

## Law Bulletin

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### **DIGITAL BANKS AND SERVICE MODEL BANKING OPERATION PRINCIPLES**

The Regulation on the Operation Principles of Digital Banks and Service Model Banking (the "**Regulation**") entered into force on 1 January 2022. Accordingly, new regulations and definitions with respect to the related business models have been introduced for the banking and finance sector.

Following the relevant developments, as digital banks become ever more popular, access to the related services will be provided in a more practical and cost-effective way in comparison to traditional banking services.

#### **1. Digital Banks**

Under the Regulation, a digital bank is a credit institution that provides banking services through electronic banking services distribution channels instead of physical branches.

##### ***Incorporation and Operation Permit***

The conditions concerning incorporation and operation permits within the scope of the Regulation will be applied as additional provisions without prejudice to the Regulation on Indirect Shareholding and Transactions Subject to Permission of Banks.

Digital banks must have a paid-in capital of at least TRY 1 billion, paid in cash, to obtain an operation permit. The Banking Regulatory and Supervisory Authority (the "**BRSA**") has the authority to increase this amount. Upon the application of digital banks that have TRY 2.5 billion or more of the required minimum paid-in capital at the time of application or after, the BRSA can remove the operation limitations defined in the Regulation, either completely or gradually, as part

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of a transition plan for those digital banks that the BRSA believes can manage the risks in their new environment.

If the applicant's controlling shareholders are legal entities that provide services in technology, electronic commerce, or telecommunications, the BRSA may require the controlling shareholder legal entities, or those having control over these legal entities, to be resident in Turkey and to sign an information exchange agreement with the Risk Center to share data as to their indebtedness, as well as their financial power for those who reside in Turkey.

The personnel who are identified as top-level executives in charge of information systems must be appointed to at least the level of a general manager and at least one member of the board of directors must have a minimum of ten years' professional experience in information systems management.

## ***Operation Limitations***

Digital banks' credit clients may only be comprised of financial consumers and small and medium-sized enterprises ("**SME**"). If an SME grows larger in size than an SME after digital banks start to provide services to them, then only services that are provided to enterprises larger than an SME (like foreign currency loans made to enterprises that are larger than SMEs) can be provided to these enterprises unless they are re-categorized as an SME. Additionally, digital banks will be able to perform all transactions carried out by deposit and participation banks and loan transactions as defined under the Banking Law through interbank and capital markets and may provide loans to other banks.

Digital banks cannot be organized in the same way as correspondent, agency, or representation organizations, except for general directorates and service units that are affiliated with the general directorate and cannot use the said service units as physical branches for any other purpose. Digital banks cannot provide safety deposit boxes, nor offer consignee transactions and custody services, except for those to be carried out in a digital environment. However, these banks must open at least one physical office through which they will address client complaints. In addition, if customers are provided with face-to-face services including marketing services from support service institutions that are in compliance with the Regulation on Support Services, these will not constitute breaches under the Regulation. Likewise, digital banks and support service institution personnel may provide face-to-face services to clients for transactions that were started through electronic banking distribution channels, but which cannot be concluded through these channels due to de facto impossibility and for those that cannot be concluded at physical access points such as ATMs.

Under the Regulation, limitations have been imposed on unsecured cash loans provided to consumers. Accordingly, the total unsecured consumer cash loans that can be provided to any customer cannot exceed four times the said customer's average monthly net revenue, excluding expenditures and cash withdrawals made from credit cards and overdraft accounts. However, if

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the customer's average monthly net income cannot be determined, the upper limit will be set at TRY 10,000. Moreover, digital banks can evaluate and determine income by using their income estimation models, provided that these are based on objective criteria using the customer's information to evaluate their solvency.

## ***Existing Banks' Transition to Digital Banks***

Under the Regulation, existing banks are not required to make another application if those that hold operation permits and provide services through their physical branches within the scope of their existing operation permits wish to deliver services through electronic banking services distribution channels completely or partially. The Regulation also allows them to provide services in the same way under the same legal entity using a different brand name if those services are limited to the scope of the existing operation permits. These regulatory provisions on digital banks will not be applied to the said banks, and they may close their branches only with a plan deemed appropriate by the BRSA. If these banks wish to carry out their activities only through electronic banking services distribution channels, the service unit responsible for on-site inspection of the institutions' information systems that are subject to the BRSA's supervision and control are required to obtain the appropriate opinion as to the banks' information systems' adequacy.

## **2. Service Model Banking**

Under the Regulation, service model banking enables interface providers to intermediate their clients' transactions through their interfaces and service banks by connecting to the services through open banking means. Service model banking can only be provided to domestic resident interface providers and only within the framework of their operating permits. Banks are prohibited from acting as interface providers. Interface providers cannot use expressions that imply they operate like a bank, payment institution and/or electronic money institution. They also cannot imply that they collect deposit and participation funds like a bank, or that they collect funds like a payment service provider.

### ***Interface Provider and Service Bank Relationship***

The bank will decide whether to provide services to the customer using service model banking through the interface provider, including loan allocation decisions. In this context, the customer's banking services will be carried out with respect to the bank's balance sheet.

In order for a service bank to provide banking services to the interface provider's customer, a contractual relationship must be established between the relevant customer and the service bank. Additionally, the provisions required in the service agreement between the service bank and the interface provider are set forth in the Regulation. Also, system and data backups that transfer confidential data to the interface provider, which are processed by the interface provider, must be retained domestically. This also pertains to the parties that receive services on behalf of the interface provider.

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Under the Regulation, interface providers and service banks are jointly and severally liable to ensure that the interface provider's mobile app or web browser-based interface, which are used by the clients to receive these services, are in compliance with the Regulation on Information Systems and Electronic Banking Services of Banks' identity verification and transaction security obligations that govern electronic banking.

## ***BRSA's Permission and Authority***

The interface provider, in addition to receiving service banking assistance, can also be classified as a support service enterprise to banks in terms of mediating the contractual relationship to be established between the bank and the customer, or as it enables the provision of banking services to the customer through the interface according to the contract. Therefore, the BRSA's permission is required in order to give support services to the banks.

Service banks are obliged to publish a list of interface providers to which they provide services and to post information on the scope of the said interface providers' use of banking services on their websites. They must also submit copies of each executed service agreement with the interface providers to the BRSA and copies of any amendments.

Under the Regulation, the BRSA is authorized to revoke the permit given to an interface provider in various circumstances. In this context, the permit may be cancelled if the interface provider allows the service bank to provide services to its customers through the interface it has developed and, within this scope, if all kinds of fees, expenses, commissions and benefits that it requests from its customers in return for the service fee paid to the said bank, if any, are used to circumvent these provisions, or if it is determined that the interface provider's support services to the bank do not comply with the legislation.

## **CONTACT**

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