Payments Market Review

2020

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ABBREVIATIONS

API	application programming interface
ATM	automated teller machine
CBDC	central bank digital currency
DLT	distributed ledger technology
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
EFTPOS	electronic funds transfer at point of sale
EMI	electronic money institution
EU	European Union
Fintech	financial technology
KYC	know your customer
ML	money laundering
OECD	Organisation for Economic Co-operation and Development
PI	payment institution
PIS	payment initiation service
PSD2	Second Payment Services Directive
PSP	payment service provider
SCA	strong customer authentication
SEPA	Single Euro Payments Area
TF	terrorist financing

SUMMARY

Lithuania's payments market has been relatively successful in responding to challenges posed by the lockdown. Payment service providers (PSPs) have rapidly adapted to the new normal: they have rearranged customer service flows, increased the limit for contactless payments to €50, and ensured reliable payment solutions for e-commerce. Nevertheless, this was accompanied by certain inconveniences, i.e. a number of bank branches as well as some ATMs at shopping centres were not accessible to customers. It also took longer for new payment cards to reach customers by post and the sign-up for the e-signature service was not available for some time. Bank branches were generally providing only those services that could not be offered remotely, and in order to manage customer flows and ensure safety, customer pre-registration was introduced. There is no evidence whether this has caused any significant reduction in payment service accessibility. Compared to the corresponding period last year, the lockdown period saw a significant increase in internet payments, meanwhile the amount of cash withdrawn from accounts was significantly smaller.

Holding and having remote access to a payment account became of crucial importance during the lockdown. This not only allows customers to handle their financial matters remotely or shop online, but also provides access to e-Government services. Under a prolonged lockdown, people who do not hold a payment account or do not use online banking might find it difficult to fulfil their needs without any assistance. The lockdown has compelled PSPs to introduce a possibility of becoming a new customer remotely, while emphasising the need to improve legal regulation in this regard.

The public sector stands out as a significant user of payment services. On a monthly basis, state institutions are receiving payments (taxes, charges, payments for services) and, at the same time, executing payments (pay pensions, benefits, etc.). Moreover, all institutions also make other routine payments (transfer salaries to their employees, pay to their suppliers and service providers, etc.). It is estimated that transfers related to the public sector (excluding municipality level institutions) could account for 15% of all credit transfers executed in Lithuania.

State institutions, which execute a significant number of payment transactions and have some specific demands, have to focus on customer convenience. Most state institutions that collect payments from a large number of people have e-service portals that also allow making payments. Solutions they apply are similar to e-commerce payments, i.e. they use the Bank link service or intermediary services. However, some payers, depending on the bank used, are obliged to use and pay extra charges to an intermediary that is selected by the state institution through a tendering procedure. Similarly to the prevailing practice in the private sector, these costs should be borne by the payee, i.e. by state institutions themselves. When collecting payments, state institutions should focus on making the payment procedure customer-friendly and make sure that all payers are subject to the same conditions, therefore they should apply the same pricing and consider ways to make use of other payment methods applied for e-commerce, such as card payments or the payment initiation service (PIS). Providing a possibility to make payments using a payment card would also enable customers of PSPs based in other countries to pay for services provided by Lithuanian institutions. At the moment, major state institutions receive quite a few payment services free of charge, which helps save public resources, however, costs incurred by PSPs have to be covered from the revenues earned from providing services to other customers (residents and firms) or other financial services.

State institutions offer a possibility to make payments in cash and supply vulnerable social groups with cash, thus playing an important social role. Payments in cash (when paying taxes or service charges) can be made using services provided by electronic money institutions (EMIs) or payment institutions (PIs); in Lithuania, such institutions have a wide network of offices. The State Social Insurance Fund Board (hereinafter – SoDra) offers a possibility to receive pensions in cash. To this end, it uses non-bank PSPs that provide the cash payment service.

Statistics show that using more secure identification measures is not enough to prevent fraud. In September 2019, new security requirements with regard to the authorisation of e-payment transactions came

into force across the EU. As a result, paper code cards were replaced by other instruments, mostly the Smart-ID app or a code generator. Partly because of contactless and online payments, the main bulk of payment transaction fraud is linked to card payment transactions. Credit transfers stand out in terms of the value of fraudulent activities. The rise in the use of Smart-ID has led to the increase in fraudster attacks related to this instrument. The Bank of Lithuania has been consulting market participants regarding the security of Smart-ID.

The choice of banks to avoid customers that are seen as posing higher ML/TF risk, rather than managing the associated risks, has a negative impact on the EMI/PI sector and reduces the possibilities for firms and residents to make payments in foreign currency. This implied closures of bank accounts, termination of business relationships or refusal to start one. The Bank of Lithuania has received quite a few reports concerning such actions taken against EMIs and PIs licensed in Lithuania. Individual companies and natural persons also encounter such problems. This trend is not limited to credit institutions operating in Lithuania – the issue is also discussed at the level of the European Banking Authority (EBA). The Bank of Lithuania is analysing the situation and has submitted to banks its position concerning the opening of accounts for EMIs and PIs. The situation in the market will continue to be actively monitored.

The Payments Council has prepared recommendations for encouraging the use of non-cash payment instruments at general education institutions and for developing open banking. In July 2020, the Payments Council adopted recommendations for ensuring that in five years' time non-cash payments are available in at least 80% of school canteens, and that the number of pupils holding at least one non-cash payment instrument grows by 10% each year. To this end, the Payments Council recommends developing infrastructures adapted for non-cash payment solutions in canteens of education institutions, simplifying the acquisition of non-cash payment instruments for minors, reducing prices of such payment instruments and developing the pupils' practical financial literacy. The Payments Council has also identified areas where it is appropriate to develop open banking when creating new financial services, and encourages PSPs to continue developing related services, i.e. for customer creditworthiness assessment, anti-fraud and ML prevention as well as developing personal financial analysis and management skills.

Active discussions among central banks on the type of money that could meet the demands of a modern economy has led to a discussion on the possibilities of and threats posed by central bank digital currencies (CBDC). Combining the features of cash and reserve accounts currently offered by central banks could lead to the development of a new form of money – CBDC, i.e. electronic payment instruments intended for the general public and issued by the central bank. Most central banks have so far only assessed CBDC at a theoretical level, while some have already entered the testing phase and only a few have announced about their explicit plans to issue CBDC. The Eurosystem has not yet taken the decision whether to issue CBDC in the nearest future, but has already started a public consultation to better understand the public and market expectations.

In the past few years, the card payments market was significantly affected by EU legal regulation, however opinions on its impact diverge. In addition to PSD2 (which covers all payment instruments), the Interchange Fee Regulation (which covers the card payments model) has also had a significant effect; in 2020, the Cross-Border Payments Regulation came into force. As a result of the Interchange Fee Regulation, the fee that the merchant's bank pays to the cardholder's bank (interchange fee) was reduced in Lithuania, which in turn resulted in the reduction of the final price of the service paid by merchants. In its report on the application of the Interchange Fee Regulation, the Commission stated that the main objectives had been achieved and did not propose any amendments to the Regulation in the nearest future. However, EU market participants see the impact of the Regulation in a rather different light: they do see the positive effect it has had as regards certain issues but feel the lack of the expected regulatory benefits in some other areas. It is agreed that the Interchange Fee Regulation has helped to reduce fees paid by merchants, but it also entails certain drawbacks, for example, major companies are said to have experienced the largest reduction in fees paid, meanwhile small merchants did not necessarily feel the benefits because it is other costs, such as the lease of the EFTPOS terminal and not the merchant service charges, that account for the largest share of the cost of card payment acceptance. The application of this Regulation to commercial cards causes major discussions. The Cross-Border Payments Regulation ensures a possibility for travellers to compare currency conversion charges that different service providers apply when payment cards are used for payments in foreign currency. According to the Regulation, the issuer of the payment card and the merchant's PSP are both obliged to submit information on currency conversion charges in the same way.

The goal of the European Commission and the ECB – which are shaping the EU payments policy – is achieving that the European payments market is efficient, competitive and independent. The new Commission has given particular attention to the digitalisation and improvement of financial services and to promoting innovation and has consulted the public in this regard. In September 2020, the Commission published Digital Finance and Retail Payment strategies. It has given particular attention to the implementation of the EU product, instant payments, as well as strengthening of consumer protection and competition. The ECB payments strategy also concerns the strengthening of the European payments market. The ECB has established several key principles and they should be implemented in the payment solution that is developed at the initiative of market participants. In 2020, several major European banks initiated the development of a new solution which potentially conforms with the principles of the ECB.

In 2019, the trends in the use of payment services did not change in Lithuania: the market witnessed a further rapid increase in the number of non-cash payments, it continued to be dominated by banks, while the market share of payment cards saw a further increase. In Lithuania, non-cash payment transactions averaged 233 per capita in 2019, a year-on-year increase of 30. Card payments represent an increasing share of the non-cash payments market, as they are the main instrument for non-cash payments at points of sale. However, the full potential of payment cards has yet to be seized in Lithuania, i.e. cards are still used more often for withdrawing cash, rather than for making payments. The payments market is dominated by banks, meanwhile the sector of transfers made at customer service offices is dominated by EMIs and PIs. The use of payment cards issued by foreign PSPs at EFTPOS terminals located in Lithuania is increasing; this is partly driven by the fact that Lithuanian residents have been more active in using services provided by foreign PSPs (e.g. Revolut, PayPal, N26). In 2019, the Bank of Lithuania offered to market participants a service via its CENTROlink payment system that allows making instant payments using only the payee's mobile phone number. As of the end of April 2020, this service is available to customers of Swedbank and SEB banks. The service is planned to be launched for customers of other banks in 2021.

I. THE IMPACT OF LOCKDOWN RESTRICTIONS ON PAYMENT SERVICE ACCESSIBILITY

The payments market has performed quite well in responding to the lockdown. PSPs have rapidly adapted to the new normal: they have rearranged customer service flows, offered wider contactless payment possibilities and ensured reliable payment solutions for e-commerce. Major incidents and unavailability of services were prevented, partly due to the proper prior preparation. Nevertheless, this was accompanied by certain inconveniences, i.e. a number of bank branches and some ATMs at shopping centres were not accessible to customers, it also took longer for new payment cards to reach customers by post and the sign-up for the e-signature service was not available for some time. These issues were addressed through reorganising PSPs' internal processes and by adopting legal acts specifying lockdown conditions[1].

Lockdown conditions have directly affected customer service at bank branches. The initial versions of the Resolution of the Republic of Lithuanian Government on the introduction of the lockdown in the territory of the Republic of Lithuania, adopted on 14 March 2020, affected the operations of bank branches operating on the premises of shops and shopping centres.[2] Many of these branches could not ensure customer service. The more recent versions of the Resolution allowed providing financial services at shopping centres in line with the established safety and hygiene requirements.

PSPs ensured the availability of services that could not be provided remotely at bank branches. Branches were generally providing only those services that could not be offered remotely, and in order to manage customer flows and ensure safety, customer pre-registration was introduced. There is no evidence whether this has caused any significant reduction in payment service accessibility.[3] In specific cases, market participants sought individual solutions. Based on the data provided by banks, customer flows to customer service offices have decreased considerably (by 50% or more) [4], and those customers who would arrive at the office would mostly ask for the following services: opening of a bank account, issuance or replacement of an authentication instrument (e.g. Smart-ID), issuance or activation of a payment card, conclusion or amendment of an online banking agreement and cash or payment transactions.

In view of the recommendation to avoid unnecessary contact with potentially unsafe surfaces, PSPs increased the limit for contactless payments to €50. At the end of March 2020, banks operating in Lithuania signed a memorandum on doubling the limit for contactless card payments.[5] According to banks, the increased limit allows processing up to 95% of transactions made at points of sale without a physical contact between the payer and the EFTPOS terminal. At the decision of banks, the €50 limit was maintained after the lockdown period.

During the lockdown, the number of online payments noticeably increased, and the demand for cash decreased sharply. In the second quarter of 2020, the number of payments made using the Bank link service rose by 51% compared to the same period last year, meanwhile, the number of online card payments increased by 125%. These are the most popular means of payment for goods purchased online.[6] At the same time, the amount of cash withdrawn from ATMs decreased by 21%, as compared to the same period in 2019.

Holding and having remote access to a payment account became important as never before. This not only allows customers to handle their financial matters remotely or shop online, but also provides access

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[1] Resolution of the Republic of Lithuania Government of 14 March 2020 on the introduction of the lockdown in the territory of the Republic of Lithuania, as subsequently amended.

[2] PSPs were also directly affected by Article 15(2) of the Republic of Lithuania Law on Civil Protection.

[3] In order to limit social contact between its employees and customers, one of the banks refused to establish business relationships with new customers for some time.

[4] Nevertheless, customer flows had increased at some customer service offices.

[5] Resolution on the introduction of the lockdown in the territory of the Republic of Lithuania contained a recommendation to use non-cash instruments for making payments.

[6] Recently, the payment initiation service has gained traction for making payments online, however comparative data on the use of this service are not available.

to e-Government services. According to a population survey conducted in 2019[7], 11% of Lithuanian residents aged 18 years or older did not have a payment account, and more than a third of people of retirement age were not using any instruments of online banking. Under a prolonged lockdown, these people might find it difficult to fulfil their needs without any assistance. Banks and credit unions offer residents a payment service package which, in line with legal acts, includes the package of the main payment account that entitles the customer to receive a minimum package of payment services, including the online banking service, at a fixed fee.

The lockdown has compelled PSPs to introduce a possibility of becoming a new customer remotely, while emphasising the need to improve legal regulation in this regard. Before the lockdown, major PSPs did not have any solutions intended for the general public for establishing business relationships remotely, although legal acts provide for such a possibility.[8] At the moment, such solutions are already applied by several banks. Nonetheless, because of different additional conditions (e.g. the requirement that the future customer should provide a valid certificate of a qualified e-signature), this type of service is not accessible to the absolute majority of potential customers. Alternative methods of becoming a new customer are based on direct video communication using a smart phone, however, due to a number of different reasons, they will not be accessible to all categories of customers[9]. Thus, it is too early to claim that remote solutions can fully replace a physical visit to the bank branch. Due to the risk of repeated lockdown, there is a need to review legal regulations which provide for a possibility to establish business relationships remotely; the said risk also reminds us of the need to implement a proactive policy on electronic identification means which would enable Lithuanian residents to use secure and convenient electronic identification instruments.

BOX 1. ESSENTIAL SERVICES DURING EMERGENCY SITUATIONS

The following general provision was envisaged for private entities whose activity is not separately mentioned in the Resolution of the Republic of Lithuania Government on the introduction of the lockdown in the territory of the Republic of Lithuania (initial wording) (e.g. education, healthcare): “It is recommended for the private sector to organise its work in the same manner as in the public sector”. The public sector – i.e. state and municipal institutions, agencies, state and municipal enterprises – was instructed to organise work and provide services to customers remotely, with the exception of the cases when respective functions need to be exercised at the workplace. The public sector was also instructed to ensure the exercise of essential and urgent functions (Article 3.2.1 of the Resolution). The Resolution does not elaborate on what “the exercise of essential and urgent functions” means, however the explanation on this matter was provided to the public sector by the Ministry of the Interior of the Republic of Lithuania: “Urgent exercise of functions (works) covers the provision of urgent (most important) services to persons and dealing with them when they apply for these services. Institutions that administer the provision of services or directly provide services to persons should themselves identify services that are urgent (most important) during the lockdown and whose availability and uninterrupted provision should be ensured as priority”.

Taking into consideration regulation that was in effect during the lockdown, it might be concluded that banks and other PSPs were recommended to organise their work, provision of services and customer service on a remote basis, with the exception of the cases when functions needed to be exercised at the workplace. More instructions, for example, on which services should be provided by PSPs, were not established either in the Resolution or laws regulating operations in emergency situations.

However, in this context, it is worth mentioning the public contract institute. It obligates legal entities

[7] See https://www.lb.lt/en/publications/review-of-the-survey-of-the-habits-of-lithuanian-residents-in-using-payment-services-2019.

[8] See the Republic of Lithuania Law on the Prevention of Money Laundering and Terrorist Financing.

[9] For example, such solutions would not be available to legal persons, also to natural persons who do not have the technical means or belong to higher-risk groups.

(businesses) that enter into public contracts to provide services or sell goods to anybody that applies to them (e.g. transport, communications, electricity, heating, gas and water supply organisations) (Article 6.161(1) of the Civil Code). The institute of a public contract is also relevant for banks. After all, a deposit agreement (when the depositor is a natural person) is considered a public contract (Article 6.892(2) of the Civil Code). A bank account agreement is not directly listed as a public contract in the Civil Code, however, it has public contract features: the contract with the customer that applies with the request to open an account has to be concluded by the bank according to its terms and conditions on opening certain types of accounts, which comply with the regulations of the laws and legal acts on bank activities; the bank is not entitled to refuse to open an account, if the possibility to open such account is envisaged in the law, the documents regulating the bank's activities or its authorisation, with the exception of the cases, when such refusal is allowed under the law (Article 6.614(2 and 3) of the Civil Code).

Thus, it is debatable which criteria banks should comply with during emergency situations. If they followed the public contract criterion, that would mean banks would provide services to all applicants, since the legislator used the public contract institute to ensure accessibility of services that are strategically important to satisfy resident needs. On the other hand, if banks followed rationality and proportionality principles, as indicated in the explanation of the Ministry of the Interior, they could themselves decide on which services are necessary (most important) to customers and what volume of services would allow ensuring their accessibility and continuity.

It can be assumed that during emergency situations banks should themselves assess the situation on a case-by-case basis and individually evaluate which of their services are essential and urgent to costumers in that specific situation. After lockdown restrictions were imposed in Lithuania, they most probably followed this principle. It was observed that during the lockdown existing customers, rather than new ones, applied to banks more often, whereas the reasons for their application were various issues related to services already in place (e.g. blocking of a payment card, Smart-ID installation after replacement of a mobile phone).

II. PUBLIC SECTOR PAYMENTS

State institutions initiate and receive a significant number of payments and have some specific demands. On a monthly basis, companies pay different taxes (added value tax, personal income tax, social insurance contributions, etc.), while self-employed persons pay compulsory health insurance contributions. Every month, SoDra pays pensions and social benefits; more than 800 thousand people receive pensions. All institutions also make other routine payments, e.g. transfer salaries to their employees, pay to their suppliers and service providers, receive payments for services provided. It is estimated that transfers related to the public sector (excluding municipality level institutions) could account for 15% of all credit transfers performed in Lithuania. Tax-collecting institutions set specific requirements and have some specific demands, for example, a payment order must contain a code number which helps administer the funds received. Also, they use specific APIs created by PSPs for exchanging large amounts of information[10].

State institutions that execute large numbers of payment transactions hold their accounts at several banks, and services provided by a single bank are quite enough to meet the demands of the smaller ones. There are several reasons for holding accounts at several or even all banks on the market. First of all, it is important to state institutions that payment transactions are executed rapidly, i.e. they are interested in promptly receiving the information on the receipt of funds to be able to provide a service without any delay. Also, sometimes the institution itself needs to rapidly transfer funds, for example, funeral benefits. Payments within the same bank are executed immediately. Another reason is fees. Institutions wanted to make sure that both their payments and those made by residents and firms are executed at a lower cost.

[10] Such APIs enable a convenient and automatic submission of a large number of payment orders from the internal information system of the institution to the PSP's system, also to obtain and process the information on the receipt of payments.

Several years ago, it was a common practice to apply a fee for every transfer received from another PSP, meanwhile, crediting of funds to accounts within the same bank was free of charge, and transfers within the bank also bore lower costs. Currently, these reasons are not as relevant as they once were, for example, fees for incoming payments are no longer applied and making a payment within the bank and to other banks bear the same fee when using a payment services package. If there is a need to promptly transfer funds, an instant payment service can be used.[11] Nonetheless, even today it might be relevant for some institutions to hold more than one account. For institutions that execute a large number of payment transactions, it would be useful to break down the flow of transactions across several banks and thus transfer funds to payees within one day, irrespective of the technical capacities of banks. Due to the negative interest rate applied, keeping the fund balance at several banks helps save up, also this allows distributing the risk of losing funds. The said requirements are not as important to smaller institutions, therefore they often use services of a single PSP.

Major state institutions receive quite a few payment services free of charge. According to the Republic of Lithuania Law on State Social Insurance, fund turnover transactions of SoDra are executed free of charge. The pricing applied to other institutions is to be agreed during the procurement procedure; institutions that execute large numbers of payments and have large balances of funds receive services under particularly favourable conditions. This is useful to state institutions as it helps save public resources. However, costs incurred by PSPs have to be covered from revenues earned from providing services to other customers (residents and firms) or other services.

State institutions that offer many services or collect payments form a large number of people use e-service portals which also allow making payments. The main purpose of this type of portals is enabling customers to order and receive services and to check the related information, however, it also allows them to fulfil their tax obligations or pay for services received. Making payments via the portal is convenient since the user is instantly provided with a correctly filled out payment order and the payee can instantly link the payment to the service provided or a specific tax obligation. There are different solutions applied. Major institutions maintain their own portals, meanwhile smaller institutions employ a centralised solution developed by the Information Society Development Committee. Therefore, payment options offered are also slightly different. Major institutions provide a possibility to make payments using the Bank link service, and where there is no agreement with a particular PSP on the provision of this service or the state institution is smaller, a centralised solution of the Information Society Development Committee, which can be accessed via the e-Government Gateway, is used. The use of this solution relies on intermediary services. Intermediaries make sure that customers of numerous PSPs are able to make payments on the e-portal.

State institutions should seek to ensure a convenient payment procedure and equal conditions for all payers. Solutions that are applied on e-portals are similar to e-commerce payments. Thus, public institutions could apply the same principles concerning the means of payment proposed and the fees applicable to customers. If, on e-portals of state institutions, the payer has to use intermediary services (at the moment, depending on the payer's bank, this can be the only option available to the payer), the payer must pay to the intermediary, too. According to the prevailing practice in the private sector, costs related to the acceptance of payment orders at e-shops are to be borne by the payee, and the payer pays only for the services provided by their PSP. This applies if the PIS or Bank link service is used, or card payments are made. Thus, including new methods of payment (PIS and card payments) would allow payers to avoid paying a fee to the intermediary selected by the state institution and would improve the experience of public service users. Moreover, providing a possibility to make card payments would also enable customers of PSPs based in other countries to pay for services provided by Lithuanian institutions.

In some municipalities, budgetary institutions make payments and manage their accounting in a centralised manner. Companies that do the accounting for budgetary institutions draw up accounts for numerous institutions (e.g. more than 200 in Vilnius); they also perform all functions related to the execution

[11] At the moment, not all PSPs operating in Lithuania offer their customers the instant payment service.

and administration of payment transactions. Municipal budgetary institutions receive large numbers of payments for services provided by education institutions (kindergarten services, sports activities, different after-school activities at specialised institutions, rent of school premises, etc.). When collecting payments, payment notices are sent to parents or institutions providing the relevant services and they in turn present paper receipts to the parents. Based on those notices, payments can be made either by a transfer or using the pre-filled order (bill payment) function on the online banking system or in cash at customer service offices of EMIs and PIs accepting such payments. Since collecting payments for education and related services involves relationship with a number of payers, it would be appropriate to consider adopting measures that would facilitate the collection of such payments. For example, an e-invoice service[12] could facilitate payments and payment accounting process; for payers, applying this service would facilitate and accelerate the payment initiation process.

In the public sector, a possibility to pay in cash is also important; by paying benefits in cash, state institutions supply vulnerable social groups with cash. As a result of their activities, some institutions use cash for making payments. For example, at cultural institutions (in theatres, etc.), there is a possibility to pay for tickets or services that are provided at the offices of state institutions in cash. In other cases, institutions do not have any direct contact with cash, but use PSPs that provide cash-related services. For example, cash can be used at EMIs and PIs for making payments (for paying taxes or service fees). SoDra offers a possibility to receive pensions in cash. To this end, it uses non-bank PSPs that provide the cash payment service. Payments are delivered to the payee's home, also there is a possibility to collect pension in cash at a local post office. Where residents or companies make payments to a state institution, payments in cash can be replaced by e-payments (e.g. by providing a possibility to make card payments). For example, pensions in cash are delivered to the homes of people who cannot use other instruments because of health problems or other reasons. In such cases, the use of cash plays a social function. Thus, by supplying vulnerable social groups with cash, state institutions play an important social role.

BOX 2. CENTRAL BANK DIGITAL CURRENCIES

Inspired by the possibilities of distributed ledger technology (DLT), central banks started discussions on the form of money that would be suitable in the 21st century[13]. The types of money currently offered by central banks – cash (banknotes and coins) and reserve accounts – are popular as never before[14], however, they are not adapted for the digital age. Cash is meant to be used by the general public, but it is restricted by its paper or metal form, whereas reserve accounts, although having digital form, are not available to everybody. If the features of these two types of money were merged, a new form of money would emerge – central bank digital currencies (CBDC), i.e. electronic payment instruments issued by a central bank to be used by the general public[15]. Currently, most central banks are assessing CBDC only at a theoretical level, some started the testing phase and only a few announced plans to issue CBDC[16]. The Eurosystem has not yet decided to issue CBDC in the nearest future, but already started public consultations to better understand the technology, its benefits as well as public and market expectations.

It is assumed that CBDC could be a suitable instrument to implement objectives raised for central banks, if one or several further scenarios materialised: for example, if the use of banknotes for payment continued to

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[12] A service whereby an e-invoice for services is provided to the payer via their online banking system. The payer can pay the e-invoice by simply clicking a button (there is no need to fill out the payment order) and, if e-invoices are provided on a regular basis, they can select the option to have the invoices received from a specific service provider paid automatically.

[13] See the presentation on CBDC by Vitas Vasiliauskas presented at an international conference on 12 April 2019.

[14] Although importance of banknotes in daily payments gradually decreases, they remain a popular saving instrument, which increases overall demand for banknotes. Amounts held as reserves increased mostly due to the lockdown easing policy.

[15] For a more comprehensive discussion on CBDC, see "CBDC – in a Whirlpool of Discussion", *Occasional Paper Series*, Bank of Lithuania, No 29, 2019.

[16] For example, the central bank of China.

decrease or new generation global private means of payment entered the market[17], or if a new monetary policy instrument was needed or there was a lack of reliable payment alternative during natural disasters. In this and other cases CBDC would be useful and could complement payment tools provided to the public by private entities (deposits in credit institutions and e-money held in EMIs).

There are many discussions on the functional features of CBDC needed for them to become a popular means of payment and not to create imbalances in the financial system. It is technologically possible to pay interest on CBDC, but this would encourage higher than necessary outflow of deposits from credit institutions. It would also be possible to establish the CBDC balance or operational limits, however, in this case the popularity of CBDC as a means of saving would decline. Off-line CBDC transactions could replace banknote functionality, but would limit the possibility to manage potential fraud. Central banks have not yet decided on the best technology to be used – a centralised one or DLT. There is more clarity with regard to the use of intermediaries: to be able to serve millions of customers, central banks will need to outsource some functions to third parties that would be able to make business relations with new customers according to established rules, issue CBDC payment instruments (e.g. apps or cards), consult CBDC users at their branches or remotely, as well as ensure ML/TF prevention. It is still discussed which business model would encourage third parties to provide these and additional services, however, the main expectations are that CBDC should be very affordable for payers.

Aside from the prospective benefits of CBDC, there are also risks, which, if not contained, may negatively affect financial stability. If the public was highly interested in CBDC (e.g. due to secure and convenient use), it would affect not only monetary policy, but also bank crediting possibilities and price. It is projected that in such a case residents and firms would transfer a significant part of their deposits to the central bank by acquiring CBDC. Banks would need to close the resulting "hole" in deposits by raising interest rates on deposits, through central bank loans (thus increasing the central bank's balance and the economic impact)[18] or by borrowing in capital markets (probably for higher interest), which could make new loans more expensive. As a result, if banks were to deviate from optimum crediting or their ability to assume risk declined (e.g. due to lower profitability), the overall economic development could be affected. Research shows that CBDC could only exacerbate the negative impact on the stability of banks affected by a financial crisis (if it happened), as with the rise of panic a large part of deposits would be quite rapidly converted to CBDC.

The use of CBDC in third countries raises many questions. Currently, euro (banknotes, euros in bank accounts) are also accessible to third-country entities. For example, euro is the second most traded currency in the global foreign exchange market and the second most popular currency in terms of SWIFT operations[19]. This raises questions on the manner and terms and conditions of CBDC distribution outside the euro area. Significant CBDC circulation in third countries may affect capital flows, exchange rates and, ultimately, monetary policy efficiency. Under higher demand for CBDC, the euro exchange rate could rise, thus reducing the competitive edge of the euro area economy. CBDC could become a target of cross-border money laundering networks and could be used for financing criminal activities. Therefore, various restrictions on accessibility, limits and interest on operations when CBDC is used by foreign entities have been under consideration.

[17] For example, stablecoins or CBDC of foreign central banks.

[18] Central banks grant loans only in exchange for reliable collateral. This would result in the rise of demand for safe asset classes.

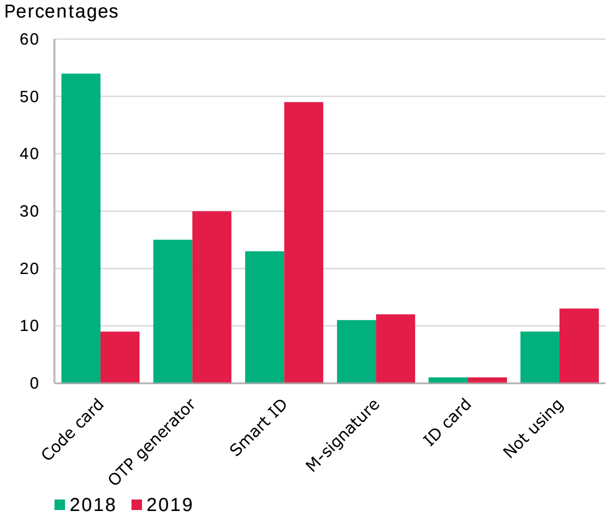
[19] See https://www.ecb.europa.eu/pub/ire/html/ecb.ire202006~81495c263a.en.html#toc2.

III. PAYMENT SECURITY AND AUTHENTICATION REQUIREMENTS

In September 2019, new security requirements with regard to customer authentication for e-payment transactions came into force across the EU.[20] PSPs must apply a procedure for the authentication of a payment service user, which is based on the application of elements of at least two different categories – knowledge (what only the payment service user knows), possession (what only the payment service user holds) and inherence (what is only inherent in the payment service user). Initiation of remote payment transactions must involve an additional security requirement, i.e. a dynamic linking of the payment transaction to a specific amount and a payee. This means that, during customer authentication for payment transactions, information on the amount of the transactions and the payee is provided in an environment other than that where the payment is initiated.

Smart-ID and the code generator became the most often used means of payment in 2019.

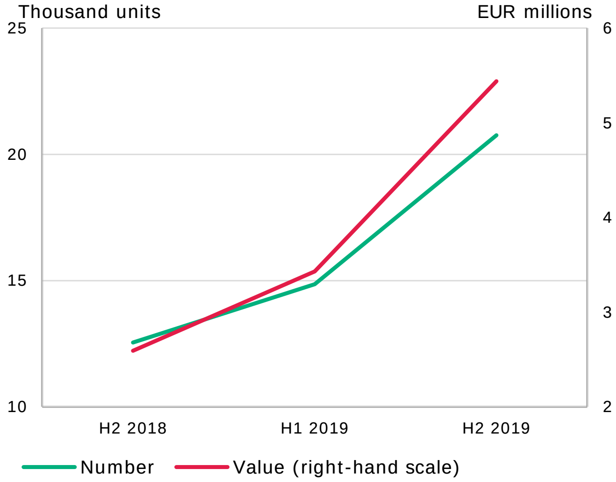
Chart 1. Methods of connecting to the online banking system by group of residents holding a payment account



Source: Bank of Lithuania.

As the number of payment transactions grows, the level of fraud is also increasing.

Chart 2. Level of fraud affecting PSPs established in Lithuania



Source: Bank of Lithuania.

As a result of the new requirements, paper code cards were replaced by other instruments, mostly Smart-ID or a code generator. Around 50% of Lithuanian residents holding a payment account use Smart-ID for connecting to the online banking system. The popularity of other instruments (mobile signature, personal identification card) has basically not changed. The number of residents who do not use any of the online banking instruments has slightly increased. Although statistics has not yet reflected that, biometric authentication, which is faster and more convenient than password (knowledge)-based methods, is gaining popularity in apps used by some banks. However, using such an instrument requires a smart phone with a biometric (fingerprints or face) scanner function.

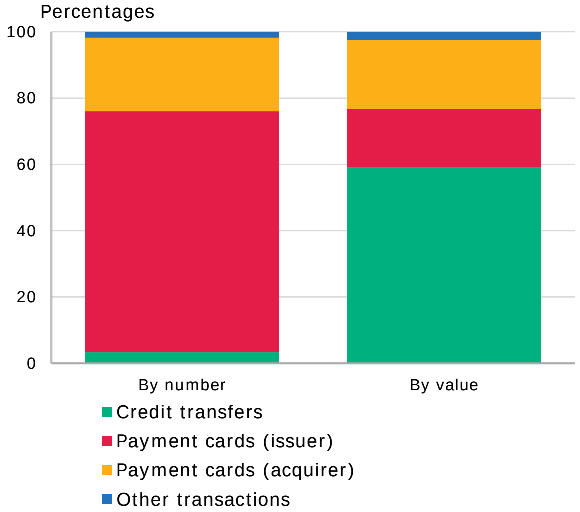
Statistics on cases of fraud show that using more secure measures is not enough to prevent fraud. In 2019, a total of 35.6 thousand of cases of fraud were recorded; the value of funds taken over by fraudsters

[20] The requirements are set out under Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication. Requirements concerning execution of online card payments have to be implemented by the end of 2020.

reached about €8.9 million.[21] Partly because of contactless and online payments, card payment transactions account for the largest share of total cases of fraud. When making contactless payments, a more secure authentication procedure is used for every other transaction or so (the user is asked to enter a PIN code), meanwhile, when executing e-commerce transactions, the user is asked to do that quite seldom. However, this will change in 2021 when stricter security requirements will also be applied with regard to online card payments. Credit transfers stand out in terms of the value of funds affected by fraud. Although stricter authentication is already applied when executing these transactions, customers are often tricked into confirming payment transactions to the wrong payee or freely hand over the temporary control of their payment account to fraudsters. Preventing such cases requires additional measures, such as customer training and the actual and indicated payee verification service.

By the number of cases, fraud is most often committed when using payment cards, and, in terms of value, credit transfers are in the lead.

Chart 3. Breakdown of fraudulent transactions in 2019



Source: Bank of Lithuania.

The rise in the use of Smart-ID has led to the increase in fraudster attacks related to this instrument. One of the widespread types of fraudster attacks involves sending an SMS to the bank customer with a request to update information on their Smart–ID account. A non-suspecting customer is then redirected to the fictitious online banking page where they enter their login data (ID, personal identification number). This is enough to initiate the Smart-ID request to the customer's phone. If it is confirmed using a PIN code, fraudsters can temporarily take over a one-time control of the payment account and make one or more payments to the account that they control. Funds are immediately cashed out from the account.

The Bank of Lithuania has been consulting market participants regarding security of Smart-ID. The Estonian company SK ID Solutions AS that manages this instrument provides a number of additional security measures which PSPs can install in their systems and thus improve security of Smart-ID (e.g. the user is asked to select a control number). The Bank of Lithuania is carefully monitoring the situation in the payments market and, if necessary, will introduce additional security requirements.

[21] Statistics on the share of losses incurred by customers and PSPs are not available.

BOX 3. ACCOUNT ACCESS CHALLENGES WHEN BANKS PURSUE DERISKING[22]

In 2019 and 2020, there has been a rise in cases when EMIs and PIs encounter difficulties in opening bank accounts intended to process payments of customers and/or hold their funds, as well as restrictions of using such accounts (e.g. to process payments in US dollars). This significantly hinders efficient e-money issuance and provision of payment services to their customers.

Legal acts require banks and other credit institutions to adhere to the principles of objectivity, non-discrimination and proportionality when taking decisions on new accounts and account management services for EMIs and PIs. Since 1 April 2019, credit institutions have to notify the Bank of Lithuania about their decisions to refuse to open a bank account or restrict its use.

From April 2019 to September 2020, 7 banks submitted 32 notifications concerning 73 institutions. The main reasons behind their decisions were requirements imposed by correspondent banks, the choice to apply a derisking strategy and failure to provide information required for risk management.

There are cases when banks close a legal or natural person's payment account or refuse to open it due to the fact that these customers are seen as posing high ML/TF risk. Such attribution may also be determined by insufficient information about the firm or natural person. The lack of required information aggravates ML/TF risk management and thus the bank may take a decision to abandon the business relationship. It is therefore very important that firms and natural persons provide all information requested by banks for ML/TF prevention purposes on time.

The issue of mitigating risks assumed by financial institutions is also important and discussed at the European level. In order to assess the extent of derisking, its factors and impact on customers at the EU level, the European Banking Authority announced a public consultation. The primary objective of this consultation is to find out why financial institutions decide to avoid risks related to certain sectors or customers instead of managing them.

On 25 May 2020, the Bank of Lithuania adopted a position on the right of EMIs and PIs to access bank accounts opened with credit institutions to ensure (i) that risk management instruments applied by credit institutions are proportionate to ML/TF risks and (ii) the exercise of the right of EMIs and PIs to have accounts at credit institutions and use them provided in the legislation. The position expresses a view that banks must ensure that their decisions and actions related to opening (or closing) the accounts of these institutions are impartial and objective. The Bank of Lithuania considers that banks should ensure that extreme measures, such as termination of business relationships with EMIs or PIs or refusal to initiate them on the basis of ML/TF risk, are taken only after assessing the circumstances on a case-by-case basis and only when it is impossible to apply other risk management and mitigation tools.

The Bank of Lithuania will conduct regular monitoring of EMI and PI access to bank accounts. Its purpose is to encourage banks to assess corporate riskiness and motives for account closures more carefully, ensure that banks follow the principles of proportionality, objectivity and non-discrimination, facilitate the process of opening bank accounts and protect EMIs and PIs from additional obstacles to conduct business.

IV. NON-CASH PAYMENTS AT SCHOOLS

Teaching the young generation on how to use electronic payment instruments is becoming an important financial literacy issue. According to surveys conducted by the Organisation for Economic Cooperation and Development (OECD), the ability to use financial products, i.e. bank accounts, payment cards and other online payment instruments, is related to the financial literacy level of youngsters. Therefore, state

[22] Derisking is a financial institution's strategy, when the financial institution chooses not to provide services to customers attributed to a higher ML/TF risk group instead of managing risks related to them.

institutions and market participants have directed their attention to schools where pupils gain their first experience of making a payment unassisted. Schools also represent a suitable environment for rendering theoretical financial knowledge and applying it in practice.

Non-cash payments are considered to be a more secure instrument than cash. This is the opinion of 70% of the surveyed pupils and 84% of the surveyed parents.[23] It is quite simple to block a lost non-cash payment instrument and the funds will not be lost. But if you lose cash, you can only rely on the honesty of the finder. Moreover, 81% of the surveyed pupils and 85% of the surveyed parents believe that non-cash payments are easier to handle.

Only a small number of education institutions provide a possibility to make payments using non-cash instruments[24], therefore this issue has been chosen for discussion in the Payments Council. In 2019, the Payments Council formed a task force which analysed a number of important aspects related to non-cash payments at school canteens. The task force drafted a report on the development of measures for promoting an open ecosystem for non-cash payments at general education institutions and provided its recommendations in this regard. In July 2020, the Payments Council adopted recommendations for developing an infrastructure adapted for non-cash payment solutions in canteens of education institutions, simplifying the acquisition of non-cash payment instruments for minors, reducing prices of these payment instruments and developing pupils' practical financial literacy. It is expected that the implementation of recommendations will help to ensure that, in five years' time, non-cash payments will be available in at least 80% of school canteens and that the number of pupils holding at least one non-cash payment instrument will grow by 10% each year.

BOX 4. ACTIVITIES OF THE PAYMENTS COUNCIL

Throughout almost three years of its activity, Lithuania's independent payments market forum – the Payments Council – has discussed and prepared recommendations to payment market participants and institutions formulating and implementing the payments policy on five important payment-related issues, took care of the dissemination and implementation of these recommendations, and has been strengthening cooperation among payment service providers, users, regulators and the academic community in the development of Lithuania's payments market.

Members of the Payments Council prepared recommendations to payment market participants and institutions formulating and implementing the payments policy on how to promote instant payments, optimise collection of KYC information and create the conditions for implementing innovative remote identification tools in Lithuania. In 2019, members of the Payments Council did a significant amount of work themselves implementing these recommendations, informing other interested institutions about them and cooperating on their implementation. Instant payments are becoming the new norm in Lithuania's payments market – at least 80% of accounts in Lithuania were reachable for the instant payment service at the end of the first half of 2020. This means that most residents and firms may make payments without interruption on a 24/7 basis. As recommended by the Payments Council, the largest banks offering instant payments offer them as a standard service, thus the pricing of such payments does not differ from ordinary credit transfers. To implement recommendations on the optimisation of the KYC information collection process, the Republic of Lithuania Law on the Prevention of Money Laundering and Terrorist Financing was amended to eliminate legal obstacles to retrieving most of the customer data required to collect KYC information from state registers and information systems (the customer only needs to confirm the already collected data). The FAQ page on the Bank of Lithuania website has been updated accordingly. In addition, intensive discussions were held in recent years with respective ministries, the Financial Crime Investigation

[23] The survey was initiated by the Ministry of Finance of the Republic of Lithuania together with the Ministry of Education, Science and Sports.
[24] In spring 2020, a possibility to pay for food using non-cash instruments was available at 12% of general education institutions.

Service and the Centre of Registers on the comprehensiveness of information provided by state registers, access to registry data using the one-stop shop principle and the possibilities of using new remote identification tools.

In 2019, the Payments Council also considered two new issues – measures for encouraging non-cash payments in general education institutions and expansion of open banking. In July 2020, the Payments Council adopted recommendations related to these issues (for more information, see Chapters IV and V of this Payments Market Review).

To ensure efficient and beneficial work of the Payments Council, after two years of the launch of this independent forum, its activities, composition and code of business were reviewed. In July 2020, members of the Payments Council agreed on the following matters: (i) to continue its work, since the benefits that the forum provides are recognised by market participants; (ii) to maintain the Payments Council as an independent permanent collegiate body, whose activities are based on the principle of independence; (iii) to continue to focus the Payments Council's work on encouraging cooperation, discussions and search for common positions when making decisions with regard to problem areas, as well as providing recommendations; (iv) to encourage more frequent meetings of the Payments Council; and (v) to involve more stakeholders in its activities. The Payments Council's reports, positions and recommendations are published on the websites of the Bank of Lithuania and the Ministry of Finance[25]; they are also provided directly to relevant stakeholders.

V. OPEN BANKING

Developing open banking involves the implementation of regulatory requirements and application of open banking principles when providing related services. The concept of open banking is usually associated with services covered by PSD2[26], i.e. payment initiation and account information services. But the principles established in the PSD2 could be applied more widely with regard to other financial and non-financial services. These principles would encompass a transparent and open establishment of conditions for accessing customer data or services, providing access to eligible institutions[27], and ensuring compliance with data protection provisions, as required under the EU general data protection regulation[28].

Best efforts are focused on the implementation of regulatory requirements, but the experience accumulated can also be used for expanding the application of open banking. The dedicated APIs provided for under PSD2 had to be developed by 19 September 2019. Until that day PSPs both in Lithuania and the rest of the EU have focused their efforts on developing these APIs. Later on, some PSPs continued to work on them – the developed APIs underwent a coordination process to ensure their stable operation. With market participants focused on API development provided for under the PSD2, there were few opportunities to give attention to innovation. Moreover, many institutions had to modify their priorities and plans as a result of the COVID-19 pandemic. Nevertheless, it is expected that the experience obtained will allow planning the extension of open banking use cases.

The task force of the Payments Council, which continued to work on developing open banking, has evaluated its potential use cases. In response to the public consultation initiated by the Bank of Lithuania, market participants have supported further expansion of open banking. The Payments Council, which involves many interested parties, was considered to be the most suitable forum for this type of activity. The task force formed by the Payments Council has drafted a report on the development of open banking in Lithuania. The

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[25] See https://www.lb.lt/en/payments-council and https://finmin.lrv.lt/en/competence-areas/financial-services/payments-council.

[26] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

[27] This does not contradict the possibility to provide access on the basis of a bilateral agreement only.

[28] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC.

report discusses potential applications of open banking, covering only financial services and insurance, and provides a classification and evaluation of the described use cases. It also provides recommendations with regard to the potential application of open banking, such as customer creditworthiness assessment, reduction of risks related to fraud or ML/TF, financial analysis and development of financial management skills.

Open banking use cases would be mostly based on commercial grounds, while the key conditions for their business model sustainability include legal certainty, financial capacities and technical solutions. Those aspects of open banking that are not covered by PSD2 must be based on general legal regulations and agreements, where personal data protection comprises the most important aspect. Therefore, the impact assessment with regard to personal data protection is required on a case-by-case basis. It is obvious that the implementation of all potential use cases of open banking requires IT system adjustments and coordination between entities that manage data and provide services and third parties (intermediaries). This requires not only harmonised technical standards but also financial resources to invest into and maintain interfaces. The open banking business model will be viable only if the benefits it provides outweigh or at least are equal to the costs and can be adequately shared among the entities involved. These benefits can be measured not only in terms of the revenue generated, but also in view of the reduction of costs (e.g. through risk management) and social benefits.

Activities related to the development of open banking are on hold at the EU level, however the European Commission has provided for its development possibilities. The development of the SEPA API Access Scheme, which was initiated by the Euro Retail Payments Board[29], has been freezed, while development works on APIs, as required by PSD2, continue. However, the Digital Finance Strategy[30] published by the Commission provides for the development of innovations based on data sharing. This will also cover open banking. The Bank of Lithuania will actively participate in the discussion on data sharing and will seek to ensure balanced regulation that would open up possibilities for developing innovations and help manage the emerging threats.

BOX 5. PAYMENT INITIATION SERVICE

The payment initiation service (PIS) has been transferred to a more secure environment and is becoming an integral part of e-commerce solutions. Since September 2019, the PIS has been provided using APIs, which are developed free of charge by PSPs (banks, credit unions, EMIs) that administer the accounts. This was determined by PSD2 provisions. Before they entered into effect, the PIS was provided in a different manner, i.e. providers connected to online banking platforms managed by credit institutions on behalf of payers. The use of API allowed to increase stability of the service and reduce PIS providers' access to customer data that are not necessary for the provision of the service. Although previously the PIS was not provided by banks, currently they are also among the providers of this service, thus complementing e-commerce solutions (Bank link service, payment cards).

PIS providers are still searching for the most optimum solution in terms of the scope of the service. Even a small change usually poses challenges to customers. Since September 2019, the PIS has changed substantially. Some confusion has been caused by the absence of a single PIS standard: different PIS providers apply slightly different additional functions. Some models allow the customer to select the account from which the payment will be made without seeing the account balance in the PIS provider's environment; other models show the account balance, while still others show all of this only in the bank's environment. Although often customers do not even notice, additional functions (e.g. display of the account balance) usually determine the fact that, in addition to the PIS, the customer is also offered the account information service. Moreover, the volume of personal data management may increase and the customer

[29] The Euro Retail Payments Board (ERPB) is a forum moderated by the ECB where representatives of PSPs and payment service users deal with strategic-level issues relating to the market of retail euro payments.
[30] For more detailed information on the digital finance strategy, see Box 6 of this Payments Market Review.

has to be notified about it accordingly. After assessing customer responses, PIS providers adjust the service accordingly.

Initial trends show that PIS providers are inclined to transfer part of responsibility related to the service to banks. The use of API provides unique possibilities for PIS providers to decide which functions to provide themselves and which functions should be provided with the help of banks. Banks operating in Lithuania provide both possibilities – an operation's authentication in the bank's controlled environment (SCA with redirect) and an operation's authentication using third-party apps, for example, Smart-ID (decoupled SCA). Still, practice shows that, at least at this stage, PIS providers are inclined to direct customers to the bank's environment. Soon, the possibility to select the account from which the operation should be settled will appear in the bank's environment. Thus the PIS will become even more similar to the Bank link service, a service that is well known to Lithuanian residents. Moreover, banks will soon supplement API with new features, for example, it will be possible to create a periodic payment or a future payment through the PIS provider. Popularity of these innovations in the market will depend on the needs of PIS providers and the market as a whole.

VI. THE IMPACT OF EU REGULATION ON THE CARD PAYMENTS MARKET

In the past few years, the card payments market was significantly affected by EU legal regulation, but opinions on the impact of regulation diverge. In addition to PSD2 (which covers all payment instruments), provisions of the Interchange Fee Regulation[31] (which covers the card payments model) have also had a significant effect. Opinions of market participants concerning its impact and the implementation of the objectives set out therein differ. Moreover, in 2020, provisions of the Cross-Border Payments Regulation[32] came into force, which are aimed at increasing transparency of currency conversion fees, where currency conversion is part of a payment transaction, including card payments.

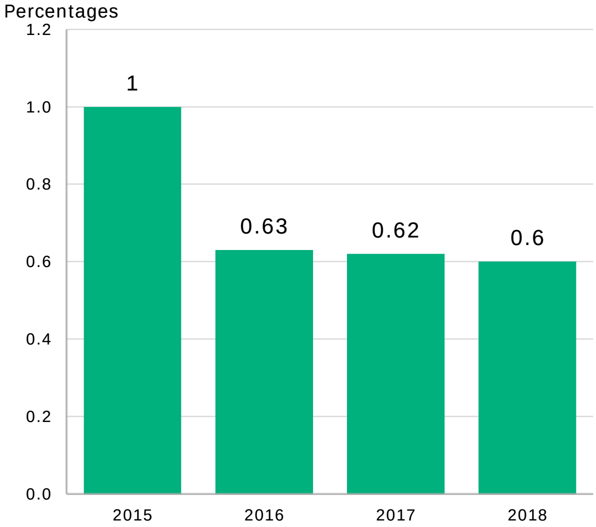
As a result of the Interchange Fee Regulation, the fee that the merchant's bank pays to the cardholder's bank was reduced in Lithuania, which in turn resulted in the reduction of the final price paid by merchants. Before the entry into force of the Regulation (2015), the interchange fee for payments using consumer debit and credit cards constituted, on average, respectively 0.62% and 0.78% of the payment value. According to the Regulation, the interchange fee must not exceed 0.2% (for debit cards) or 0.3% (for credit cards) of the payment amount. This fee is part of the charges paid by the merchant, thus, the reduction allowed applying more favourable fees to merchants. Before the entry into force of the Regulation, the average merchant service charge was 1% of the payment amount; in 2018, it was reduced to 0.6%. The fees applied by PSPs to cardholders have also changed. Nearly all banks have waived the one-off card-issuance fee, but the periodically paid cardholder's fees were increasing. In 2015–2019, the average annual cost of the consumer debit card at Lithuanian banks increased from €5.12 to €9.12. Nevertheless, a large share of Lithuanian residents (and recently, about two thirds of people holding a payment account) use payment service packages which cover the issuance of a payment card, card payments and other services; they do not have to separately pay for the card. Card fees have been changing for several years, and the pricing mode for payment services has also changed, therefore it is impossible to make any definite conclusions as to whether payment card-issuing Lithuanian banks have taken any steps to compensate for their reduced revenues from the interchange fee by increasing the revenues earned from other services.

[31] Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions.

[32] Regulation (EU) 2019/518 of the European Parliament and of the Council of 19 March 2019, amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges.

Upon the entry into force of the Interchange Fee Regulation, the average merchant service charge was reduced and remained quite stable in the subsequent years.

Chart 4. Average merchant service charge in Lithuania as compared to the purchase value



Source: Bank of Lithuania.

In its [report on the application of the Interchange Fee Regulation](), the European Commission stated that the main objectives had been achieved and did not propose any amendments to the Regulation in the nearest future. The main objective to reduce the interchange fee and charges paid by merchants was achieved. In the long run, part of merchants' savings end up with consumers as the prices of goods and services are accordingly slightly reduced. The Commission noted that international card scheme fees have increased both for card issuers and for acquiring PSPs. The Commission did not identify any causal relationship between changes in the fees for cardholders and the impact of the Regulation; these fees basically did not change. According to the report, the Commission did not notice any significant shift from consumer cards to business cards (given that fees applicable to business cards do not fall under regulation, they generate higher profits for PSPs), with the market share of the latter not showing any changes. Also, the Commission noted that transparency of fees paid by merchants has improved: merchants can see the fees that are applied to different types of cards and accordingly take decisions to accept or not to accept specific cards. Nevertheless, the Commission acknowledged that it could not properly assess the impact of transparency requirements on small merchants. Also, it indicated several areas which require a more in-depth analysis. For example, provisions on and the impact of the prohibition of circumvention, i.e. prohibition to set other types of fees or discounts whose impact would be analogous to the impact of the interchange fee, should be evaluated. This requires collecting more data and conducting continuous monitoring both at national and EU levels. Additional attention should also be given to the applicability of the Regulation to three-party card schemes, where other PSPs are used for the issuance of cards and acquiring card transactions. Merchants are increasingly using services provided by foreign service providers, but still to a quite low extent. Mainly big merchants, often operating in several countries, make use of such an opportunity. Service contracts that merchants conclude with their service providers are usually long-term, therefore the impact of the use of services provided by foreign service providers could become evident in the longer term.

EU market participants see the impact of the Interchange Fee Regulation in a rather different light: they do see the positive effect it has had as regards certain issues, but feel the lack of the expected benefits in some other areas. They agree that the Regulation has helped to reduce fees paid by merchants but also notice a number of drawbacks. For example, major companies are said to have experienced the largest reduction in fees paid, meanwhile small merchants did not necessarily feel the benefits because it is other costs, such as the lease of the EFTPOS terminal and not the merchant service charges, that account for the largest share of the cost of card payment acceptance. In the opinion of the EU trading companies' association Eurocommerce, other fees have increased (e.g. card schemes); merchants are not guaranteed that the cost of card payments will not exceed the cost of cash payments. Also, they note that merchants find it difficult to make use of their right not to accept payment cards that are subject to higher fees (business cards, cards issued outside the EU) because it is hard to distinguish them from other cards. According to Eurocommerce, the Regulation should not provide for any exceptions and the restrictions on the interchange fee should apply to all types of cards, including business cards and cards issued outside the EU. Representatives of the payment card business sector are of the opposite opinion: in their opinion, business cards are a special product intended for businesses, they increase payment effectiveness, ensure better employee protection, also compliance with requirements on the prevention of money laundering and other legal requirements, therefore business cards should continue to be subject to the exemption. Therefore, at the moment, it is not reasonable to make amendments to the Regulation.

The Cross-Border Payments Regulation ensures a possibility for travellers to compare currency conversion charges that different service providers apply when payment cards are used for payments. When a card payment is made (or cash is withdrawn from the ATM) in a state whose currency differs from that of the payment card held by the payer, the merchant (or a PSP responsible for the ATM) may offer to convert the amount payable to the currency of the payer's account and provide a possibility to make a payment in their currency. If the payer does not choose to convert the currency at the point of sale, the currency conversion is performed by the payer's PSP, i.e. the card issuer. Both service providers must indicate the currency conversion charges applied in the form of a currency exchange mark-up, i.e. as a percentage mark-up over the ECB exchange rate. This allows the payer to compare the cost of both offers and select the more favourable one. Card issuers must include information on the applied currency exchange mark-up in the contract, also make the information publicly available, e.g. on a website. It must be noted that the applied currency exchange mark-up can change on a daily basis. Some PSPs provide this information with the help of a calculator tool. The Bank of Lithuania monitors the situation to ensure that market participants provide the necessary information as required. Requirements on the transparency of currency conversion came into force quite recently, in April 2020, thus, at this point, it is difficult to assess their impact on payment service users. In Lithuania, there are also a number of points of sale and ATMs that allow to choose currency conversion when paying with a card issued abroad.

BOX 6. STRATEGIC VIEW OF EU INSTITUTIONS ON THE PAYMENTS MARKET

Having started work in a new composition at the end of 2019, the European Commission also announced its priorities for action, including the field of payments, and organised several important public consultations. Much attention was paid to the digitalisation of financial services and promotion of innovation. It has been assessing the actions and instruments needed to improve the provision of various digital financial services. To encourage innovation, newly-emerging phenomena were discussed, for example, crypto-assets and their use for executing payments and providing other financial services, as well as the use of artificial intelligence. Having evaluated the market response, the Commission announced the Digital Finance Package, covering strategies for digital finance and retail payments as well as legislative proposals on crypto-assets and digital operational resilience in the financial sector.

The Digital Finance Strategy has several objectives: (i) to reduce fragmentation in the financial services market so as to ensure the possibility to receive and provide cross-border financial services; (ii) to ensure that the EU legal framework facilitates innovation beneficial to consumers and contributes to market efficiency; (iii) to create the European financial data space in order to promote data-driven innovation; and (iv) to address emerging challenges and risks related to the ongoing digital transformation. It foresees facilitating the possibility to create business relationships remotely. For this purpose, it is envisaged to harmonise the ML/TF prevention rules and to review regulation of electronic identification to allow for a possibility to transfer the required personal data from one service provider to another with the user's consent. In the future, the Commission plans to present legislative proposals on the access to various financial data as well as improve the collection of data required for supervisory purposes. To ensure appropriate consumer protection legal acts regulating financial services will be reviewed in line with the principle "same activity, same risk, same rules".

Specific legislative proposals are an integral part of the Digital Finance Strategy. The regulation on crypto-assets will establish that entities providing services related to crypto-assets have to obtain authorisation to engage in such business and adhere to the established requirements; these entities will also be supervised. The proposed Regulation on Digital Operational Resilience envisages harmonised standards for managing risks related to information and communication technologies in order to ensure a similar level of security in all areas. Financial market participants should ensure adequate system security, their regular testing, report incidents that occur to responsible institutions and comply with the established requirements on the management of risks related to third-party services.

The Retail Payments Strategy covers four interrelated goals: (i) digital instant payment solutions used across the EU; (ii) innovative and competitive payments market; (iii) efficient and interoperable payment systems, availability of other necessary infrastructure; (iv) better conditions for cross-border payments (outside the EU). Much attention is paid to the implementation of instant payments in both remote payments and payments at points of sale, ensuring reliability of this service and reduction of the risk of fraud. At the same, the strategy aims to ensure that payment service users could choose from various payment instruments, including cash. To improve conditions for competition, the Commission plans to consider the issue of allowing non-bank PSPs to access payment systems and the need to establish requirements on the access to other technical infrastructure.

The payments strategy announced by the ECB at the end of 2019 is also related to improving conditions in the European payments market. The ECB established several guiding principles that should be implemented when developing a market-led payment solution for physical and electronic points of sale. Such solution should ensure pan-European reach and customer experience, convenience and cost-effectiveness, security, the European brand and governance, as well as the possibility of global acceptance. In 2020, several large European banks initiated the development of a new solution that could comply with all of these principles.

VII. USE OF PAYMENT SERVICES IN LITHUANIA

In 2019, Lithuania's payments market saw a further rapid increase in the number of non-cash payments. In 2019, the number of payment transactions made by firms and residents via Lithuanian PSPs increased by 14.6%, following an increase of 10.3% and 14.2% in 2017 and 2018 respectively (see Chart 5). In 2019, as in the previous year, the increase in the number of payment transactions (19.8%) (19.5% in 2018) was mainly driven by the very active use of payment cards; the number of credit transfers also went up (8.5%) (9.2% in 2018). In 2019, in Lithuania, a total of 650.8 million payment transactions were initiated via Lithuanian PSPs, with their value reaching €284.4 billion (see Table 1): domestic transactions, i.e. transactions made between payers and payees whose PSPs operate in Lithuania, accounted for 91% (90% in 2018), and cross-border transactions accounted for 9%.

In 2019, as in the previous year, the increase in the number of non-cash payment transactions was mainly driven by the more active use of payment cards and credit transfers.

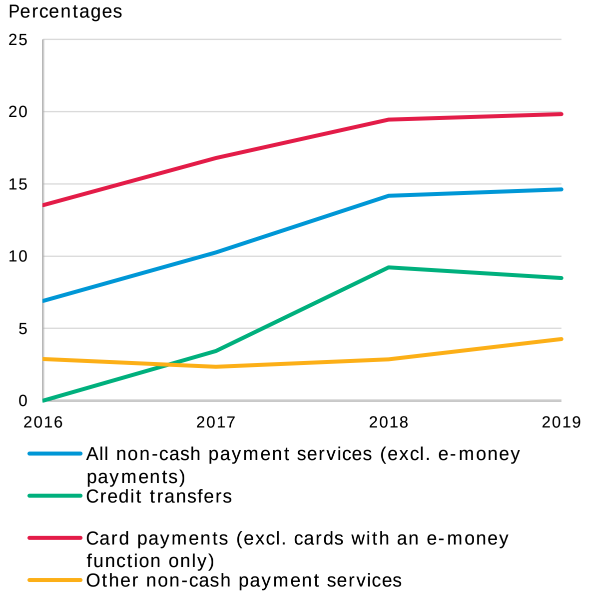
Table 1. Payment services provided by Lithuanian PSPs in 2018–2019

Payment services	Number of transactions			Value of transactions		
	millions		Change, %	EUR billions		Change, %
	2018	2019		2018	2019	
Total payments executed via PSPs	567.8	650.8	14.6	266.1	284.4	6.9
Credit transfers	183.8	199.4	8.5	256.9	273.4	6.4
Card payments	328.1	393.2	19.8	6.7	7.8	17.2
Other payment services	55.8	58.2	4.3	2.5	3.2	30.2

Source: Bank of Lithuania calculations.
Note: For confidentiality reasons, e-money payments and payments made using services provided by foreign PSPs (Revolut, PayPal, etc.) are not included.

The growth rate of the number of non-cash payment transactions is increasing on an annual basis.

Chart 5. Annual growth rates of payment transactions in 2016–2019

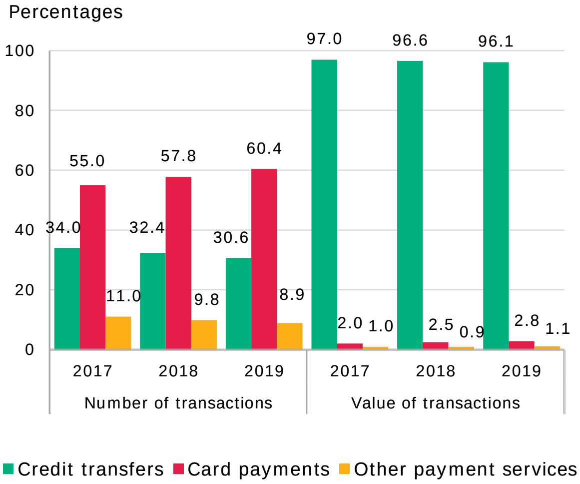


Source: Bank of Lithuania calculations.

Card payments represent an increasing share of the Lithuanian non-cash payments market, as they are the main instrument for non-cash payments at points of sale. In 2019, card payments accounted for 60% of all payments made via Lithuanian PSPs (see Chart 6), a 2 percentage points increase year on year. Payments made using physical cards or a mobile phone, where the app is linked to a payment card, are the main instrument used by natural persons for non-cash payments at points of sale. At the moment, there are no other widely used alternative payment instruments in Lithuania. Due to payment peculiarities related to large-value transactions (e.g. payments between firms), credit transfers are prevalent in terms of value, accounting for 96% of the value of all transactions. In 2019, the market share of both credit transfers and other non-card payments, including cash and non-cash remittances and payments via mobile operators, declined by 1 percentage point each.

The market share of card payments has been growing consistently.

Chart 6. Structure of payments made in Lithuania via PSPs by number and value of transactions in 2017–2019

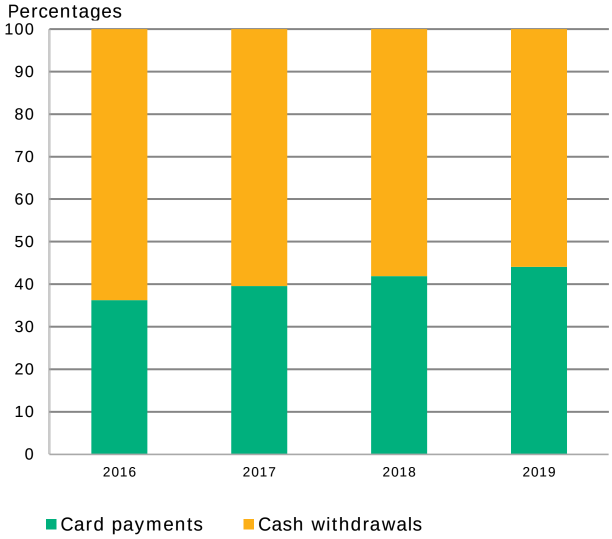


Source: Bank of Lithuania calculations.

Note: For confidentiality reasons, e-money payments are not included.

In Lithuania, payment cards are still more often used for withdrawing cash than for making payments.

Chart 7. Ratio of the amount spent using a payment card to the amount of cash withdrawn using a payment card in 2016–2019



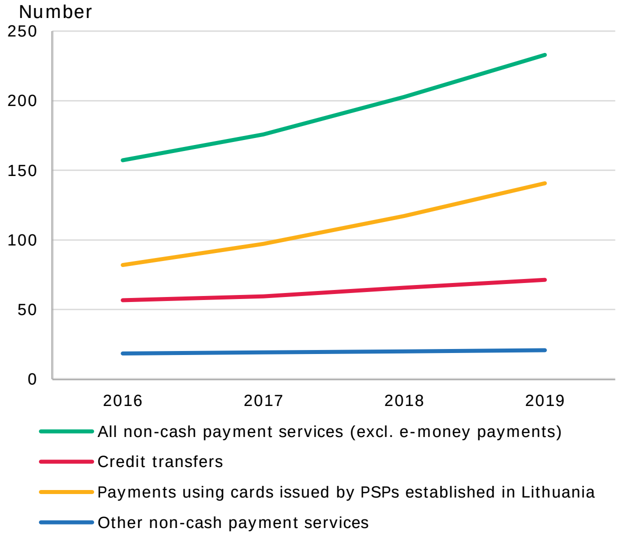
Source: Bank of Lithuania.

The full potential of payment cards has yet to be seized in Lithuania, i.e. cards are still more often used for withdrawing cash than for making payments. The frequency of cash usage is often determined by what share of payment card funds is used for payments at points of sale or online (the rest is cash withdrawals at ATMs). The share of card payments is growing on a year-on-years basis and, compared to 2018, it increased by 2 percentage points to 44% in 2019. In 2018, the share of card payments in euro area countries, on average, accounted for 61% of payment card funds used for payments. The high intensity of cash usage in Lithuania is determined by public habits, payment instruments chosen by businesses, the lack of payment services that could replace cash payments, and the potential existence of the shadow economy.

In Lithuania, non-cash payment transactions averaged 233 in 2019, an increase of 30 compared to 2018. In 2019, card payment transactions, credit transfers and money remittance or payments via telecommunications operators averaged respectively 141 (117 in 2018), 71 (66 in 2018) and 21 (20 in 2018) per capita (the latter services were most often intended for making specific payments, e.g. utility payments in cash, payments for parking) (see Chart 8). Calculations of the number of transactions per capita include payment transactions made both by residents and firms. In 2019, the EU average was 305 payment transactions per capita, while the euro area average was 286.

In Lithuania, non-cash payment transactions averaged 233 per capita.

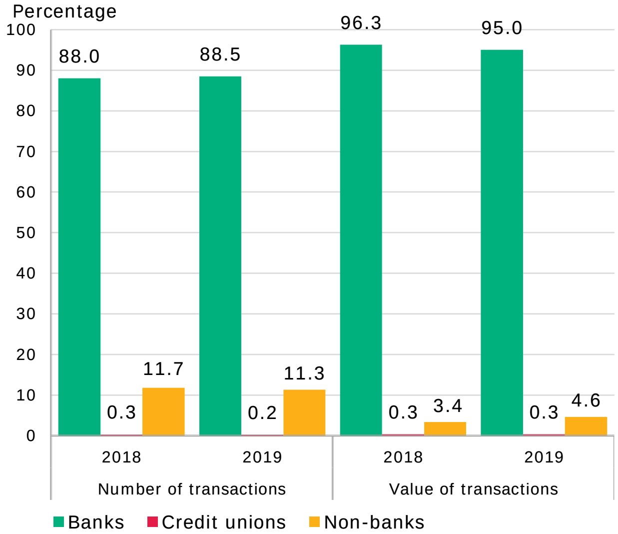
Chart 8. Non-cash payment transactions per capita in Lithuania in 2016–2019



Source: Bank of Lithuania calculations.

Lithuania's payments market is dominated by banks.

Chart 9. Market share held by PSPs by total payment services

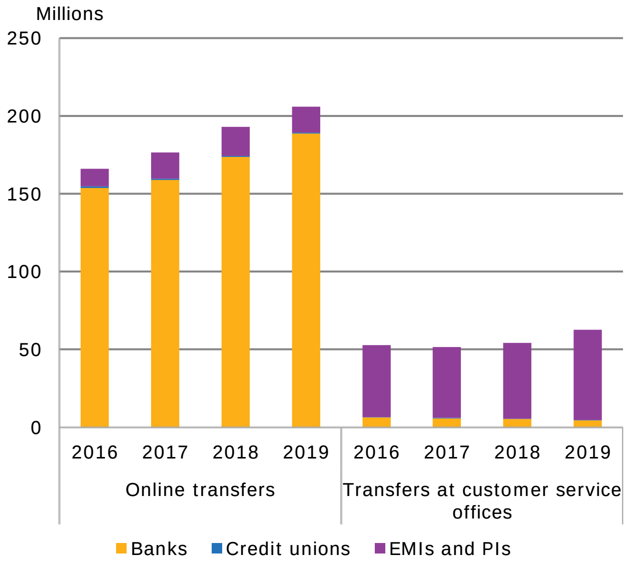


Source: Bank of Lithuania.

Lithuania's payments market is dominated by banks, meanwhile the sector of transfers conducted at customer service offices is dominated by EMIs and PIs. In 2019, bank customers, customers of EMIs and PIs and customers of credit unions performed respectively 88.5% (88% in 2018), 11.3% (11.7% in 2018) and 0.3% of all payment transactions made via Lithuanian PSPs (see Chart 9). Bank-initiated transactions account for 95% of the value of all payment transactions made via Lithuanian PSPs. The largest share of the card payments market belongs to banks: in 2019, payments made using bank-issued cards accounted for 99.8% of all payments made using payment cards issued by Lithuanian PSPs; banks conducted 99.5% of card payment acceptance transactions at points of sale. In 2019, 76.7% of transfers in Lithuania were conducted online, while the rest were made at customer service offices (these were remittances and credit transfers initiated at bank branches). In the online transfer market, bank customers conducted 92% of all transfers (see Chart 10). As for payments processed at customer service offices where payments are mainly made in cash, EMIs and PIs have retained their dominant position, holding a market share of 93%.

As regards transfers made at customer service offices, EMIs and PIs have taken the dominant position.

Chart 10. Number of transfers made by PSPs in 2016-2019



Source: Bank of Lithuania calculations.
Note: For confidentiality reasons, e-money payments are not included.

The use of cards issued by foreign PSPs at EFTPOS terminals located in Lithuania is increasing; this is partly driven by the fact that Lithuanian residents have been more active in using services provided by foreign PSPs. In 2019, 3.9% (3.4% in 2018) of transactions at ATMs located in Lithuania were made by Lithuanian and foreign citizens using payment cards issued by foreign PSPs, while payments made at points of sale in Lithuania using payment cards issued by foreign PSPs accounted for 8.6% (6.9% in 2018) of all card payments made at points of sale in Lithuania. The increase in the use of payment cards issued by foreign PSPs could be driven by tourist flows to Lithuania and the rising use of services of foreign PSPs (Revolut, PayPal, N26, etc.) by Lithuanian residents.

The proxy lookup service was launched in Lithuania – it will improve consumer experience with regard to payment transactions. One of the important novelties in Lithuania's payments market is the newly-launched proxy lookup service which was offered to market participants by the payment system CENTROlink; the system was developed and is managed by the Bank of Lithuania. This service allows making payments to other banks using only the payee's mobile phone number. This service is already available to customers of Swedbank and SEB banks. It is planned to be launched for customers of other banks in 2021. It must be noted that MoQ, a mobile payment app that was developed and launched by Lithuanian telecommunication companies at the end of 2018, which allows making payments among the app users using the payee's mobile phone number, is no longer available.

BOX 7. SIGNIFICANCE OF THE PAYMENT SYSTEM CENTROLINK FOR MARKET NEWCOMERS AND INNOVATION

CENTROlink, a new generation retail payment system developed and managed by the Bank of Lithuania, provides a possibility for PSPs licensed in the European Economic Area (EEA) to process interinstitutional payment orders and provide payment services to natural persons and legal entities. By expanding payment infrastructure, the Bank of Lithuania seeks to respond to the needs of not only banks, but also fintech companies and focuses on the expectations of both Lithuanian and foreign PSPs, thus offering a wide range of services. Through Bank of Lithuania's infrastructure, users of the CENTROlink system (banks, specialised banks, credit unions, EMIs and PIs) can make credit transfers, direct debit payments and instant payments across the SEPA area.[33]

CENTROlink is particularly important to those PSPs that are not banks, as it makes it possible for them to compete in the payments market, as reflected in the rising use of CENTROlink services. At the end of the first half of 2020, there were 121 financial institutions connected to CENTROlink. This number increased by 20% in the first half of the year. EMIs and PIs comprised 85% of system users. This was also influenced by the direct debit service offered by CENTROlink, which is not provided in Lithuania, but is important to PSPs operating in foreign markets. The number of all types of payment services provided through CENTOlink also increased in the first half of 2020: SEPA credit transfers increased by 93%, whereas SEPA direct debit transfers grew as much as 19 times compared to the respective period in 2019. In the first half of 2020, 27.5 million SEPA credit transfers and 6.2 million SEPA direct debit transfers were processed. With the expansion of instant payments in the payments market, the number of instant payments processed in the payment system increased significantly in the first half of the year to 4.1 million. Compared to the first half of 2019, it rose almost 4 times. At the end of the first half of 2020, there were 10 financial institutions offering instant payments to CENTROlink customers, a 2.5 times increase year on year.

By expanding its infrastructure, the Bank of Lithuania seeks to create conditions for new payment services to appear in Lithuania's payments market. The implementation of the proxy lookup service in October 2018 allowed to simplify payment initiation: the proxy lookup service helps to find the account number of a PSP's customer using their mobile phone number or email address. In March and April 2020, two major banks in Lithuania (AB SEB bankas and AB Swedbank) started using this service and offered private entities an interbank payment service using a mobile phone number. It allows for simpler initiation of payment instructions, when payer's and payee's banks provide instant payment services. In this case, the transferred funds are instantly credited to the beneficiary's account. The growing number of users of this service and its adaptation to business needs in the future should promote even faster expansion of instant payments in the country.

[33] See https://www.lb.lt/en/fpsu-sepa.