

A NEW ERA FOR THE FINTECH SECTOR

I – INTRODUCTION

The last month of 2021 was unarguably remarkable for the financial technology (“FinTech”) sector.

Firstly, the decision of the Judges and Prosecutors Council on the establishment of specialized courts for cybercrimes and financial crimes was published. Following the decisions, secondary legislation for the payment services and electronic money issuance entered into force, and the Turkish Competition Authority published the sector Report on FinTech where the sector is examined thoroughly in the light of the brand-new secondary legislation. Moreover, the regulation on the operating principles of digital banks and service model banking entered into force in the same month and the sector was completely shaped after the publication of this regulation.

Within this context, the regulatory framework for the sector was determined and established through the decision, regulations, and the report complementing each other just as the rings of a chain. Hereby with this article, we aim to provide general information regarding the sectoral regulations and summarize the potential impacts of the regulations from a short-term point of view.

II – LATEST REGULATIONS OF 2021

1- Establishment of specialized courts

The decisions dated 25 November 2021 and numbered 1229 and 1230 (“**Decisions**”) of the First Chamber of Judges and Prosecutors Council (“**Council**”) have been published in the Official Gazette dated 30 November 2021 and numbered 31675. The Council decided to establish specialized courts to hear the below-mentioned cases:

- i- *Cases arising from the cybercrimes stipulated under the Turkish Criminal Code,*
- ii- *Cases arising from the financial crimes stipulated under the Law on Payment and Securities Settlement Systems, Payment Services, and E-Money Institutions (“**Law**”).*

In this manner, we believe that the Council took an appropriate decision regarding the determination of the areas requiring expertise and the requirement of establishing specialized courts. Reducing the impact of cybercrimes and financial crimes recently becoming widespread and malignant depends on the effective and disincensive judgment process. At this point, it is substantial to ensure that the digital evidence collected depending on the type of the crime can be evaluated by the judges not only by the experts assigned to the cases. Therefore, the specialized courts consisting of judges having a technical background and know-how doubtlessly will take faster, effective, and disincensive decisions in the forthcoming days. As a matter of fact, the Decisions taken will lead to progress on the judicial reform and implementation of the Human Rights Action Plan.

2- Secondary legislation regarding the industry

The Regulation on Payment Services and Electronic Money Issuance and Payment Service Providers (“**Regulation on Payment Services and Electronic Money**”) and Communiqué on Information Systems of Payment and Electronic Money Institutions and Data Sharing Services



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in the Field of Payment Services Providers (“**Communiqué on Information Systems of Payment Services and Electronic Money**”) have been published in the Official Gazette dated 1 December 2021 and numbered 31676 and entered into force as of the publication day. Thus, the Regulation on Payment Services and Electronic Money Issuance, Payment Institutions and Electronic Money Institutions (“**Abrogated Regulation**”) published in Official Gazette dated 7 June 2014 and numbered 29043 and Communiqué on the Management and Supervision of Information Systems of Payment Institutions and Electronic Money Institutions (“**Abrogated Communiqué**”) have been repealed.

The Regulation **on Payment Services and Electronic Money** was drafted on the grounds of the Law by the Central Bank of the Republic of Turkey (“**CBRT**”) and aims to regulate the operations of payment and electronic money institutions (“**Institutions**”) and procedures and principles with regard to providing payment services and issuance of electronic money. Considering the provisions stipulated in this direction, it is safe to say that financial liabilities of the Institutions identified in the regulations are preferred to be increased to strengthen their financial structures. With the Regulation **on Payment Services and Electronic Money**, operating permit procedures are strictly regulated, amount of the minimum equity capital to be paid is increased, and the Institutions identified in the regulations are obliged to hold collateral before the CBRT. Additionally, the cooperation of the Institutions identified in the regulations with foreign institutions, the transactions allowed to be made in foreign currency and the transactions that can be carried out through branches and representatives are stipulated. In this context, it can be alleged that there are new and stricter provisions in many aspects.

Considering the scope of the Regulation **on Payment Services and Electronic Money**, Institutions are aimed to be more accredited. Particularly, reporting obligations in various contents to the CBRT set forth for the Institutions demonstrates that the Institutions identified in the regulations are subject to a continuous auditing mechanism. Our evaluations are presented below under the section “*III - Evaluations on the Regulation on Payment Services and Electronic Money Issuance and Payment Service Providers*” where the Regulation is examined closer.

3- Report of the Turkish Competition Authority regarding the FinTech companies providing payment services

Turkish Competition Authority published the Survey Report on the Financial Technologies Providing Payment Services (“**Turkish Competition Authority Report on FinTech**”) on 08 December 2021. Although the payment services market is subject to the CBRT regulations, the CBRT has not been given a special duty and authority to establish competition in the market or to ensure fair competition conditions under the Law or regulations drafted based on the Law. However, for instance, the Information Technologies and Communications Authority, in its capacity as a sectoral regulator, has been given a special task and authority to determine the conditions of competition in the electronic communication market under the Electronic Communications Law No. 5809. Therefore, it is obvious that the control of the competition conditions in the payment services market will not be carried out with a special duty and



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authority of the regulator, but within the framework of the Law No. 4054 on the Protection of Competition that authorizes the Turkish Competition Authority. In this regard, the sector Report, namely the Turkish Competition Authority Report on FinTech, drafted by the Turkish Competition Authority is a remarkable work that examines the market from the competition perspective.

The Turkish Competition Authority Report on FinTech consists of the following sections:

- (i) exclusionary actions of established enterprises,
- (ii) regulations, and
- (iii) market dynamics.

The Turkish Competition Authority Report on FinTech evaluates the reasons for the emergence of FinTech sector, impacts on the sector, difficulties in the marketing of products and services faced by the players, obstacles to increase of innovation and competitive conditions in the market, exclusionary effects, and actions originating from both the market and established enterprises. Suggestions from the perspective of competition are also included for the development of the sector considering the sectoral dynamics.

It is stated that the fact that FinTech companies are highly dependent on the banking infrastructure in their activities, creates a vertical relationship between FinTech companies and the banks. In this regard, and in cases where services cannot be provided by the banks to FinTech companies, Fintech companies are not able to provide products and services they have developed to the consumers.

The Report evaluates that the market structure, in which FinTech companies receive services from the banks in the upstream market and compete with the banks in the downstream market, shows similar characteristics to markets such as telecommunication and retail.

The Turkish Competition Authority established a convergence between the telecommunication market and the payment services market and stated that each bank shall be in a dominant position, taking into account the customer data of companies providing financial services. In our opinion, this evaluation is remarkable as previously the strongest argument of the banks to refrain from executing contracts to provide infrastructure and/or services to the FinTech companies was that the banks are not obliged by the Turkish Competition Authority to execute contracts based on the low market share threshold.

4- The State Report of Presidency Finance Office regarding the FinTech ecosystem:

“The State of Fintech Ecosystem in Turkey, 2021” (“**State Report**”) prepared under the coordination of the Finance Office of Presidency of the Republic of Turkey has been published.

State Report has been prepared to provide references to local and foreign investors, entrepreneurs, and academic literature. In the State Report, regulations adopted in financial technologies in recent years that lead up to the development of the Turkish FinTech sector are

indicated in detail. The innovations that took place on a national basis and the new business models that emerged in this direction are mentioned.

It is stated that there are 70.3 million active retail digital banking users and it has been reached 1.7 million POS terminals, 52 thousand ATMs, 82.8 million credit cards, 54.4 million prepaid cards in Turkey; the contactless payment rate reached the level of 48%. It is also noted that in the ecosystem in which 520 fintech companies actively operate, more than \$64 million investment was made in 2021 and FinTechs authorized in 2021 sold a total of 48 million USD worth of shares in 2021.

In addition to this, the main vision and strategy of the National FinTech Strategy Document, which is being worked on by the Presidency Finance Office, has been established. Moreover, the National FinTech Strategy Document, a roadmap to provide developments in the sector, which will reveal an action plan for the FinTech ecosystem between 2022 and 2025, is predicted to be published in the first quarter of 2022.

5- Regulation on digital banking:

The Regulation on the Operating Principles of Digital Banks and Service Model Banking (“**Regulation on Digital Banking**”) has been published in the Official Gazette dated 29 December 2021 and numbered 31704 and entered into force on 1 January 2022.

With the Regulation, the procedures and principles regarding the activities of branchless banks, which serve through electronic banking services distribution channels and the provision of banking services to financial technology companies and other businesses as a service model have been determined. In terms of digital banks, operation limitations, mandatory service continuity level, and licensing requirements are stipulated under the Regulation on Digital Banking.

Within the scope of the Regulation, digital banks are provided with the opportunity to perform all the activities that can be performed by the credit institutions, depending on whether they are deposit banks or participation banks unless otherwise stipulated under this or other secondary legislation. Moreover, digital banks are obliged to comply with the legislation that all credit institutions should comply with, in addition to this regulation.

Operation restrictions and exceptions to these restrictions are set forth for the digital banks in the Regulation on Digital Banking. One of the restrictions is that the customer portfolio of the digital banks can only consist of financial customers and small and medium sized enterprises. However, some transactions are not subject to these customer portfolio restrictions such as transactions considered as loan and conducted in the interbank markets or to operate in the monetary and capital markets. As an exception to the customer portfolio restriction, digital banks can provide loans to other banks and foreign currency loans to enterprises that are larger than medium-sized enterprises.



Digital banks are prohibited from organizing under any name and establishing any agency or a correspondent or representation office excluding the general directorate or units affiliated with the general directorate. Digital banks are required to establish at least one physical office to handle customer complaints provided that it is not used as a branch. In addition, digital banks were given the opportunity to serve their customers through the ATM networks to be established by themselves.

The service continuity percentage undertaken for internet banking and mobile banking distribution channels of digital banks cannot be lower than 99.8%

The general conditions of establishment and operating permit of digital banks are the conditions for obtaining establishment and operating permits of the banks stipulated under the Regulation on Transactions Subject to Permission and Indirect Shareholding of Banks. The minimum paid-up capital required for digital banks to obtain an operating license has been determined as one billion Turkish Liras, paid in cash and free of any collusion. It is stated that the Banking Regulatory and Supervisory Board may stipulate that the applicant must sign an information exchange agreement with the Risk Center if the applicant's controlling partners are legal entities providing technology, electronic commerce, or telecommunication services.

As per the Regulation on Digital Banking, the total unsecured consumer cash loans that can be extended to any financial customer cannot exceed four times the average monthly net revenue of the customer. In case the average monthly net income of the customer cannot be determined, the upper limit will be TRY 10,000.

Additionally, the principles of Service model banking are regulated under this regulation and the service bank will be able to provide service model banking services only to domestically localized interface providers and solely within the framework of its operating permits.

About the status of existing banks, the banks apart from the digital banks and that have already obtained an operating permit and provide services through their physical branches within the framework of their current operating permits, will not need to submit a separate application within the framework of the Regulation on Digital Banking. For the mentioned banks, the provisions of this regulation regarding digital banks will not be applied.

III- EVALUATIONS ON THE REGULATION ON PAYMENT SERVICES AND ELECTRONIC MONEY ISSUANCE AND PAYMENT SERVICE PROVIDERS

Some concepts defined for the first time under the regulation, as well as prominent and important regulations, are included under this heading.

- **The widened scope of electronic money and the status of crypto assets**

According to the Regulation, intangible assets that are only issued in exchange for one-to-one fiat money, money created virtually and distributed over digital networks can be considered electronic money if they are: *i)* issued against funds accepted by the issuing payment or electronic money institution, *ii)* stored electronically, *iii)* used to perform payment transactions defined in the Law, and

iv) regarded as a payment instrument by real and legal persons other than the issuing payment or electronic money institution.

Although crypto assets come to mind with the expression of intangible assets that are created virtually and distributed over digital networks, the provision of issuance in exchange for one-to-one fiat money signifies that crypto assets cannot be considered in this context. The evaluations pertain to crypto assets not having the characteristics of electronic money will continue to be valid within this context.

- **“Anonymous pre-paid instrument” as a concept regulated for the first time**

The Regulation includes a concept called “anonymous pre-paid instrument” that we come across for the first time, with the definition of *“a pre-paid instrument that is not connected to the payment account in any way and has not been identified or verified; becomes usable by pre-payment or pre-loading; can be issued as re-loadable or non-reloadable, and that is allowed to be used up to the loaded balance amount.”* These instruments can only be used for payment transactions where the anonymous pre-paid instrument holder is physically at the workplace and the anonymous pre-paid instrument is physically used; payment transactions and invoice payment transactions regarding the purchase of goods or services to be made by service providers and intermediary service providers that are certified with a trust stamp.

Having looked at the definition, anonymously issued shopping and meal cards, whose balance can be replenished and used in store and market shopping; transportation cards used for public transportation with similar functions, can be considered anonymous pre-paid instruments. With some exceptions, it is stipulated that these anonymous pre-paid instruments cannot be used in online transactions.

- **Tightening of the requirements for applications for operation permits and a two-stage evaluation**

Firstly, the corporate name of the company applying for an operation permit is required to contain phrases showing that it is a payment institution or an electronic money institution, and an application fee of five thousand Turkish Liras is stipulated to be paid. In addition, the requirement for minimum paid-up capital amounts varies depending on the scope of services of the companies applying.

After completing these requirements and necessary documents, which can be considered a preliminary application process, the operation permit process begins. This process, which previously consisted of a single stage, is now regulated in the Regulation as a two-stage consisting of an informative investigation stage and a final stage, and stricter conditions were introduced for obtaining the operation permit. According to the regulation, Institutions will also be required to pay a license fee of one million Turkish Liras, upon receipt of the operation permit.

- **Minimum equity requirements**

As it was before in the repealed Regulation, the minimum equity amounts have been determined according to the scope of services of the payment institutions. It is regulated that the minimum equity amount cannot be less than 5.5 million Turkish Liras for payment institutions providing intermediary services for invoice payments exclusively, 9 million Turkish Liras for other payment institutions, and 25

million Turkish Liras for electronic money institutions. It is stipulated that these minimum amounts will be re-evaluated by the CBRT in January each year, taking into account the annual changes in the price indexes published by the Turkish Statistical Institute. Additionally, in cases where the equity amount is above the mentioned minimum equity limits, additional intervals have been determined according to the size of the payment volumes of the Institutions, and it has been regulated that calculations must be made accordingly.

- **Share acquisitions and share transfers**

According to the repealed Regulation, any transfer between existing qualified shareholders is subject to permission, while some transfers are not subject to permission in the current Regulation, only the requirement of notifying CBRT is stipulated. In this context, the acquisition of shares representing 10% or more of the capital, or the transfer of direct or indirect shares of a shareholder that does not exceed 10%, 20%, 33%, or 50% of the capital, and that does not change the privileges of qualified shareholders, is not subject to permission.

- **Operations that cannot be performed by Institutions**

Institutions will only be able to perform the operations specified in their operation permit applications that are approved by the CBRT, and they must obtain permission from the CBRT for their intended operations to offer a payment service not specified in the application. However, they will not be able to engage in any business operations other than supplementary and ancillary services to make their operations safe, along with training and consultancy services related to their fields. Without prejudice to the exceptions, Institutions cannot make foreign exchange purchase/sale transactions regarding payment transactions where both parties to the transaction are resident in Turkey and used by payment service providers located in Turkey. In addition, they will not be able to accept deposit funds or participation funds, provide loans, or give the impression that they are operating as a bank.

- **Opening branches and agencies**

Institutions will be able to carry out their operations by opening branches or through agencies via electronic and physical channels. According to the regulation, the agency relationship should be based on a written agency agreement and the agency should be registered on the list by the Payment and Electronic Money Institutions Association of Turkey. Regarding the authorizations of the agency, it should be emphasized that the agency of the electronic money institution will not be authorized to issue electronic money.

- **Cooperation with foreign Institutions**

Undoubtedly, one of the most remarkable changes made by the Regulation has been the regulation of the cooperation of Institutions with legal entities residing abroad. According to the Regulation, Institutions will be able to cooperate with legal entities residing abroad, which have obtained permission from the CBRT, in line with their objectives or operations. However, the foreign legal entity in question must also be authorized to provide payment services or issue electronic money, by the relevant authorities of the country where its headquarters is located. The legal entity residing abroad with whom the cooperation is made will not be the exposed face of the service alone, before the

customer. However, Institutions will continue to be accountable to domestic customers for the services provided within the scope of the cooperation.

- **Protection of payment funds, payment fund remuneration authorization, and collateral obligation**

Within the scope of the Regulation, Institutions will follow the payment funds by separating them from other funds and will be able to use them only to carry out the payment transaction. These funds will be created by a bank on behalf of the Institutions and will be deposited in protection accounts that will only be used for the protection of these funds. It is stipulated that remuneration of payment funds in an overnight term in the bank where the protection account is held does not constitute a violation of the Regulation's provisions.

Under the Regulation, payment fund protection accounts and electronic money protection accounts will be blocked by the related bank, ensuring the compensation of the rights of the fundholders and the fulfillment of the legal obligations of the Institutions.

In addition, an obligation to hold collateral at the CBRT is imposed on Institutions. The minimum amount of collateral required to be stocked at the CBRT has been determined as two million Turkish Liras for payment institutions providing intermediary services for invoice payments exclusively, three million Turkish liras for other payment institutions, and five million Turkish liras for electronic money institutions.

- **Workplace registration system against malicious use**

It is stipulated that a workplace that offers goods and services with a payment method within the scope of payment services, will be given a workplace code specific to that workplace by the Interbank Card Center (BKM) to facilitate the processes related to payment transactions and to prevent fraud and malicious use in the field of payments.

- **Personal data protection**

The Regulation includes the term “sensitive customer data” and defines it as “*personal data and customer security information used in issuing payment orders or verifying the identity of the customer, and which, if captured or changed by third parties, may allow fraud or fraudulent transactions on behalf of the customer.*” In this context, Institutions are obliged to take the necessary measures for the protection of secrets and personal data, especially sensitive customer data and data belonging to themselves, in the procurement of external services. Under the Law on the Protection of Personal Data No. 6698 (“KVKK”), it is regulated that the express consent of the customer must be obtained, and the data obtained without a request or instruction from the customer cannot be shared or transferred with third parties in the country and abroad.

IV – CONCLUSION

Regarding the establishment of specialized courts, we consider that the determination of areas requiring legal expertise and the establishment of specialized courts are remarkable steps leading to progress on the judicial reform and the Human Rights Action Plan.

Moreover, the National FinTech Strategy Document, which is planned to be published by the Presidency Finance Office in the upcoming days, is considered to be an important roadmap for the development of the sector.

Regulation on Digital Banking being another new regulation gives more elbow room to the FinTech players to operate independently of the banks, and this enables them to offer innovative services in the financial services sector. In this regard, we believe that the diversity of products and services arising from the independent atmosphere will positively impact the consumers purchasing products and services from the market.

With regard to the long-awaited regulation in the field of payment services, it is safe to say that the Regulation will enable Institutions to be more effective against the banks in the market. As the operations of payment and electronic money institutions are regulated under this Regulation, this will pave the way for the consumer to trust these institutions. On the other hand, there are new obligations and stricter rules for the Institutions to carry out their operations starting with the obtainment of operating permit.

It is concerned that these regulations may complicate market penetration for the new players and create difficulties in compliance processes for the players that are already in the market, and these difficulties may eventually induce players to exit the market. As a matter of fact, the Turkish Competition Authority presented its evaluations in the same direction in the Turkish Competition Authority Report on FinTech, stating that the regulations were drafted by considering financial institutions such as banks having a wide range of activities and a large impact on the country's economy, and implementation of these regulations to the FinTech companies operating in one or a few areas will put a burden on them which is not in proportion.



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