



**BANK OF LITHUANIA
FINANCIAL MARKET SUPERVISION SERVICE**

CEO of electronic money
institutions and payment
institutions

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Associations as listed

**ENHANCING THE OPERATIONAL MANAGEMENT, INTERNAL CONTROL AND
COMPLIANCE CULTURE OF ELECTRONIC MONEY INSTITUTIONS AND PAYMENT
INSTITUTIONS**

Dear Head of Institution,

We are applying to you concerning the strengthening of governance, internal control and compliance culture in electronic money/payment institutions. One of the strategic directions of the Bank of Lithuania is enhancing the maturity and compliance culture of the FinTech sector. Therefore, in supervising electronic money institutions and payment institutions (hereinafter – Institutions) based on the prospective approach, which seeks to identify potential risks and take measures to eliminate them as early as possible, we would like to draw Institutions' attention once again to certain requirements laid down in the following legal acts to be observed by the Institutions in their daily operation, in order to enhance their compliance culture and the compliance with which will be taken into account when supervising Institutions (routine or non-routine checks, documentary analysis, inspections, etc.).

I. Information and communication technologies and security risk management.

The Requirements for information and communication technologies and security risk management (hereinafter – the ICT and Security Risk Management Requirements) adopted by Resolution No 03-174 of the Board of the Bank of Lithuania of 26 November 2020 on approval of the requirements for information and communication technologies and security risk management¹, in force since 1 January 2021.

An Institution must include ICT and security risk management in its overall internal control system, approve its ICT strategy, base its ICT and security risk management on a model of three effective defence lines, approve an information security policy, carry out various information security tests, create and implement ICT incident and issue management process, implement management processes for ICT projects and ICT modifications, create a reliable business continuity management process and apply other established measures.

Business functions, auxiliary processes and information resources must be classified by their level of importance, taking into account confidentiality, integrity and accessibility requirements. An Institution must assess ICT and security risks at least once per year (or every time where there are major infrastructure changes) and establish what measures need to be taken to reduce the identified ICT and security risks to an acceptable level.

An Institution must draw up an operational and security risk assessment report for the current calendar year and submit it to the Bank of Lithuania via the Notification Module no later than within 14 days following the completion of the ICT and security risk assessment. The deadline for the submission of reports is 31 December of the current year.

¹ <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/f63d6331302a11eb8c97e01ffe050e1c>.

II. Internal control and governance. The Requirements for electronic money and payment institutions concerning the governance system and the protection of received funds approved by Resolution No 03-106 of the Board of the Bank of Lithuania of 23 July 2020 on amending Resolution No 247 of the Board of the Bank of Lithuania of 30 December 2009 on the Requirements for electronic money and payment institutions concerning internal control, risk management and the protection of received funds² (hereinafter – Governance Requirements), in force since 1 January 2021.

The Bank of Lithuania has noted that Institutions start to create an internal control mechanism only upon receiving a letter from the Bank of Lithuania or after the Bank of Lithuania initiates an inspection. The Bank of Lithuania has also noted that internal control processes, policies and procedures are not adapted for a specific Institution. Please note that in ensuring adequate internal control and an adequate risk management system an Institution must have approved a risk management strategy, defining the scope of risk, the limits for each risk type and internal procedures for risk identification, assessment, monitoring, mitigation and control (Paragraph 11 of the Governance Requirements). A person responsible for the implementation of the risk management function must:

- provide the Institution's management body with the Institution's risk map at least on a quarterly basis;
- submit the annual risk management report on an annual basis (Paragraph 13 of the Governance Requirements).

When analysing business practices of the Institutions, the Bank of Lithuania has noticed an increasing number of cases where Institutions fail to respect their recruitment commitments assumed during the licensing process and to ensure the minimum number of employees carrying out management and control functions.

An Institution's governance system is deemed reliable where the Institution has appointed persons responsible for control functions and the appointment takes place after considering the legal requirements and the nature, scope and complexity of the Institution's risks (Paragraph 9.4 of the Governance Requirements) as well as the competence of the responsible persons. The absolute majority of new market participants do not start to carry out their activities properly until they employ a manager permanently residing in Lithuania and the staff members with required qualifications and experience, who should ensure Institutions' risk management, regulatory compliance and compliance with Institutions' internal documents, including compliance with anti-money laundering and counter-terrorist financing requirements, information security, outsourcing monitoring and control and the organisation of internal audit. Given the above, the Bank of Lithuania would consider it good practice, if Institutions starting their activities had at least 4 (four) employees recruited:

- a manager permanently residing in Lithuania;
- a compliance officer;
- an information security officer;
- an anti-money laundering and counter-terrorist financing officer.

The number of officers would later increase in accordance with Paragraph 9.4 of the Governance Requirements. It is also important to note that Institutions may not combine the compliance function and the information security function with the internal audit function. The combining of the compliance function and the information security function with other control functions may only be acceptable, where this would not undermine the efficiency and independence of compliance and information security functions (Paragraphs 7, 8, 16, 18 and 20 of the ICT and Security Risk Management Requirements).

III. Notifications of the changes in management and persons acquiring a qualifying holding in the Institution's authorised capital and/or voting rights. Newly selected (appointed) managers of electronic money and payment institutions may enter into office only if the Bank of Lithuania does not object their candidacies (Article 16(6) of the Republic of Lithuania Law on Electronic Money and Electronic Money Institutions and Article 9(6) of the Republic of Lithuania Law on Payment Institutions).

Persons seeking to acquire a qualifying holding in the authorised capital and/or voting rights of an electronic money institution or a payment institution must obtain the Bank of Lithuania's decision whereby it does not object the proposed acquisition (Article 17 of the Republic of Lithuania Law on Electronic Money and Electronic Money Institutions, Article 10 of the Republic of Lithuania Law on Payment Institutions and Articles 24 and 25 of the Republic of Lithuania Law on Banks). It should be noted that the Bank of Lithuania decision not to object a candidacy of the manager of an electronic money institution or a payment institution or

² <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/a248366ed03f11ea8f4ce1816a470b26?jfwid=-y8onxg46w>.

transactions related to the acquisition of such institutions does not signify the actual appointment of the new manager or acquisition of a qualifying holding in the authorised capital and/or voting rights, thus, having received the Bank of Lithuania's decision not to object the manager's candidacy or the proposed acquisition, electronic money and payment institutions must separately notify the Bank of Lithuania about new managers actually starting their office or persons having acquired a holding in the authorised capital and/or voting rights of the Institution.

IV. Requirements for the protection of client funds. Measures provided for in legislation (Article 25 of the Republic of Lithuania Law on Electronic Money and Electronic Money Institutions and Article 17 of the Republic of Lithuania Law on Payment Institutions) ensuring the protection of property rights of electronic money holders and/or users of payment services are in line with some of the key (essential) requirements for the activities of Institutions and are intended to ensure that where Institutions face any financial difficulty or bankruptcy, electronic money holders and/or users of payment services are protected and that their funds are not subject to recovery for Institutions' liabilities.

When analysing quarterly financial reports submitted by Institutions and carrying out routine and non-routine checks, the Bank of Lithuania has noted that Institutions fail to ensure adequate protection of funds of electronic money holders and/or users of payment services, which is why we draw Institutions' attention to the fact that their management bodies must not only approve internal documents laying down the process for the protection of funds of electronic money holders and/or users of payments services as well as accounting and internal control procedures for such funds, but also such internal documents must always be followed when carrying out licensed activities and must be revised with a periodicity decided by Institutions.

V. Due assurance of capital requirements. The Rules for calculating initial capital and own funds of electronic money institutions and payment institutions (hereinafter – the Rules) approved by Resolution No 03-83 of the Board of the Bank of Lithuania of 24 May 2018 on the approval of the rules for calculating initial capital and own funds of electronic money institutions and payment institutions and report forms for calculating initial capital and own funds of electronic money institutions (payments institutions) (recast in force since 1 September 2020).

Institutions must have measures in place ensuring that equity requirements, which are among the key prudential requirements, are continuously complied with.

In analysing the quarterly supervisory reports received from Institutions, the Bank of Lithuania has noted that some Institutions ensure compliance with equity requirements only after the reporting date and check the capital only at the end of the quarter. It has been observed that the market does not sufficiently learn from its own mistakes and those of other Institutions and, considering the violations detected so far, we hope for a significant shift in the Institutions' approach as to the importance of compliance with this requirement. The Bank of Lithuania stresses that if Institutions are operating with a loss and therefore fail to fulfil their equity requirements, the Institutions' managers must consider income earned and expenses incurred during previous periods, customer attraction plans and other aspects project performance results and plan their activity in such a way that Institutions operate in a stable and reliable manner and meet applicable equity requirements at all times and not just at the end of the quarter. It should also be noted that Institutions' managers should not strive to ensure compliance solely with the minimum equity requirement. Equity should be increased by such an amount that could cover potential losses during future periods, i.e. provide for certain reserves. To enforce continuous compliance with the equity requirement, the Bank of Lithuania recommends that Institutions appoint an employee responsible for the monitoring of the aforementioned data to ensure continuous compliance with the equity requirement and the application and updates of relevant procedures.

VI. Drawing up, data reliability and timely submission of annual audited financial statements, audit reports and other reports. The Procedure for drawing up supervisory financial and operating reports of electronic money institutions and payment institutions and submitting such reports and other information to the Bank of Lithuania (hereinafter – the Reporting Procedure) adopted by Resolution No 03-105 of the Board of the Bank of Lithuania of 23 July 2020 amending Resolution No 03-259 of the Board of the Bank of Lithuania of 20 December 2018 on approval of the procedure for drawing up supervisory financial and operating reports of electronic money institutions and payment institutions and submitting such reports and other information to the Bank of Lithuania³, which, except for

³ <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/9ee36082d03f11ea8f4ce1816a470b26?jfwid=14f2289ehh>.

Subparagraph 4.4 of the Resolution, is in force since 1 January 2021. The Procedure for drawing up supervisory reports on money laundering and/or terrorist financing prevention measures of electronic money institutions and payment institutions and submitting them to the Bank of Lithuania adopted by Resolution No 03-261 of the Board of the Bank of Lithuania of 20 December 2018 on approval of the procedure for drawing up supervisory reports on money laundering and/or terrorist financing prevention measures of electronic money institutions and payment institutions and submitting them to the Bank of Lithuania⁴, in force since 1 January 2019.

Possessing reliable and accurate financial and other data and submitting them to a supervisory authority in accordance with the statutory procedure is a prerequisite for the Bank of Lithuania to perform the supervisory function properly and timely and, after analysing the information submitted to the Bank of Lithuania and by monitoring a supervised financial market participant, to take follow-up supervisory actions adequate for managing the risks posed by the supervised financial market participant. At the same time, it is one of the conditions for the protection of property rights of users of payment services in the case an Institution experiences financial or other difficulties.

There are cases where Institutions submit their reports late, the data submitted are not accurate and reports are amended and checked after the deadlines. It should be noted that Institutions must have effective internal control procedures in place to ensure reliable, adequate and timely entry and submission of internal and external financial information, whereas the head of the Institution's administration is responsible for the submission of correct supervisory financial and operating reports and other information to the Bank of Lithuania in accordance with the procedure laid down in the Reporting Procedure (paragraph 4 of the Reporting Procedure). As this Resolution also approved new reports, the Bank of Lithuania also draws Institutions' attention to the fact that the Institution must draw up supervisory financial and operating reports and submit them to the Bank of Lithuania by the set deadlines (Paragraph 7 of the Reporting Requirements).

We have also noted cases when Institutions were late in submitting the audited annual financial statements (when audit of financial statements is mandatory), audit conclusions, audit reports and documents indicated in Paragraph 10 of the Reporting Procedure according to deadlines set in Paragraph 11 of the Reporting Procedure. In addition, Institutions do not always ensure that audit reports comprehensively disclose separate accounting information on the correctness of separation of electronic money issue, payment services provision and other activities and provide notes on the internal control procedures applied by the Institution to ensure compliance with the requirements for the protection of customer funds established in legal acts. Given the above, Institutions must assess and implement appropriate measures for the management of all related risks, to include their management in the internal risk management documents, as envisaged in Section III of the Governance Requirements. Institutions should take measures to ensure that submitted supervisory reports contain correct information, that Institutions are in compliance with the requirements applicable to them according to legal acts at all times and that reports and other indicated documents are compliant with all requirements established in legal acts and are submitted timely.

VII. Outsourcing of business functions. The Rules for outsourcing business functions of financial market participants (hereinafter – the Outsourcing Rules) approved by Resolution No 03-166 of the Board of the Bank of Lithuania of 10 November 2020 on approval of the rules for outsourcing of business functions of financial market participants⁵ in force since 1 January 2021.

An Institution must ensure proper management, supervision, monitoring and control of outsourcing agreements, i.e. establish a position of an administrator of the outsourcing of business functions, appoint an employee directly accountable to the Institution's body or to instruct the Institution's body or a member thereof to control the outsourcing of business functions. An Institution may not outsource the Institution's body's responsibilities and roles to other persons and may not become an empty shell.

Data of the outsourcing agreements must be entered in the register of outsourcing agreements and electronically submitted by the Institution to the Bank of Lithuania, at the Bank of Lithuania's request.

The requirement differs from former ones, as the duty to notify the Bank of Lithuania about the agreement to be concluded only concerns important business functions. An institution should submit a notification and a draft agreement at least 1 month prior to the date of

⁴ <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/53e3de800ae211e98a758703636ea610>.

⁵ <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/5feedc20245d11eb8c97e01ffe050e1c>.

conclusion of an agreement for the outsourcing of important business functions.

VIII. **Handling customer complaints.** The Rules for the investigation of complaints received by financial market participants (hereinafter – the Complaint Investigation Rules) adopted by Resolution No 03-105 of the Board of the Bank of Lithuania of 6 June 2013 on approval of the rules for the investigation of complaints received by financial market participants⁶, recast in force since 1 July 2017.

The process of complaint investigation by Institutions must be in line with the requirements laid down both in Article 90 of the Republic of Lithuania Law on Payments and the Complaint Investigation Rules. It should be noted that Institutions are obliged to have an approved complaint investigation policy containing the information on complaint investigation processes and implementing and supporting their efficiency (Paragraph 7 of the Complaint Investigation Rules).

IX. **Money laundering and terrorist financing risk management.** Money Laundering and/or Terrorist Financing Prevention Guidelines for Financial Market Participants adopted by Resolution No 03-17 of the Board of the Bank of Lithuania of 12 February 2015 on approval of money laundering and/or terrorist financing prevention guidelines for financial market participants⁷, recast in force since 1 March 2020.

An Institution must ensure that the internal control system covers the money laundering and terrorist financing risk management and that adequate procedures are drawn up as necessary for implementing control of the aforementioned risk management process, whereas an Institution must monitor them and maintain their efficiency and adequacy. The roles and responsibilities of an Institution's management bodies must be clearly assigned and regulated, whereas members of the management bodies must be familiar with and knowledgeable about money laundering and terrorist financing risks associated with the Institution's business and ensure their appropriate identification and assessment, the determination of an acceptable level of risk and the implementation and control of risk management measures. It is necessary to ensure adequate separation of employees' functions to avoid conflicts of interest that increase or may increase money laundering and terrorist financing risks. An Institution must encourage employees to respect stringent ethical standards and identify potential areas of conflicts of interest as well as their management measures. It should be noted that an Institution must ensure that money laundering and terrorist financing risk management (mitigation) measures are applied to all customers.

Considering that inspections by the Bank of Lithuania identify many significant deficiencies in the area of money laundering and terrorist financing prevention, please note that it is important for an Institution to ensure that employees whose job duties are related to the implementation of money laundering and terrorist financing prevention measures are adequately qualified and possess the necessary knowledge in the area of money laundering and terrorist financing prevention to perform their job functions (duties), and ensure that employee knowledge and competences are improved and they participate in professional development. Please be reminded that the Bank of Lithuania continuously updates its website section on frequently asked questions for financial market participants⁸, the training section⁹ and the section of recommendations to Institutions¹⁰ and has drawn up and made publicly available an overview of business-wide money laundering and terrorist financing risk assessments performed by financial market participants¹¹. Moreover, by the end of 2021 the Bank of Lithuania plans to draw up an overview of the most common deficiencies in the area of money laundering and terrorist financing, in which it will provide more elaborate comments on how to enhance compliance culture in the area of money laundering and terrorist financing prevention.

We ask managers and responsible persons of Institutions to pay their attention once again to the aforementioned statutory requirements and take respective measures, so that Institutions function in a way that they are compliant with their licensing requirements, commitments assumed during the licensing process, including those regarding the number of employees, and respect other statutory requirements for their activities at all times throughout the period of their activity.

⁶ <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/TAIS.450611/scCcmENBqF>.

⁷ <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/91797560b6f011e4a939cd67303e5a1f/asr>.

⁸ <https://www.lb.lt/en/faq-prevention-of-money-laundering-and-terrorist-financing>.

⁹ <https://www.lb.lt/lt/mokymai>.

¹⁰ <https://www.lb.lt/lt/rekomendacijos>.

¹¹ <https://www.lb.lt/lt/leidiniai/finansu-rinkos-dalyviu-atliekamu-visos-veiklos-pinigu-plovimo-ir-teroristu-finansavimo-rizikos-vertinimu-apzvalga>.

Please note that you do not have to reply to this letter of the Bank of Lithuania. Finally, please be reminded that responsibility for the appropriate implementation of statutory requirements for Institutions' activities in all cases falls on the Institution itself.

Direktorė

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