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EUROSISTEMA

Activities of financial market participants

# **Review of the Activities of Electronic Money and Payment Institutions**

2021

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ISSN 2669-0551 (online)

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## SUPERVISION OF ELECTRONIC MONEY INSTITUTIONS AND PAYMENT INSTITUTIONS

In 2021, the maturity of the electronic money institution (EMI) and payment institution (PI) sector continued to be one of the Bank of Lithuania's strategic objectives, therefore the institutions operating in the sector were encouraged to devote more attention and resources to the following key areas: prevention of money laundering and terrorist financing, compliance with the requirements for the protection of equity capital and safeguarding of customer funds, internal control requirements, and compliance enhancement. To promote the sector's maturity, the Bank of Lithuania organised a series of consultative events and expressed its expectations to the institutions. In order to draw the attention of the EMIs and PIs to the quality of governance and internal controls, the Bank of Lithuania organised a series of training and consultative events on these [topics](#) in the autumn of 2021. Compliance meetings are periodically held with representatives of EMIs and PIs who are responsible for the implementation of AML/CFT measures in order to discuss money laundering and terrorist financing risks identified by the Bank of Lithuania.

In order to increase the maturity of the sector and ensure compliance of institutions, the Bank of Lithuania sent a [Dear CEO Letter](#) to the heads of the EMIs and PIs on 17 February 2022, as it did in [2021](#), which this time aimed to discuss issues related to the implementation of business plans, provision of licensed services, changes to business models, safeguarding of customer funds, internal audit and internal controls, risk management (including AML/CFT measures and information and communication technology and security), as well as provision of information.

**Changes to business models and start-ups.** The Bank of Lithuania pays special attention to cases where a financial market participant decides to change its business model. In this case, they should contact the Bank of Lithuania and inform it in advance of the planned changes. It was pointed out to the institutions that business plans and financial projections submitted at the time of licensing, inclusion of new licensed services or acquisitions should be realistic and feasible. Institutions should make every effort to take real action to start and carry out their licensed activities, to actively address emerging issues and to find alternative solutions to problems.

**Risk management.** It is essential that, as risks increase, operational risk management as well as tools, procedures and resources for monitoring customer knowledge and business relationships should be strengthened in parallel. As financial services are increasingly moving online, so do the risks involved. For example, in 2021, there was an increase in reports of possible fraud by institutions' customers (investment fraud, fake e-shops, identity theft). It is therefore essential that the EMIs and PIs, which make up the bigger share of the FinTech sector, manage their risks properly and do not become a tool used by fraudsters to transfer funds.

**Internal controls.** Inspections often reveal deficiencies in the internal control systems of institutions, such as inadequate segregation of duties or conflict of interest. Serious weaknesses in the management of money laundering and terrorist financing risks continue to be identified, and institutions need to put in place appropriate internal policies and control procedures to prevent them. Institutions should also review their established procedures for the implementation of international financial sanctions as well as the technological solutions that are in place to ensure that the sanctions are applied properly and efficiently.

**Safeguarding of customer funds.** In addition, there are still cases where institutions do not adequately safeguard customer funds. The Bank of Lithuania points out that institutions must not only have a documented process of safeguarding these funds as well as the accounting and internal control procedures, but also ensure that they are followed on an ongoing basis.

**During the period under review, the Bank of Lithuania continued to focus on monitoring compliance with the requirements for the prevention of money laundering and terrorist financing, the protection of equity capital and safeguarding of customer funds.** In order to ascertain how institutions manage risks and ensure compliance, the Bank of Lithuania carried out thematic reviews on a sample of EMIs and PIs. As part of its supervision of EMIs and PIs through various inspections, desk reviews and investigations it had identified deficiencies in their internal control, risk management and governance systems, so it analysed how the EMIs and PIs managed to achieve compliance with the [requirements for robust internal controls and a management system](#). The analysis assessed the current state of play in the EMI and PI sector, looked at the issues involved and identified potential risks, presenting recommendations for further action. Half of the institutions analysed were found to be largely compliant, but there were no fully compliant institutions among those reviewed. It was

also found that internal control and management documents were not being reviewed and approved, the responsibilities and accountability of staff and managers were not properly defined, and risk analysis and assessment were not being carried out. Some good practice has also been identified where staff are made aware of human resources policies and related procedures, and these actions are properly recorded and retained, and where the use of new or developing information technology (IT) is evaluated for the purposes of the business to ensure that information is collected, processed and provided in a timely manner.

In addition, the internal audit function has been observed to be inadequately or not fully implemented in the supervision of EMIs and PIs. Therefore, the Bank of Lithuania analysed and assessed the compliance of the selected EMIs and PIs with the [requirements for the internal audit function](#). The adequacy analysis of the internal audit function found that more than half of the participants in the analysis ensure the internal audit function adequately or with minor deficiencies. However, a significant number of the institutions were found to be significantly deficient in the performance of the audit function, which could result in failure to achieve the internal audit objectives. The institutions were found failing to maintain continuity in the audited areas and not paying sufficient attention to the inherent risks (operational, IT and cyber security). There were also good examples observed of periodic updating and approval of the internal procedure descriptions, where not only the strategy for conducting internal audits is regulated, but also the corresponding detailed procedures.

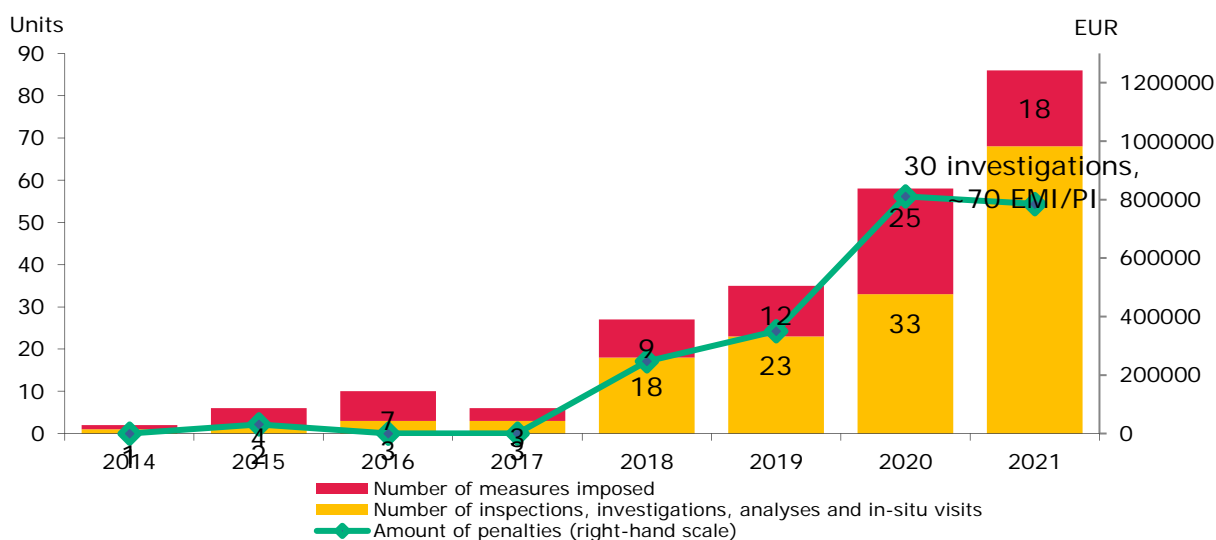
The Bank of Lithuania also conducted a [desk review of the agreements on custody of customer funds concluded with credit institutions](#) and assessed whether the provisions of these agreements ensured adequate and effective safeguarding of customer funds in accordance with the requirements of Article 25 of the Law on Electronic Money and Electronic Money Institutions of the Republic of Lithuania (LEMEMI) and Article 17 of the Law on Payment Institutions of the Republic of Lithuania (LPI). Just over a quarter of the agreements submitted for evaluation were found to be compliant, 55% were partially compliant and 19% of the institutions were found non-compliant. The non-compliant agreements do not specify that the funds held in the accounts are owned by the customers, do not disclose for whose benefit the account agreement is concluded, do not specify the law under which the account is opened, and do not discuss the custodial obligations.

Following the review, the Bank of Lithuania summarised the results and published them in one-page publications in order to ensure that both the reviewed institutions and those not reviewed could correct the most common errors and deficiencies, also seeking to draw their attention to the identified good practices. In addition, an analysis of ICT and security risk management in the EMI sector was carried out. The conclusions and recommendations of the analysis were presented to the sector's representatives. Information security risks in the EMI and PI sector will continue to be assessed in 2022.

The Bank of Lithuania regularly updates its website sections on [Frequently Asked Questions \(FAQs\)](#), [trainings](#) and [recommendations for institutions](#), designed specifically for financial market participants, also publishing its position papers and analyses on individual issues.

**Ways to reach out to market participants and ensure their compliance are constantly being explored (through Letters of Expectations and consultative events), but the real situation in a particular institution or sector can usually only be observed during inspections, sectoral analyses or in-situ visits.** In 2021, more than 30 inspections, sectoral analyses or in-situ visits were carried out, covering a total of approximately 70 EMIs and PIs. The licences of three institutions have been revoked and penalties have been imposed on nine institutions (see Chart 1) for infringements in the management of money laundering and terrorist financing risks and/or failure to comply with the license requirements and/or inactivity for more than 12 months. The assessment of the financial situation of one institution led to restriction of its activities after it was found that it could have harmed the interests of the public, users of payment services and/or holders of electronic money. More information on the measures imposed by the Bank of Lithuania is available on the Bank of Lithuania's [website](#).

Chart 1. EMI and PI supervisory actions



Source: Bank of Lithuania

The Bank of Lithuania has updated and prepared a number of [position papers and guidelines relevant to the EMI and PI sector](#), which the institutions should take on board and use them to assess their own compliance. On 27 January 2022, the [position paper](#) on crypto-assets and initial coin offerings was updated to include information on the positions published by European Union (EU) institutions and to clarify the terms used.

On 1 March 2022, a [position paper](#) was prepared on the conditions for professional indemnity insurance in cases where EMIs and PIs provide account information and/or payment initiation services. It takes the view that insurance cover should go beyond the minimum insurance conditions to include personal data protection and cyber risks. The position paper lists the minimum insurance conditions under which insurers operating in our country provide cover to EMIs and PIs. The Bank of Lithuania believes that insurance conditions should not be limited to the minimum, therefore the position paper proposes to extend insurance coverage. This would make it possible to strengthen the protection of the interests of the institutions' customers and to increase the efficiency of payment initiation and account information services. According to information in the Bank of Lithuania's possession, the main reasons for insurers' conservative attitude are related to insufficient knowledge and clarity of the insurance risks (payment initiation and account information services are relatively new on the market) and the undeveloped case law on such insurance.

The Bank of Lithuania has joined the the review process of the European Banking Authority's (EBA) response to the European Commission's [Call for Advice](#) on the Second Payment Services Directive (PSD2). Proposals to amend PSD2 have been made in various areas of payment services and supervision where challenges have arisen in its practical implementation. The EBA's opinion on the PSD2 [review](#) was published on 23 June 2022.

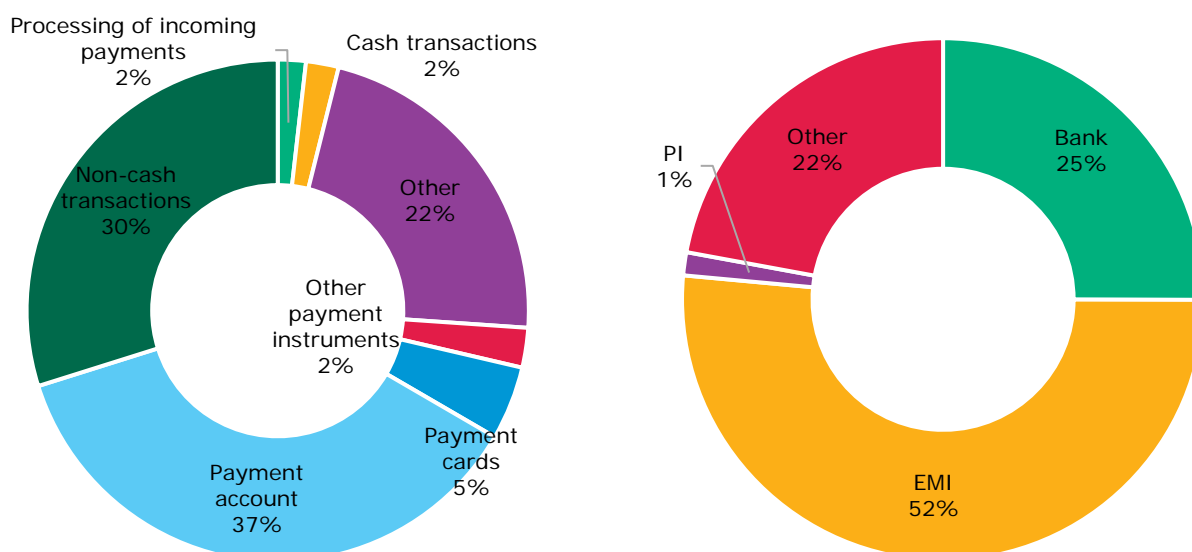
The description of the procedure for the inclusion of profits in capital, approved by the Resolution of the Board of the Bank of Lithuania No 03-91 of 16 June 2022 on the approval of the description of the procedure for the inclusion of profits in capital, which also applies to EMIs and PIs, details the information to be provided to the supervisory authority in order to obtain the authorisation for the inclusion of interim or year-end profits in the total Common Equity Tier 1 capital.

**The aim is to ensure the protection of consumers' rights, and therefore the circumstances specified in the applications submitted to the Bank of Lithuania are evaluated in the context of risk-based supervision of financial market participants.** Where infringements of legal requirements are detected, a decision is taken on whether to conduct a separate investigation or to impose sanctions on the financial market participant. In 2021, half of all complaints were received in relation to payment services provided by credit institutions and other payment service providers. Payment services provided by EMIs and PIs accounted for more than 50% of all complaints (see Chart 2). As in 2020 (37% of all complaints received about payment services), the most frequent complaint was about payment accounts opened by EMIs and PIs in the name of payment service users and used for payment transactions. Such complaints mainly concerned the opening, management and closure of payment accounts and the application of payment account fees. These include

complaints about restrictions placed on an account as well as termination of business relationships due to the application of AML/CFT requirements. Complaints have also been received about the fees charged on the payment account and the refusal of a market participant to open an account.

A third of the complaints were related to non-cash payment transactions. These include complaints related to the performance or non-performance of non-cash payment transactions (credit transfers), the failure to credit a payment transaction to a payment account, the application of a commission fee for a payment transaction, the (non)provision of information on payment transactions, etc. In order to ensure that consumers can easily and simply find all the relevant information on the complaints procedure and the complaint handling process, the Bank of Lithuania's website has a new [section](#) that clearly presents information on consumer complaints. All the most important aggregated information for consumers and market participants on the supervision of services is published in quarterly [one-pagers](#).

Chart 2. Complaints by type of payment service provider and type of payment service

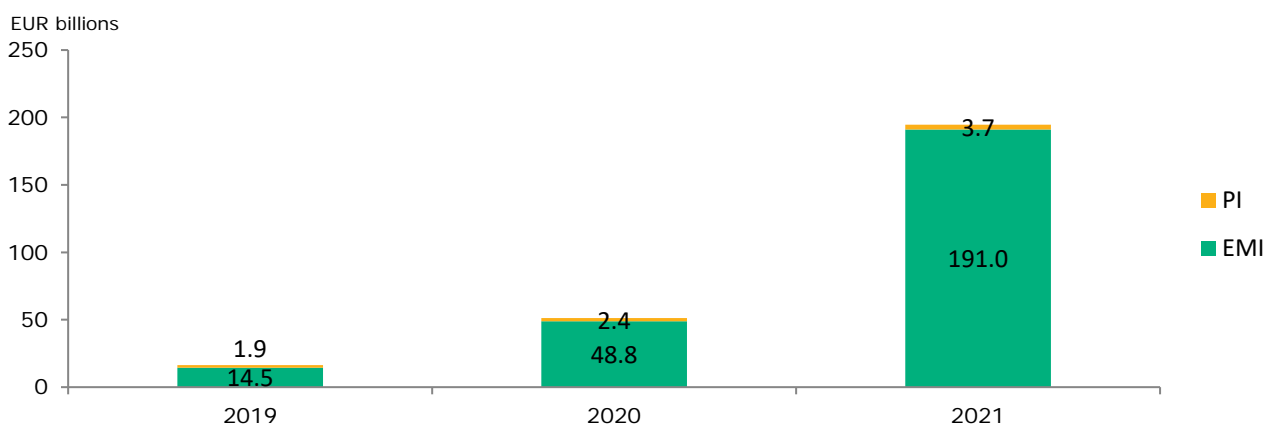


Source: Bank of Lithuania.

### PERFORMANCE OF EMI'S AND PI'S LICENSED IN THE REPUBLIC OF LITHUANIA

**During the period under review, a rapid expansion of the sector continued to be observed.** The amount of payment transactions by EMIs and PIs has been increasing rapidly and at the end of 2021 amounted to EUR 194.7 billion, according to audited data. This represents an increase by a factor of 3.8 from the end of 2020 (see Chart 3). The revenue of EMIs and PIs from licensed activities increased by a factor of 3.5 over 2021, reaching EUR 502.1 million at the end of the year, with 92% of this revenue reported by EMIs and 8% by PIs (see Chart 4).

Chart 3. Amount of payment transactions by EMIs and PIs

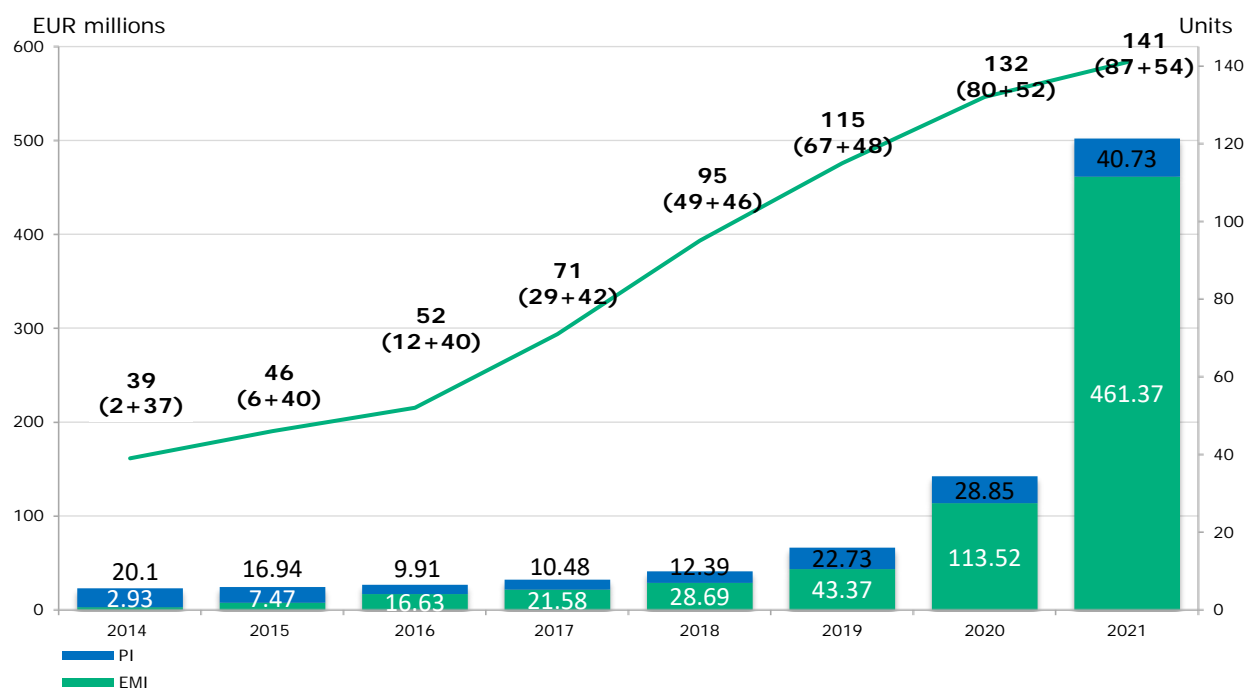


Source: Bank of Lithuania.

Change in the number of **EMIs and PIs**. **During the period under review, the number of EMIs and PIs operating in Lithuania grew by 7% to 141 at the end of the year.** On 31 December 2021 87 EMIs and 54 PIs were registered in the public list of electronic money and payment institutions, of which five EMIs and 10 PIs had a restricted activity licence<sup>1</sup> valid only in the Republic of Lithuania and four PIs had a licence only to provide the account information service<sup>2</sup>. In 2021, compared to 2020, the change in the number of EMIs was the highest, increasing from 80 to 87, while the number of PIs increased by two.

**During the period under review, the interest in obtaining an EMI or PI licence issued by the Bank of Lithuania remained high.** As part of the Newcomer programme, 81 potential market participants interested in licensing opportunities in Lithuania approached the Bank of Lithuania in 2021. More than half of these market participants (68%) were interested in EMI and PI licences. The Bank of Lithuania usually processes around 25-30 applications for an EMI or PI licence at any one time, with the exact number of applications changing regularly. In terms of geography, the highest level of interest continues to be expressed from companies based in the United Kingdom (26%) and the United States (14%), followed by companies from Lithuania (10%) in third place.

Chart 4. Revenue from licensed activities and number of EMI and PI licences



Source: Bank of Lithuania.

Although 65 EMIs and PIs made a loss during the period under review, those EMIs and PIs whose main activity consisted of the provision of licensed services alone generated a gross profit of EUR 65.9 million (an 11-fold increase), while their corporate profit tax payable amounted to EUR 16.2 million (up by a factor of 4.5). It should be noted that as much as 93% of the sector's total pre-tax profits are attributable to a single market participant, which paid 64% of the sector's total corporate profit tax.

It should be noted that the EMI and PI market is still developing, with the break-even point achieved by companies in their third year of operation on average. The average number of employees of the EMIs and PIs which are required to submit annual activity reports and whose main activity consisted of the provision of

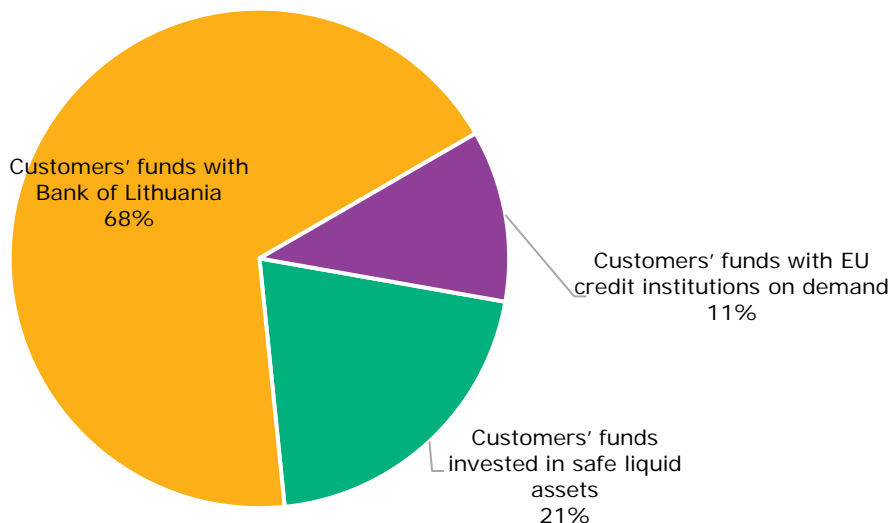
<sup>1</sup> The average amount of electronic money outstanding under a restricted licence must not exceed EUR 900,000 per month and/or the average amount of payment transactions executed in the last 12 months must not exceed EUR 3 million per month.

<sup>2</sup> This type of licence does not impose capital requirements, but it does require professional indemnity insurance or a similar guarantee.

licensed services<sup>3</sup> increased by 45% during the year to 1,265, having created on average 1,051 jobs in Lithuania.

During the period under review, most of the customers' funds held by EMIs and PIs (EUR 3.9 billion) was held with the Bank of Lithuania, followed by funds held with Lithuanian and EU credit institutions, with part of customer funds invested in safe and liquid, low-risk assets<sup>4</sup> (see Chart 5). The average amount of e-money outstanding<sup>5</sup> at the end of 2021 has increased four-fold compared to the end of 2020, reaching almost EUR 5 billion.

Chart 5. Customer funds held by EMIs and PIs



Source: Bank of Lithuania.

**The market participant with the largest market share in 2020 increased it further in 2021.** During the reporting period, Revolut Payments UAB had the largest market share in terms of both licensed activity sales and the amount of payment transactions, accounting for 49% of the sector in terms of total licensed activity revenue (20% in 2020). In terms of the total amount of payment transactions in the last 12 months, Revolut Payments UAB has a share of more than half of the market. The second position went to ConnectPay UAB and the third to Paysera LT UAB. The total amount of payment transactions of the three EMIs amounted to 68% of the market total. Compared to 2020, the top 10 EMIs and PIs have seen an increase in revenues from licensed activities from 68% to 77% of the sector's total revenue, while the amount of payment transactions has increased by 5 percentage points (see Chart 6).

Chart 6. Largest EMIs and PIs by licenced revenue and amount of payment transactions

<sup>3</sup> Average number of employees (calculated in accordance with the Labour Code of the Republic of Lithuania).

<sup>4</sup> Investments in safe, liquid and low-risk assets consist of deposits and investments in debt and equity securities.

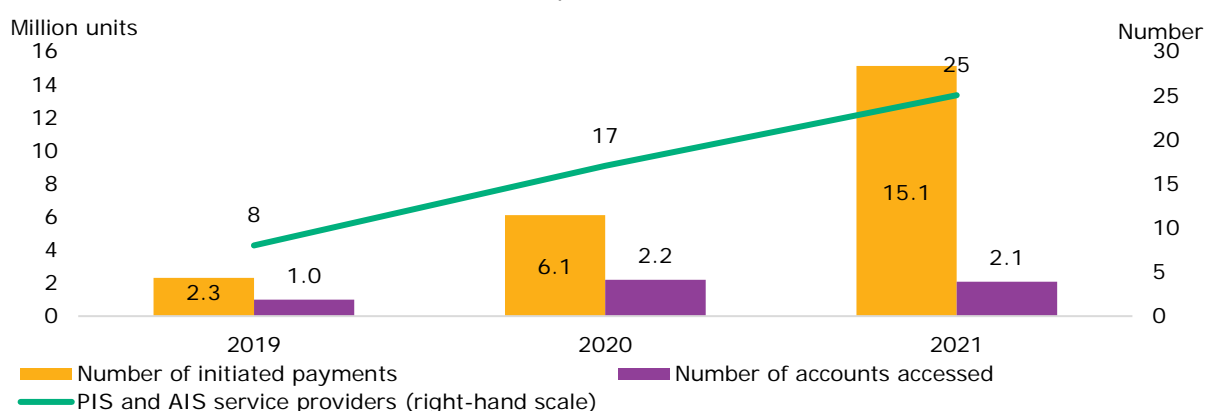
<sup>5</sup> Average outstanding e-money, calculated as the average of the total amount of financial liabilities related to e-money issued at the end of each day over the previous six months, as applied to EMIs.





The number of **EMIs and PIs that provided payment initiation services (PIS)<sup>6</sup> and/or account information services (AIS)<sup>7</sup> continued to grow during the period under review**. Compared to 2020, the number of EMIs and PIs entitled to provide PIS and/or AIS increased by a factor of 1.5, to 25 at the end of 2021. The number of initiated payments increased by almost 2.5 times during the year to 15.1 million, while the number of accounts accessed by AIS providers was slightly more than 2 million during the reporting period (see Chart 8). PIS providers offer the possibility to assure the payee (the merchant) that the payment is initiated so that they can send the goods or provide their services immediately. These services offer merchants and consumers an alternative solution to Bank Link and enable consumers to shop online even if they do not own a payment card. AIS providers collect and make available to the service user in a convenient form (phone, web account, etc.) the information collected from their other accounts with different credit institutions, EMIs and PIs, enabling the service user to monitor their balances, to review their history of expenditures and to have information on the payment transactions completed. Business models are emerging where, with the customer's consent, an account information service is used to provide the customer with other financial services, such as consumer credit or a certain insurance product, to enable an assessment of the customer's creditworthiness before extending credit, or similar.

Chart 8. Performance indicators of PIS and AIS providers



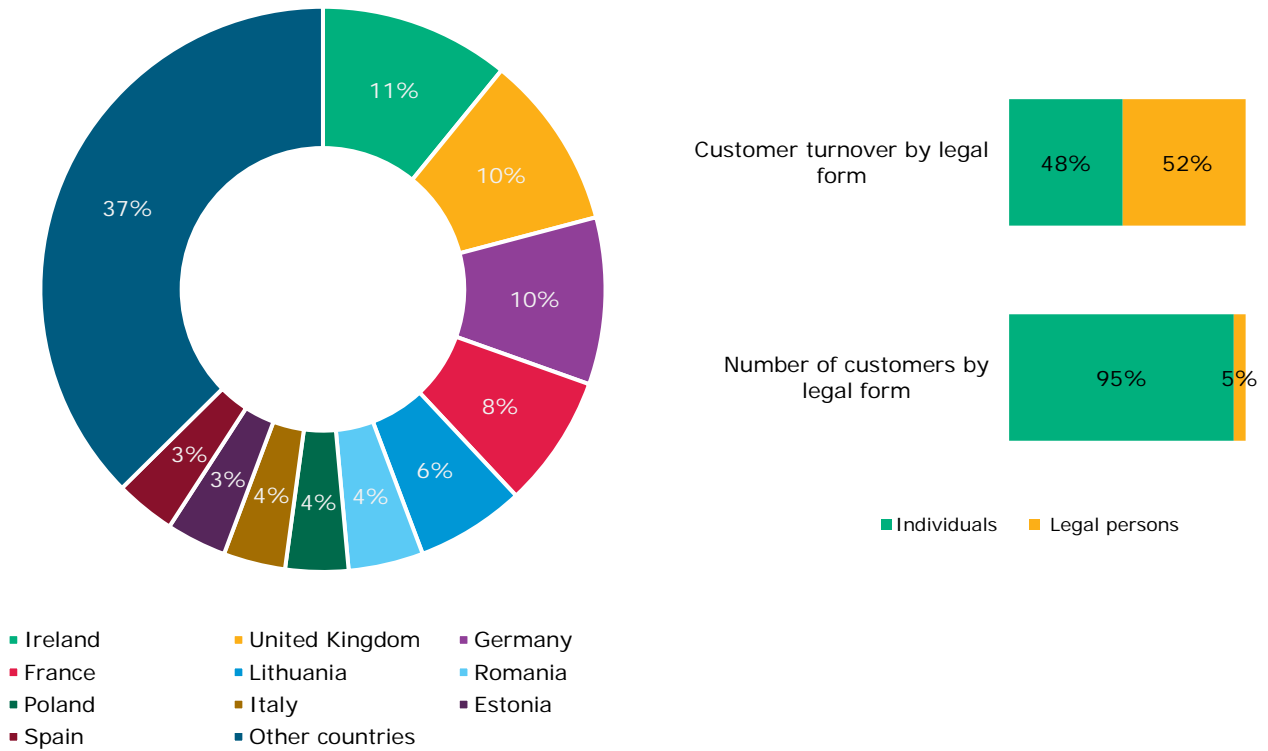
Source: Bank of Lithuania.

**In 2021, EMIs and PIs had almost 10 million active customers, and about 370,000 of them were Lithuanian residents. The largest share of payment transaction turnover came from payments made by legal persons, while payments from/to the EU dominated in terms of value of payment transactions (see Chart 9).** The reports submitted by EMIs and PIs on 31 December 2021 for the supervision of the implementation of AML/CFT measures show that, in terms of the value of payment transactions, the highest number of payment transactions was made between EU Member States, with Ireland in first place (11% of payment transactions), replacing Germany which was in the lead in 2020. In the EMI and PI sector, the largest share of payment transactions (52%) came from customers who are legal persons, although their share in the total number of customers was only slightly above 5%.

<sup>6</sup> PIS means a service where, at the request of the payment service user, a payment order is initiated from a payment account opened with another payment service provider. By providing only PIS, the payment initiation service provider does not acquire the consumer's funds at any stage of the payment chain.

<sup>7</sup> AIS is an online service for providing consolidated information on one or more payment accounts held by a payment service user with the institutions of another payment service provider or several payment service providers.

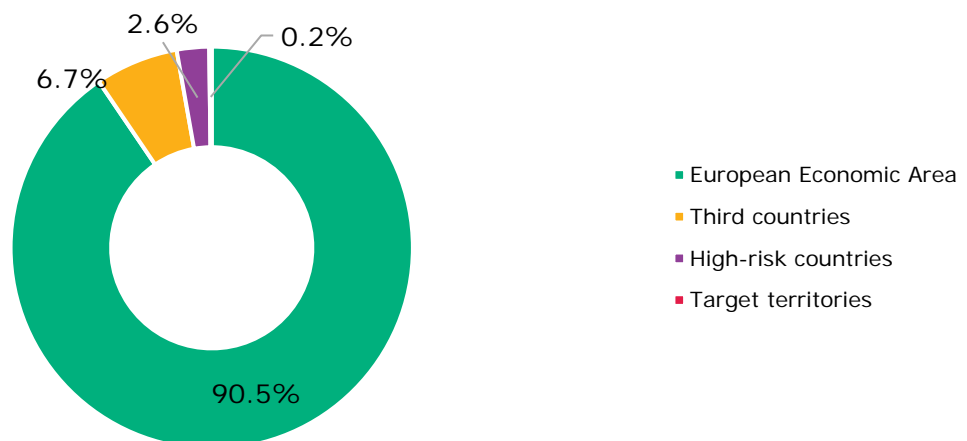
Chart 9. Value of payment transactions by country and by customer type



Source: Bank of Lithuania.

**The significant expansion of the sector has not affected the distribution of non-resident customers by different country groups.** In 2021, the distribution of non-resident clients by country was practically unchanged compared to 2020. The largest number of non-resident customers are in the European Economic Area (90%), in third countries (7%) and in high-risk countries (3%). The number of non-resident customers from high-risk countries has slightly increased compared to 2020, but this is attributed to Malta's inclusion in the FATF's list of high-risk countries<sup>8</sup> (see Chart 10).

Chart 10. Number of non-resident customers of EMIs and PIs by country group (by nationality)



Source: Bank of Lithuania.

<sup>8</sup> The Financial Action Task Force (FATF) on Money Laundering and Terrorist Financing publishes lists of countries with serious deficiencies in the prevention and suppression of money laundering and/or terrorist financing, identifying countries at high risk.

As the EMI and PI sector has been growing both in terms of new customers and new entrants, it is natural that growth was observed in all payment channels during the period under review. In 2021, a more even growth was observed in almost all country groups. In practice, the proportion of payments to/from non-EU countries has increased, but this increase is mainly due to the fact that the UK is not a member of the EU from 2021 and is treated as a third country. Excluding the UK factor, the proportion of country groups is essentially unchanged compared to 2020. Other main non-EU countries to/from which payment transactions were made are Switzerland, the United States, Norway, etc.

Value of payment transactions by country group and change

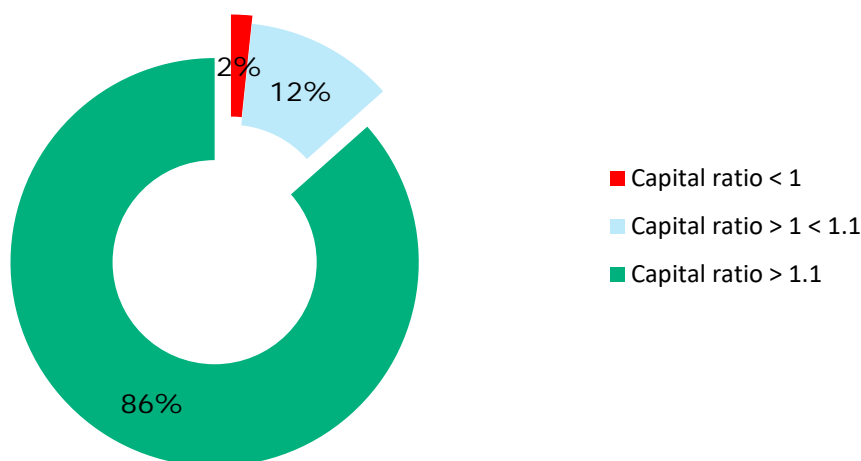
Countries	Value of payment transactions in 2021, %	Growth compared to 2020
Lithuania	6	factor of 2.9
UK	10	factor of 3.8
Other EU countries*	73	factor of 3.9
Non-EU countries, excluding the UK	11	factor of 3.7

Source: Bank of Lithuania.

\* Additionally excluding Lithuania and the UK.

**Compliance with prudential requirements must be ensured on a continuous basis with sufficient reserve.** Most of the EMIs and/or PIs with a restricted licence were compliant with the requirement for the average e-money outstanding and/or average amount of payment transactions as of the reporting date. The equity ratio is calculated as the ratio of the available equity capital to the calculated equity capital requirement and must be at least 1. On 31 December 2021, 86% of the EMIs and PIs exceeded the mandatory equity ratio, which in their case was above 1.1 (see Chart 11). However, two of the EMIs had to take measures to ensure that their calculated own funds were brought at least to be equal to the equity requirement. It should be noted that information on the key annual and quarterly performance indicators of each [EMI](#) and [PI](#) as well as on their compliance with prudential requirements is published on the website of the Bank of Lithuania.

Chart 11. Capital ratio for EMIs and PIs



Source: Bank of Lithuania.

In addition, the Bank of Lithuania publishes quarterly sectoral overviews in summarised [one-pagers](#).