Direct Debiting System

The Turkish banking industry continues to introduce new products and services, in tandem with the rest of the world. Developed as a payment system to meet the business needs and goals of corporate banking customers, the Direct Debiting System ("**DDS**") is widely preferred by corporations in Turkey. Companies operating through distributors or dealers – typically those involved in the retail, oil and energy sectors – use DDS as a collection system, while it serves distributors and dealers as a payment system.

Electronic fund transfers originated in 1992, and DDS was introduced in 2000 as part of the second-generation of EFT systems. However, no practical use of DDS was made until 2004, when the Banks Association of Turkey established rules for applying the mechanism in its *Protocol Regarding Inter-Bank Collection System*. In an article published by the Association, DDS was presented as an alternative to the standard paper check system. Current laws do not govern the DDS in detail; instead, each bank creates its own mechanism, and then negotiates the functional details with the company that will be using it as a collection system.

DDS has two main elements:

(i) the debtor (distributor or dealer) authorizes the bank to make payments from its account to the customer; and

(ii) the customer orders the bank to collect payments on its behalf from debtor's account.

While the debtor opens an account at the relevant bank (and authorizes the bank to pay the customer from this account), it is actually the customer who enters into a DDS agreement with the bank. Under the DDS agreement, the bank undertakes to pay the customer from the debtor's account. Each payment amount is determined by an invoice sent to the bank by the relevant customer. The bank's liability under the DDS agreement is limited by its role as an intermediary for payment, the completion of which is dependent on the current balance in a debtor's account.

On the other hand, in the DDS with credit line ("**Credit DDS**") – a system created through a loan agreement between the bank and the debtor – a line of credit granted to the debtor by the bank is added to the balance in the debtor's account. The relevant credit limit for each debtor is determined by the bank. In circumstances where a debtor's account balance is insufficient to cover a customer's invoice, payment to the customer can be made from the DDS credit amount granted by the bank.

While DDS and Credit DDS have certain advantages (such as efficiency, risk management, automatic invoice collection, invoice discounting, and the ability to increase a debtor's credit limit without additional costs to the customer), they also contain features that require the customer's careful consideration and attention:

- Credit DDS does not serve as a security, but is merely a payment system enabling a customer to automatically collect its receivables from a debtor's designated account (and from the DDS loan granted to the debtor if funds in the debtor's account are insufficient).

- The amount that can be collected through DDS is limited to the invoice amounts indicated in direct debiting orders and does not cover the debtor's total liability to the customer.

- The bank's liability under the DDS is limited to the balance in the debtor's account (plus the DDS credit amount for Credit DDS, if applicable). Therefore, the customer will not be able to collect the debt if the current balance in the debtor's account is insufficient, or if the bank, at its sole discretion, does not permit use of the credit amount.

- While the automatic payments offered by DDS are beneficial to the customer's debt-collection needs, they also create certain operational burdens. These burdens include written notification requirements in the DDS agreement and development of the necessary framework for electronic transfers of information between the bank and the customer.

- Although DDS is widely used, it may be argued that its interpretation and application could create uncertainty in dispute outcomes, as the system's framework is not clearly defined by laws or court precedents.

There are significant similarities between the general frameworks of DDS services provided by individual banks, but each bank has its own unique practices, and payment mechanisms and monitoring systems may differ greatly from institution to institution. Therefore, companies must carefully negotiate and draft DDS agreements in line with their internal accounting and payment system requirements.

İnci Karcılıoğlu (ikarcilioglu@kolcuoglu.av.tr) & Ömer Faruk Çıkın (ofcikin@kolcuoglu.av.tr)