbox.** Last year, the number of consultations at the FCMC's Innovation Hub increased by 30% for existing and new companies and idea makers planning to develop innovative financial services in Latvia.

At the Innovation Hub, FCMC experts advise on licensing, supervision, anti-money laundering, and other areas. Advice on the provision of payment services (29%) and crowdfunding (24%) are dominating. In addition to this, with technological developments in the financial sector, the number of companies active in the development of RegTech solutions has increased. Companies develop money-laundering risk management solutions, help automate the customer due diligence process and assessment of clients of financial institutions, check the reputation and help develop credit risk, assessment models. Last year, 18% of the advice provided by the Innovation Hub was in RegTech. There is also an interest in the provision of crypto-asset services (13% of advice).

In 2021, the FCMC expanded the Innovation Hub through regular thematic activities and dialogue with market participants in the areas of payment services, crowdfunding, and financial technology. Several hundred experts from the financial sector attended the seminars held by the FCMC last year. In addition, the FCMC experts shared their knowledge and experience in other events relevant to the FinTech sector.

In 2021, the FCMC **reviewed the licensing process** and introduced **a new approach – pre-licensing evaluation** in order to stimulate the development of the FinTech market. It is an opportunity for potential market participants to receive valuable guidance and recommendations already during the preparation of documents, thereby strengthening the quality and reducing the time for further licensing. Licensing guides for crowdfunding and payment and e-money service providers have been established to facilitate understanding of the licensing process and are available on the FCMC website.

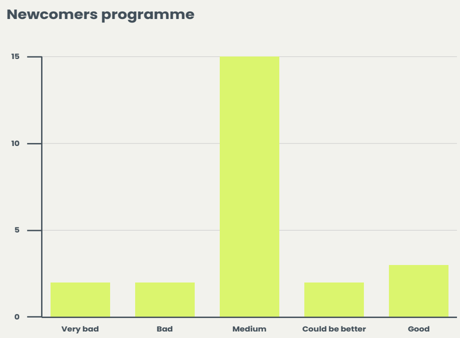
Market participants also have access to the FCMC **Regulatory Sandbox,** which provides testing of innovative financial products and services in a regulatory regime. The Sandbox gives the FCMC an opportunity to better understand financial service companies and technologies, as well as to identify and assess the risks associated with new services and business models that are not protected by the current regulation, and to ensure compliance with the regulatory framework. T he Sandbox makes it possible to identify legal obstacles that hamper the development and stability of new services, as well as to strengthen the stability of the financial system and protect the interests of service users.

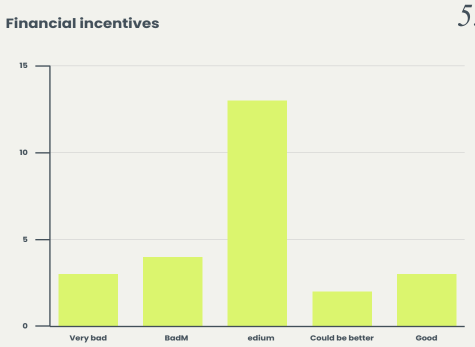
Both private companies and state and local government capital companies can apply for participation in the Securities Sandbox. There are no limitations as to what kind of financial instruments (shares or bonds) the potential issuers would like to use; companies that want to issue and offer their shares to investors, as well as companies that would rather choose the issuing of bonds to raise financing can apply for advice. It is also possible to choose which market is more suitable for the company – whether it is the regulated market with more stringent regulatory requirements or the alternative market where the regulatory burden is smaller.

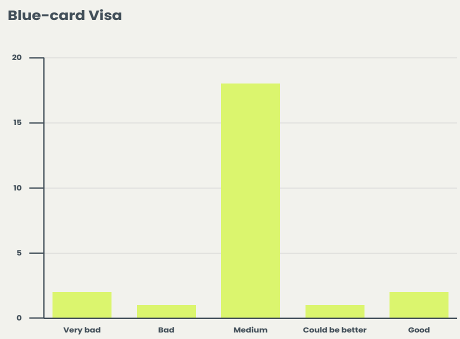
In 2022 FCMC launched **FinTechLatvia.eu** web-portal to support FinTech companies that have the power to change the financial industry as well as people's lives and behavior. The new tool is full of useful information and explanations for FinTech startups in payment, crowdfunding services, crypto asset management, and investment platform service areas. Please visit **FinTechLatvia.eu** to start a dialog with the regulator!

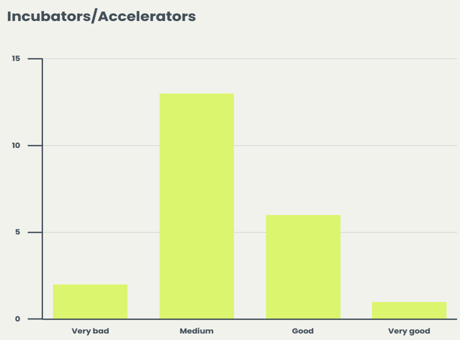
Feedback from market participants

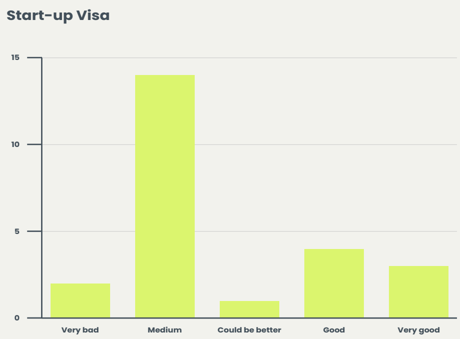
An overview of market participant feedback regarding the availability of support mechanisms in Latvia is rather satisfying since the majority of survey participants give average scores for all 6 available support mechanisms: incubators/accelerators, newcomers program, available sandboxes, blue card visas, startup visas, and financial incentives. The landscape of incubators and accelerators available to the market participants, as well as startup and blue card visas, are mentioned as some of the best available mechanisms, whereas available sandbox infrastructure and financial incentives have room for improvement.

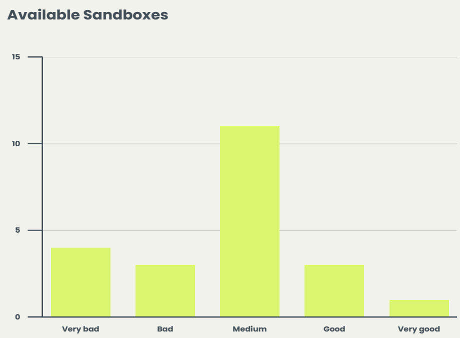












Capital Availability

FinTech companies in general can be said to look for more diverse sources of funding than startups in other industries, which usually rely on VC funding as the most common approach, at least until the later stages. Examples of startups listed on the stock exchange are rare not just in Latvia, but in the region as a whole.

Market capital

KPMG Law ZAB

Why do companies seek capital markets?

Capital markets in the Baltic States are slowly but surely gaining momentum and becoming more attractive to investors.

This growing popularity is due to the fact that capital markets offer diversified funding sources, investment opportunities, and risk sharing. Currently, for most small and medium-sized enterprises in the Baltic States, this opportunity is not yet as popular, and the investor culture is not yet as developed as in Western and Northern Europe. However, the companies are gradually embracing and mastering the opportunities offered by capital markets, and seeing recent initial public offerings in the Baltic States there is no doubt that people's interest in investing is steadily growing.

Highlighting challenges and opportunities

Challenges

Among the main reasons for the liquidation of companies is a lack of funding and the inability to attract it.

These are just a few of the challenges that companies can face:

- The bank finances existing assets and existing business - not growth
- The company does not have a stable cash flow
- The company has insufficient collateral to receive a loan
- Banks do not lend in difficult times
- Banks do not finance certain positions

As a company grows, it needs to be able to support itself with alternative sources of finance. Otherwise, the company's development will be limited - it will only be able to grow as much as the banks are willing to finance.

- Daiga Auziņa-Melalksne
Chairwoman of the Board, Nasdaq Riga Stock Exchange

Opportunities

NEO Finance AB is a Lithuanian FinTech start-up company that is engaged in peer-to-peer lending services. It owns and operates a Peer-to-peer (P2P) lending platform Paskolu klubas (eng. Loan Club) that enables retail lenders to lend money directly to retail borrowers.

In 2019 NEO Finance launched a successful IPO and raised over €0.6 million, subsequently listing its shares on the stock exchange. It was the first time that a Lithuanian FinTech startup entered the stock market.

"A successful IPO allows us to implement our expansion plans faster and more effectively, in order to continue a path of successful value creation for our clients and shareholders [..] We consider IPO as a very valuable experience which has allowed us not only to attract funds, but also to receive a lot of valuable feedback on how to further improve our services. In addition, we had the opportunity to spread the NEO Finance message across the wider international investor community"

– Evaldas Remeikis
Chairman of the board at NEO Finance

Sun Finance is a Latvian FinTech start-up company that operates as an online consumer financing platform in seven countries on three continents. In the 2021 FT 1000 ranking, Sun Finance was named the fastest-growing European FinTech with a 619-time revenue increase, or 61,837.8%.

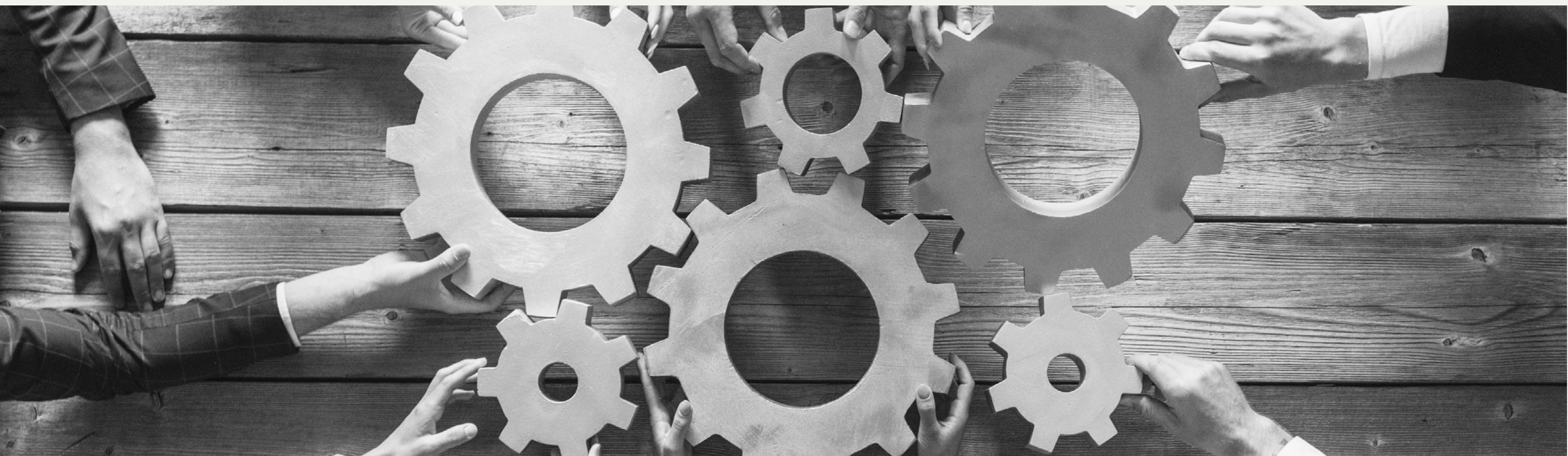
The company has already successfully implemented 3 bond issues. In 2019, it raised €10 million, in 2020 it registered a second bond issue of up to €15 million, and in 2021 its bond issue totaled €20 million and was used to refinance the first issue of bonds.

"It has been a pleasure during these three years since working with Sun Finance to see great progress both in the company's financial performance, and in building investor relations, which has helped the company to strengthen its reputation in the Baltic capital market and gradually expand the circle of investors, [..] With each bond issue, we successfully continue the course we started, which is also appreciated by investors. We will use the raised capital to diversify funding sources and focus on aggressive growth. Currently, we are working on expanding the range of lending products in existing markets, which is planned for the end of this year. At the same time, being on investors' desktops proves not only our international competitiveness but also a well-chosen business model that will help us conquer new markets and peaks,"

\- Toms Jurjevs,
Sun Finance CEO and founder

Myths vs Facts

Myths	Facts
Bank financing are sufficient for a company	Banks offer limited funding and may refuse to finance a company in times of need.
A company only goes public to raise capital	There are companies that come to the stock exchange not to sell securities, but to build credibility, visibility, reputation, and value.
The stock exchange is only suitable for large companies	The stock exchange Alternative market Nasdaq First North is also suitable for small and medium-sized companies that are dynamic and have ambitious growth plans.
Listing a company on the stock exchange will result in a loss of control	The company is free to determine the conditions for raising external finance, the control rights to be granted or not, and to what extent.
Listing a company on the stock exchange is an expensive and complex process	It depends directly on the company's level of preparedness, expectations, needs, and available resources. On average, it is 5-10% of the capital raised. Support mechanisms are outlined below.



What are the tools for attracting capital?

Capital Markets offer two kinds of financial instruments (securities) for attracting capital:

Bonds

Debt securities sold by a company to borrow funds from investors for a fixed period.

Advantages

- Ability to raise large amounts of funds in a short time.
- The ownership structure of the company remains unchanged.
- The company itself determines the terms of the borrowing, including the amount, maturity, and interest rates (coupon).
- Possibility of obtaining a larger loan than with a bank.
- Bonds can be sold whenever the company needs funds.
- Predictable loan amount.

Shares

Securities that investors acquire to become co-owners (shareholders) of a company.

Advantages

- Ability to raise large amounts of funds in a short time.
- The funds raised are not a loan and stay with the company.
- The value of the company can increase.
- Investors bear part of the risk of financial loss to the company.

Where are securities traded?

Securities can only be sold to the public on a stock exchange. In the Baltic States, only Nasdaq Baltic is in operation. This consists of the stock exchanges Nasdaq Tallinn (Estonia), Nasdaq Riga (Latvia), and Nasdaq Vilnius (Lithuania).

> **For a company, the stock exchange is like a gym, where a trainer looks after you, shows you how to do the exercises better, keeps track, and evaluates your progress**
>
> - Saimona Bleida
> Former Chairwoman of the Board of LATVIJAS KUĢNIECĪBA

Nasdaq Baltic stock exchanges offer two trading venues - the Regulated Market and the Alternative Market (First North).

Due to the above reasons, small and medium-sized companies tend to choose the Alternative Market (First North). Additional notable benefits that these companies receive when listing their securities in First North:

- Long-term increase in value for the company
- Attracting and retaining a skilled workforce
- Achieving marketing objectives and publicity
- The value of the company becomes well-known
  Increased competitiveness
- Prepares the company for wider growth
- Gaining credibility
- Easier exit for shareholders
- Easier fundraising in the future
- Gaining of new cooperation partners
- Raising more capital in a short time
  Ability to increase share liquidity

How do companies start their journey?

Compliance
Companies wishing to go public first must meet certain quantity and quality criteria:

Quantitative criteria

- Small and medium-sized companies aiming to raise capital from both private and institutional investors
- Market value of the company: at least €5-6 million
- Minimum value of free public float: €2-5 million
- Minimum amount of capital to be raised/shares to be sold: €2.3-5 million

Quality criteria

- A clear strategy for the future
- Prospective sector of activity
- Easy-to-understand business model Comprehensible, transparent financial situation
- Comprehensible shareholder structure
- Credible auditors
- Visibility, good reputation of the company and management
- Good corporate governance

The Process

Preparation for quotation on First North might take from 6 months to up to 12 months based on the readiness of the company and its engagement in the whole process; a general process is outlined below:

Support mechanisms

Companies can greatly reduce their cost for going public with the support of EU funds. They can recover up to 50% of costs up to a maximum of €100,000 for a share issue and €20,000 for a bond issue.

On 25 January 2022, the Central Finance and Contracting Agency of the Republic of Latvia (CFLA) announced its 4th project selection round, within which entrepreneurs could submit projects from 28 February to 28 April 2022. The CFLA had until 31 July to decide whether to grant aid. The project will have to be implemented no later than 31 December 2023. The European Regional Development Fund funding available for the fourth round of project applications under the measure is €375,375.00, with private co-financing of at least €375,375.00.

Further information on Measure 3.1.1.3 and the application procedure is available on the CFLA website: https://atlase.cfla.gov.lv/lv/3-1-1-3-k-4 (in Latvian).

Certified Adviser (role)

Listing securities on First North's market in accordance with the rules of the stock exchange requires an agreement with a certified adviser.

The role of a certified adviser is to support companies in the preparation process, as well as to provide the necessary support and advice after entering the First North market.

Responsibilities of the certified adviser

- Ensuring the signing of a trade agreement
- Ensuring compliance of the company during incorporation
- Monitoring the performance of the company (issuer) after admission
- Ensuring compliance of documents before and after admission

Daiga Auziņa-Melalksne
Chairwoman of the Board, Nasdaq Riga Stock Exchange

Listing on stock Exchange

Investments in FinTech start-ups and companies in Europe have risen sharply over the past years. The Nasdaq Riga stock exchange is no exception, and we are seeing the industry grow with more and more companies going public in recent years here in Latvia. We are very pleased that FinTech businesses like Eleving Group, Sun finance, and DelfinGroup are continuing to finance their growth through the capital market and have managed to attract investments of over €113 million during 2021-2022 .

Listing on the Nasdaq Riga stock exchange not only provides development capital but also generates visibility and enhances company credibility in the eyes of stakeholders and broader society. It gives the company a stock exchange quality mark. A company can choose to issue either **shares** or **bonds** and to list the securities on either the **regulated** or alternative First North market. **First North** is a proven growth platform for ambitious small and medium-sized companies, combining the benefits of being publicly listed with simplicity and a lighter disclosure regime.

All the companies that join First North must choose a Certified Advisor to work with. A Certified Advisor is crucial to the IPO process when a company attracts capital and works with investors. The advisor also guides the company through the application process, helping it meet all the First North rules and regulations, and after listing helps it ensure ongoing compliance in reporting, disclosure, and so on.

The Certified Advisor may be a corporate finance firm, an accounting firm, or an investment bank authorized by Nasdaq Baltic.

What does it take for FinTech businesses to get listed on the stock exchange? There are requirements that a company must meet in order to get listed, but I would like to draw your attention to 3 key criteria. **First**, you must have the ambition to develop, and a clear strategic action plan to achieve that ambition. **Secondly**, your company must "show up" and become consistently visible to get more leads and clients and to earn the trust and authority of the public and, most importantly, investors. Good corporate governance is **the third component of success**, underpinning the company's efficiency. Fairness, accountability, responsibility, and transparency are important factors that will define your company's future ability to attract investors, whose support will help you to finance further growth.

To get started, your company needs to follow these 4 steps:

1. You need to adopt a formal decision to list the company's shares or bonds on an exchange (to go public);

2. Next, a share or bond prospectus – a document describing the securities to be offered to investors – needs to be prepared and registered with the local financial supervisory authority;

3. Then, for new issues, an initial public offering (IPO) is carried out. It can also be done using private placement. If your company just wants to list existing shares to increase liquidity, this step is not necessary;

4. Finally, a listing application can be submitted to the stock exchange.

I would like to encourage you to start by talking to the Nasdaq Issuer services team, as every company is different and there is no one-size-fits-all solution. Contact the Nasdaq Riga team and we can discuss how we can help your company grow. For more information visit nasdaqbaltic.com.

We have chosen bonds as one of our main funding sources to support the fast growth of our business. This has allowed us to maintain a diversified capital structure and reduce overall funding costs. The strong financial performance and substantial growth prospects have allowed us to continuously attract investor interest, resulting in an increased bond ticket each time.

- Toms Jurjevs
Founder and CEO of Sun Finance Group

Capital Availability

How Venture Capital Firms Are Looking at FinTech

Andris K. Bērziņš
Managing Partner at Change Ventures, the largest and only pan-Baltic seed fund

The FinTech industry in Latvia, like in the other Baltic States, has enjoyed strong growth during the past decade. Change Ventures has invested in one Latvian FinTech startup, Nordigen, and we are definitely hunting for more. Unfortunately, we don't have any unicorns in Latvia yet, like Wise or Veriff in Estonia. This partly relates to a strong bias towards payday loan-related businesses (or angel investors from this industry), which tend to struggle to attract VC investment, for reputation risk reasons. For this reason, many FinTech startups in Latvia are having to grow their business without venture capital, though I hope this will change in the coming years.

Crowdfunding

Mārtiņš Šulte
CEO and co-founder of Mintos

Up until now, Mintos has raised €11 million funding most of its growth by revenue. Since launching in 2015, the company has almost single-handedly built up the market of investing in loans in Europe to €8.3 billion, holding about 45% of the market.

The capital in the 2020 Mintos crowdfunding campaign was raised to allow Mintos to accelerate its growth and develop new products in a regulated environment. Mintos reached its crowdfunding target of €1 million in just 15 minutes after opening to its community, raising a record amount of €6.5 million in total.

"We were thrilled to have such a response from our community. This result is a huge endorsement of our vision and it goes to show how strong the relationship with our community is" Mārtiņš Šulte, CEO and Co-Founder of Mintos, back in 2020.

The funding raised in this crowdfunding round was used to acquire Investment Firm and Electronic Money institution licenses which allow us to offer new products and services across Europe.

Marek Pärtel
CEO and co-founder of EstateGuru

2021 was the most successful year in our history. All operating countries exceeded their business targets and the total funded amount for the year was €203M, a 69% increase when compared to 2020 (€120M). Assets under management (AUM) amounted to €220.3M as of the end of 2021. Additionally, revenues were €7.1M in 2021, an increase of 58% compared to 2020 (€4.5M). We all aim to live up to our vision of making real estate investing and financing attainable for anyone, anywhere in the world.

Our business model has proven to fit into any market and work in any business environment. We have emerged stronger than ever from the Covid-19 crisis and we also see that current macroeconomic conditions favour our business model because companies and private individuals need protection against inflation, while Small and Medium Enterprises need fast and flexible financing. The strength of our vision and business model is supported by 1400 new equity investors, who joined via Seedrs, and our finalized A-round of VC investment of €5.8M led by TMT Investments Plc.

Our industry is also changing rapidly and, in many ways, becoming a mature and established investment option. What was also remarkable about 2021 is that we are finally operating in a regulated environment. We welcomed the introduction of a Pan-European crowdfunding regulation and we hope to be among the very first companies to receive the new license.

As a driver of innovation and competition, FinTech companies play an important role in the financial services market. They create innovative services in payments, insurance, regulatory technology, investment, cybersecurity, and other areas. Latvia has a dynamic and open FinTech ecosystem, and it is important to uphold a healthy infrastructure and environment of collaboration with state partners in which new FinTech companies can develop and existing ones grow further.

Harijs Ozols
Head of Information Technology at Latvijas Banka

In October 2021, Latvijas Banka launched a test platform for its Instant Payment Request Service (Request-To-Pay (RTP)). RTP will supplement the existing instant services in the payment area (instant payments and instant links) and provide even more space for innovative payment solutions. In the near future, RTP is expected to accelerate the development of new innovative payment solutions, and as the survey shows, 10% of FinTechs point out that the biggest opportunities for them will be in the sector of instant payments and payment services based on these technologies in the following years. We are happy to see that FinTechs are recognizing instant payment services as a niche for their potential development.

The Request-To-Pay service is not only about payments but is also a great opportunity to improve consumer behavior, user experience, and convenience. Many stakeholders including in the e-commerce domain could benefit from it, as the payments could become cheaper and the payment flow would become more user-friendly, allowing more time to be spent on other activities instead of manually entering payment information.

There are countless uses for RTP services, such as cross-bank payment requests for P2P use, payment initiation at physical stores, and many more, including the possibility to link them with the Instant Links registry to allow instant payment requests based on payers' mobile phone numbers or other ID. We are eager to see what FinTechs will bring to the table using this technology in the near future. Latvijas Banka is open for consultations regarding the instant services and especially the Request-To-Pay functionality. We are also looking for partnerships for proof of concept and possible pilots in this field. If your FinTech is considering working in the field of instant payments, feel free to reach out to Latvijas Banka.

Opportunities for improvement of FinTech cooperation with banks

Andrejs Bosko
Board Member at the Association of Latvian Payment Services and Electronic Money Institutions

FinTech cooperation with banks

The problem with banking infrastructure availability for FinTech companies is an old problem in the EU. But the market response to this issue has been the emergence of new banking types such as Banking Circle, Currency Cloud, Solaris bank, and many other BaaS (Banking as a Service) providers. In general, the market will always adapt and find a way to develop. The question is, where?'

The situation in Latvia is a bit more complicated. After the issues with Moneyval and the AML scandal several years ago, the regulatory approach has become more strict, and banks are now under regulators' pressure regarding customer risk appetite. As FinTech payment service providers, electronic money/payment institutions are classified as high-risk customers for banks, and banks are obliged to put a lot of effort into compliance by ensuring ongoing monitoring and enhanced due diligence for FinTech customers. Even if EMI/PI is licensed by the same regulatory body, they are subject to enhanced monitoring and due diligence from the bank's side, and at the same time, Latvian EMI/PI is subject to very strict local regulations from the other side.

Larger banks with foreign capital still prefer to keep their conservative position, and in practice are closed for collaboration with FinTechs.There is a list of local banks who work with PSP and FinTech, and they have defined this in their strategy as a focus segment. We will see improved cooperation between banks and FinTechs, greater integration of FinTechs into banks, and more banks open to serving FinTechs after regulatory efforts to clarify risks.

It is crucial to ensure that Latvia licenses PSP and EMI and that they are well supervised from the FCMC side and benefit from easy access to the banking payment infrastructure. Lithuania has made a very interesting step by allowing EMI/PI to be connected to payment infrastructure directly through the central bank for SEPA payments. It was a bold step and showed the market that Lithuania has the political will and ambition to compete with other countries as an EU FinTech hub.

In Latvia, connection to the SEPA payment infrastructure is possible through commercial banks only, and just two banks currently provide an addressable BIC service. Work has begun on an EU level on regulatory changes to ensure EMI/PI access to payment infrastructure directly without an intermediary, but it will be around 3 or 4 years until implementation.

It would be great to ensure that licensed PSP and EMI providers in Latvia could benefit from easy access to the banking payment infrastructure and that they are well-supervised by the FCMC.

Local market trends

Latvia-licensed EMI/PI are mostly concentrated on niche service development, such as payment gateway, card loyalty, co-branded services, bill payments, and e-commerce solutions. However, in the EU and around the world, many FinTech companies such as neobanks are challenging traditional banks, and so far we are not seeing this in Latvia.

Local market trends

Latvia-licensed EMI/PI are mostly concentrated on niche service development, such as payment gateway, card loyalty, co-branded services, bill payments, and e-commerce solutions. However, in the EU and around the world, many FinTech companies such as neobanks are challenging traditional banks, and so far we are not seeing this in Latvia.

Latvia has passed an extremely complicated and painful way of reforming the financial sector and the financial sector supervisory regime. However, we currently see that the regulatory body has become more open to communication and consultancy, even being proactive and making an effort to educate market participants and promote the Latvian FinTech market perspective. Several years ago there was a completely neutral attitude towards FinTech.

The Latvian approach is on license quality, not quantity. The regulatory body has therefore become more mature and more focused on the FinTech market, and the FCMC has clearly defined FinTech development as a focus.

Unlike other countries, the Latvian AML regulatory framework is much more strict and mature. We have a lot of AML guidance with very detailed requirements compared with other EU countries. This means that we will see much fewer changes in the future and less unpredictability for market participants. In other countries, regulatory bodies are currently being forced to strengthen their requirements and risk appetite, which will certainly have an impact on market participants' business strategies. This means less predictability, a negative impact on customers, and bad news for investors and shareholders.

Commercial banks open for services

Uģis Vorons
Deputy Chairman of the Management Board at Industra Bank

One of Industra Bank's strategic niches in cooperation with participants of the fast-growing FinTech industry. We are open to any innovative ideas or solutions in cooperation with fin-tech industry players to solve their needs regarding payment infrastructure or establishing trustworthy banking relationships.

We see Industra Bank's role in this constantly evolving FinTech ecosystem through digital transformation and modernization of the bank services to enable adoptable payment infrastructure for FinTech companies.

A large share of Industra Bank's strategy is driven by open banking and demand from financial services providers, fin-tech companies, and the KYC-AML framework.

This also triggered a need to start developing a Banking as a Service infrastructure at Industra Bank. We consider BaaS services with a rails-based ideology and complete API integration into our existing payment infrastructure as one of the biggest focuses for Industra Bank in the next coming year.

We expect overall revenues from cross-border payments to increase in the next five years as a result of faster payments. It is also clear that developing a new and growing infrastructure will create new revenue streams and capabilities for FinTech companies.

Viktors Bolbats
CEO at Baltic International Bank

In the Latvian FinTech space, we come up against "chicken or egg" issues. The majority of innovation was originally generated in high-demand areas and services, particular to the needs of Latvian society. The scarcity of access to financing, financial troubles, and bank activity in the 2008-2009 crisis has fueled some talented entrepreneurs backed by capital into a fast-lending, micro-lending space. I seriously consider it part of financial technology, with respect to those players who did this business responsibly, as I keep a broad look on what financial technology is. To me, it means making financial services easier and quicker to acquire by clients with help of modern IT and capital technologies. Lending and payments are apparently services where demand was and is coming from a community of both private individuals as well as small-medium businesses. I still see that the strongest players are active in or originated as players from these spaces.

Of course, I am happy to see FinTech entrepreneurs moving to areas unrelated directly to lending and payments: risk scoring, regtech, and other areas of global potential. Like business, FinTech is also subject to the accessibility of talent and to an extremely large extent, capital. An undercapitalized FinTech space, like many other more traditional areas of the Latvian economy, may be making this development slower than required.

Banks, who are typically associated with robust risk models and higher capital requirements based on balance sheet sizes, could potentially play a more active role in the future development of FinTech, but are reduced to, at best, accelerator programs with an extremely tight risk capital appetite towards the FinTech space. This is a dilemma, as regulation on banks is never-ending and ever-tightening.

Regulatory requirements for capital, Basel requirements, and IFRS9 accounting principles all carry the same message: investing in risk ventures, be that in FinTech or other sectors, is a hard call and the bank's balance sheet is not the right place. To me as an active local player who communicates daily with the FinTech community, this is painful. The regulator does a lot to launch sandbox spaces and regulation guidelines to those in the FinTech space who reach regulatory levels etc., but their main area of responsibility is still regulating banks. Those banks that are busy attracting capital themselves or carry capital above ratios without significant surpluses are hardly investors in FinTech. However, those who generate capital could play a more active role by establishing (in some times reviving) their VC, and allocating capital there.

Banks can buy into FinTech services in the regtech space in particular, but here banks are a bit sluggish, and again, due to regulation, changing a risk model or elements of their core system is a huge decision and requires a long process to pursue.

Capital availability from balance sheets that allow for VC-type investments that often deviate and reform from their original plan from a combination of existing talent and ideas that are in the FinTech and near-FinTech space should work its magic. There is a sufficient number of players whose capital position would allow the funding of a small silicon valley right here in our Latvia.

What to Expect in 2023?

FinTech companies rarely lack ambition, being amongst the fastest growing industry regionally. The same global mindset is evident in discussing future trends and opportunities. Many of the surveyed companies expect to launch new products, export markets, partnerships or consider introducing new innovations. This is a welcome trend and a positive signal of overall ecosystem growth. However, the factors of recent economic challenges and the effect of sanctions in Europe will still be a significant element that can be a challenge for the regional FinTech industry.

What are your most significant plans for the future?

DelfinGroup
We truly care about what we do. This year we will proceed with the process we started last year and continue actively investing in the development of innovative FinTech, automation, and digitalization solutions. This will both improve our existing services and allow the company to offer new products to new groups of customers. Our focus will be on establishing a platform for the circulation of pre-owned goods that will increase our presence in the Latvian retail market.

4Finance
One of the key areas for future development is clearly the further automation of business processes. We have been very actively working in this direction and will continue to do so, increasingly expanding the scope of automation responsibilities. It is very important to ensure that the product itself and additional services are available in the way the customer expects, so we keep a close eye on market trends and changes in consumer demand. We see potential in the development of mobile applications to make non-bank financial services easier to use. Market analysis also shows that the non-bank insurance segment and the "Buy now, pay later" product concept have potential.

Eleving Group
We have big things in mind, but it is too early to reveal the details and specifics. On a more general note, our primary goal is to become the ultimate mobility platform and offer our clients a full spectrum of mobility products. We see that this is the way to become one of the biggest players in Europe.

IPF Digital
We will build on the success of Mobile Wallet and launch it in new markets. It is really exciting to take this project outside of Europe and introduce it to our Mexican and Australian customers.

Can you outline (a) the biggest and (b) the most exciting trends in FinTech? What could be the effects beyond new and better services, in your opinion?

DelfinGroup

Voice-enabled payments are no fiction anymore. Now they have become a reality. This technology lets people use digital assistants like Amazon Alexa or Siri to hear their balance and make payments or money transfers. In addition, this technology allows using payments in retail stores with no payment terminals. FinTech startups can use this option to implement projects on tight budgets.

Important to mention such trends in FinTech as Cybersecurity and Quantum computing. Quantum computing is a game-changer that could destroy cryptography as we know it.

Financial institutions have started to gamify their products and services, a trend for the new generation.

4Finance

A trend that is transforming the market positively is Open banking or API. Fast access to bank customers' financial information to verify the customer's solvency before providing insurance or a loan, or allowing payment by installments, enables users to pay for goods online in a few steps, pay for services in one swipe, and receive a loan in seconds.

Along with the growing number of consumers who embrace contactless payments, mobile banking, micro-investing, online lending, travel hacking, and other FinTech-powered financial activities, cyber security comes to the fore. As more users adopt FinTech, generating more cash flow through the associated apps, bad actors launch increasingly clever attacks, making FinTech cybersecurity more important—and more difficult—than ever. This aspect is also one of our top priorities to ensure the security of the services we provide.

Another top FinTech trend is embedded finance, which allows financial technologies to be integrated into non-financial products. Increasingly, customers are demanding access to products and services that are embedded in one centralized location, pushing companies to provide financial services products through partnerships and white-label programs. Health care, consumer products, and technology companies can embed a loan, a checking account, a line of credit, or a payment option into their business model and platform.

Eleving Group

Open banking is a trend to follow since it opens many opportunities to improve the customer's experience and give them access to personalized products. For companies, it is an opportunity to use the data in an intelligent and efficient way, thus developing innovative products and services that create additional value for customers.

As for the most exciting trend, we believe introducing FinTech concepts in developing markets such as Latin America and Africa is a big thing. It will allow companies to change people's lives significantly and positively.

IPF Digital

One of the biggest trends in the FinTech lending cluster is the continuous growth of Buy now, Pay later short-term financing services. Payment solutions providers, credit companies, and merchants are seeking to make the most out of this trend, while regulators are focussing more on the BNPL sector too.

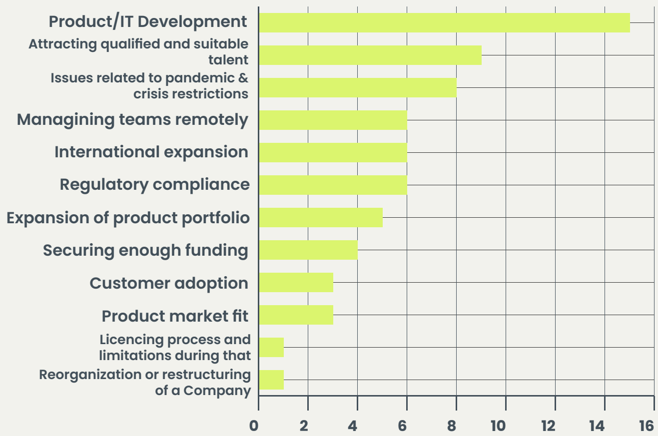
It will be exciting to see how blockchain technology continues to evolve and become more mainstream. AI solutions will definitely find more ways to improve customer service and to better identify possible fraud or money laundering activities.

Future challenges and opportunities

Some of the most pressing future challenges mentioned by the survey respondents are related to business expansion, both international and product portfolio. Securing enough funding is another issue to consider for future growth and is closely related to expansion opportunities.

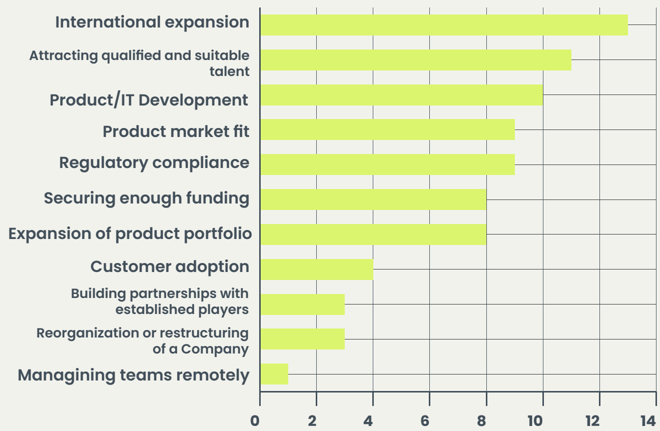
However, top future opportunities to seize according to surveyed FinTech enterprises lie in digital currencies, open banking, and personal finance as the top answers given by the survey participants.

What were your key challenges during the past year (2021)?



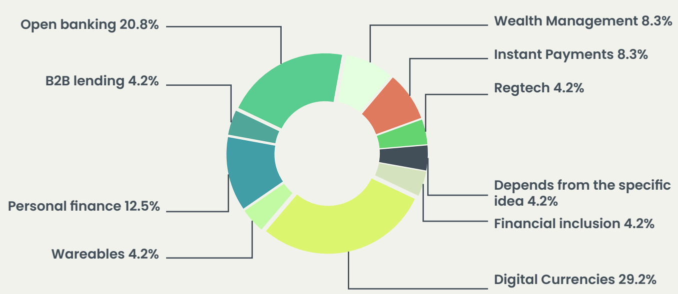
In the past year, some of the key challenges mentioned by the respondents of the survey carried out by FinTech Latvia Association, relate to both developing products / IT, as well as remote management of teams and adoption to the consequences caused by the Covid-19 pandemic.

What are your expected challenges in the next year (2022)?



Additionally for the current year's survey respondents mention concerns regarding international expansion, as well as product / IT development and issues around appropriate talent acquisition as some of the most important challenges to tackle.

Biggest opportunities for Fintech in the next 1-2 years



However, top future opportunities to seize in the next upcoming 1-2 years according to surveyed FinTech enterprises lie in digital currencies, open banking, and personal finance.

Terms and definitions

Providers of financial services and technology and support services (both considered FinTech) include companies involved in:

- **Digital lending** – P2P lending, balance sheet lending, including invoice trading, leasing, consumer credit;
- **Digital capital raising** – equity-based, reward-based, or donation-based crowdfunding, unsecured debt or equity or real-estate crowdfunding, ICO platforms:
- **Digital banking** – fully digital banks, providers of banking as a service (BaaS);
- **Digital savings** – digital savings solutions, savings-as-a-service;
- **Digital payments** – mobile payments, money transfers, e-money issuers, points of access, other payment-related services;
- **Digital asset exchange** – trading and brokerage services including different platforms, exchanges, Bitcoin Teller Machines etc.;
- **Digital custody** - digital wallets, key management services;
- **WealthTech** – robo-advisors, social trading, personal financial management, financial comparison sites;
- **InsurTech** – insurance-related products and services, including digital brokers or agents, peer-to-peer insurance, insurance comparison portals etc;
- **Credit and data analytics** – credit scoring based on alternative data, solutions based on analysis of biometric and social data;
- **RegTech** – solutions for meeting regulatory requirements, including profiling and due diligence, risk analytics, regulatory reporting, market monitoring etc.;
- **Digital identity** – services related to biometric security, KYC, fraud prevention;
- **Enterprise technology provisioning** – technological solutions for financial service providers including back-office solutions, API management, cloud computing, AI, BI tools, enterprise blockchain etc.

We exclude providers of digital accounting solutions as these are not specifically targeted at providers of financial services.

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