

CLIENT ALERT

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CROWDFUNDING 101 FOR TURKISH CAPITAL MARKETS: A BRIEF INTRODUCTION TO THE CROWDFUNDING COMMUNIQUÉ

In 2017, the amendments made to the Capital Markets Code No. 6362 formed the statutory basis of crowdfunding, creating an alternative funding method for start-ups. The Communiqué on Equity-Based Crowdfunding (the "**Communiqué**") prepared by the Capital Markets Board ("**CMB**") took effect following its publication in the Official Gazette dated 3 October 2019.

Below is a summary of key points introduced by the new Communiqué on equity-based crowdfunding (donations/grant-based or reward-based crowdfunding are not regulated).

INCORPORATION OF PLATFORMS

Only those platforms authorised and listed by the CMB may carry out crowdfunding activities. To be listed by CMB, crowdfunding platforms are required to meet a certain number of conditions:

- Platforms shall be incorporated as joint stock companies (participating banks and broadly authorised intermediary institutions may also be able to mediate crowdfunding if they meet the conditions set forth in the Communiqué), with a paid-in share capital (issued as registered shares) of at least TRY 1,000,000.
- The platform's trade name shall contain the wording "Crowdfunding Platform", and its articles of association shall indicate that the company solely engages in crowdfunding activities, consisting in the collection of funds from the public through an equity crowdfunding platform; and monitoring and auditing whether the collected funds have been used in line with the announced purposes of funding a project or a venture capital company. This being said, platforms are also allowed to provide consultancy services to "Individual Entrepreneurs" or "Start-up Companies" (both terms are defined below; throughout the remainder of this client alert, "**Start-ups**" will be the only term used for both).
- The members of board of directors (at least 3 members) and shareholders must meet a number of eligibility conditions set further under the Communiqué. The board of directors shall prepare and approve the platform's conflict of interest policy.
- The platform's board shall establish an investment committee to review and approve the applications. In order to ensure transparency and fairness, the investment committee shall determine an assessment policy.

- Moreover, internal audit, risk management, accounting, operational units and IT infrastructure must be established and relevant personnel must be employed by the platform. The platform shall conclude an agreement with Central Registry Agency ("MKG") and the custodian firm (*Emanet Yetkilisi*, in Turkish) (either Istanbul Settlement and Custody Bank (Takasbank) or any other licensed portfolio depository entities), and its IT infrastructure shall be aligned with the IT systems of the same. Potential investors and entrepreneurs will be able to communicate with each other by way of such IT infrastructure.
- Save for the activities which shall be exclusively performed by the board of directors and investment committee, platforms shall be allowed to obtain support services from third party experts. Such outsourcing shall not, however, exonerate the platform from its liabilities as regards capital markets legislation.
- Any share transfer shall be notified to the CMB, together with the documents evidencing that new shareholders also meet the requirements set forth under the Communiqué within 5 business days from the completion of the share transfer. Any share transfer not made in accordance with the Communiqué shall not be registered in the share ledger (otherwise such registration would be deemed invalid).

It is also worth mentioning that crowdfunding platforms established abroad have been left outside the scope of the Communiqué. However, if (i) such foreign platforms establish a workplace in Turkey; (ii) launch a website in Turkish; or (iii) conduct direct or indirect advertising and marketing activities in Turkey; their activities shall be deemed as targeting Turkish residents (as defined in Decree No.32 on the Protection of the Value of Turkish Currency) and the provisions of this Communiqué shall be applicable to such crowdfunding platforms established abroad.

DOS AND DON'TS FOR PLATFORMS, ENTREPRENEURS AND INVESTORS

The Communiqué sets forth the framework of the agreements to be concluded by and between (i) the platforms and entrepreneurs, and (ii) platforms and potential investors. In addition, it provides a number of obligations and requirements for the same:

Entrepreneurs

- To understand the approach of the Communiqué on crowdfunding, four definitions regarding entrepreneurs are of key importance: (i) "Individual Entrepreneur" (*Girişimci*, in Turkish) means a Turkish real person resident who is looking for financial sources to fund its Project; (ii) "Project" means the business idea which has a potential of becoming a Start-up Company and requires financial sources in order to accomplish the contemplated technology¹ and/or production² activity; (iii) "Start-up Company" (*Girişim Şirketi*, in Turkish) means joint-stock companies, either established or to be established in Turkey, having a growth potential and needing financial sources; and (iv) "Equity" means securities representing the share capital of the Start-up Company and granting shareholding rights to its holders.

¹ "Technology activity" is defined as business activity carried out for the purposes of technological development. The manufacturing of value-added and competitive high-tech products or services, or transformation of a technological invention into a commercial product, method or service shall be considered within the scope of a technology activity.

² "Production activity" means all business activities creating physical products by processing inputs in accordance with a business model having the potential of creating high added-value and jobs.

- The Individual Entrepreneurs shall be required to complete incorporation of the Start-up Company as a condition precedent for the transfer of the accumulated funds to the account of such company. The funds which will be raised during the crowdfunding campaign shall only be transferred to the Start-up Company in consideration of the shares issued by share capital increase (in other words, crowdfunding will be realized by way of share capital contribution). No fund raising is allowed by way of acquisition of shares of Start-up Companies. It is also worth mentioning that such newly issued shares may be deprived of voting rights.
- In addition to the foregoing, Start-up Companies performing technology or production activities are required to (i) be incorporated within the last five years as of the date the Information Form³ was announced; (ii) maintain a website that will be regularly supervised and controlled; and (iii) not exceed the financial statements thresholds provided under Communiqué No.II-16.1 on Principles Pertaining to Removal of Corporations from the Scope of Law and Obligation of Trading of Shares on Stock Exchange⁴.
- (i) Publicly held joint stock companies; (ii) companies whose management control is held by another legal entity; and (iii) companies where publicly held joint stock companies or capital market institutions are "shareholders having significant influence"⁵, shall not be allowed to engage in equity-based crowdfunding.

Investors

- In order to participate and fund the Start-ups, investors must become "members" of the crowdfunding platform. The Communiqué provides detailed information regarding this membership subscription process.
- Non-qualified investors⁶ may invest a maximum of TRY 20,000 through equity-based crowdfunding within a calendar year. However, this limit may be applied as 10% of the annual net income declared by the investor to the platform, provided that it does not exceed TRY 100,000. There is no such restriction for qualified investors.

Platforms

- Crowdfunding shall be conducted via campaigns announced to the public via these crowdfunding platforms. For this purpose, crowdfunding platforms shall establish a campaign webpage for each Project or Start-up Company that raises funds, and shall provide the necessary IT infrastructure to enable periodical explanations through this webpage for the 5 years following the year the campaign process begins. Any information that may affect investors' decisions shall also be disclosed on said webpages.
- The funds collected from the investors and held by the custodian firms shall be deposited and blocked in the name of the crowdfunding platform until the end of the campaign period. As soon as the collected funds reach up the threshold that was initially targeted, the

³ "Crowdfunding Information Form (Information Form)" is the form published on the campaign webpage for the purposes of fund raising for a Project or a Start-up Company. All shareholding rights and conditions and privileges attached to such shares (if any) are explicitly explained in such form. The minimum standards regarding the form will be determined by the CMB.

⁴ For the English translation of this text, please click [here](#).

⁵ According to the Communiqué, "shareholder having significant influence" means a shareholder that holds (i) shares representing directly or indirectly 10% or more than 10% of the share capital or voting rights, or (ii) preferred shares giving preferential rights to nominate board members.

⁶ To define "Qualified Investors", the Communiqué refers to the CMB's legislation on venture capital and private equity investment companies (for the English translation of this text, please click [here](#)).

crowdfunding platforms shall deposit and block such funds in the accounts of Start-up Companies. The platforms shall also disclose relevant information regarding this process (e.g. whether such funds will be deposited to an interest-bearing account by the custodian firm; or any applicable fees and commissions).

- The crowdfunding platforms shall ensure that all necessary procedures be completed up to the dematerialisation of the shares before MKK. In addition, the platforms shall take all the necessary measures to prevent any abuse or breach of confidentiality and protect the investors.
- In addition to the foregoing, the Communiqué specifically sets forth a list of activities which cannot be performed by the crowdfunding platforms:
 - Save for the special provisions applicable to participating banks, the crowdfunding platforms may not act as intermediary for any loan or financing transaction, or earn interest or by way of taking pledge;
 - The crowdfunding platforms shall be allowed solely to conduct equity-based crowdfunding (no other capital market instrument may be used by them for this purpose);
 - Crowdfunding cannot be carried out to raise funds from Turkish residents for the benefit of foreign-resident individuals or legal entities;
 - Crowdfunding platforms may not share any review, analysis or comment that may be deemed as investment advice regarding Start-up Companies or Projects;
 - Except for the advertisements and information published on the relevant campaign website, the crowdfunding platforms may not advertise any commercial products or services of the Projects and/or Start-up Companies whose campaign process is still ongoing; and
 - Secondary market transactions may only be performed by broadly authorized intermediary firms. Crowdfunding platforms may however establish an IT infrastructure to allow investors to communicate with each other through relevant websites.

FUNDRAISING PROCESS AND LIMITATIONS

- The campaign process shall start as from the fund-raising request application of the Start-Up Company or Individual Entrepreneur to the platform. The duration of a crowdfunding campaign cannot exceed 60 days. During the duration of the campaign, the custodian firm will be in charge of the collection of funds, blocking of the funds in the platform's account, and transferring such funds to the Start-up Company or returning them to the investors.
- If the targeted threshold is reached during the campaign process, (i) for Start-Ups, the relevant collected funds shall be transferred to the blocked account of the Start-up Company held by the custodian firm, and such Start-up Company shall engage in a share capital increase up to an amount equal to the collected funds, within 30 business days starting from the end of the campaign period; and (ii) for Individual Entrepreneurs, a Start-up Company shall be incorporated within 90 days starting from the end of the campaign period, and relevant collected funds shall be transferred to the blocked account of the Start-up Company. Share capital will be increased within 30 business days following its registration with the trade registry.

- Following the share capital increase process, the platform shall notify MKK of the amount contributed by each investor and the nominal value of the shares to be issued in consideration of such contribution. The Start-up Company shall be in charge of completing the dematerialisation of shares before MKK and shall transfer such shares to the accounts of each investor.
- In the event that the campaign fails (in other words, the targeted amount is not collected during the campaign process), the blocked amounts (and their interest) shall be returned to the investors.
- The Communiqué does not allow Start-ups to raise funds through crowdfunding for the purposes of purchasing/selling real estate, or real estate rights, or developing real estate projects.

POTENTIAL OUTCOME OF THE COMMUNIQUÉ

Obtaining financial backing is vital for entrepreneurs to fund software, roll out and develop products, hire staff and rent office space, and of course, for marketing. Traditionally, Turkish start-ups are mostly financed by way of equity (such as PE firms or individual business angels) and partly through debt financing (raising loans from various sources). As explained above, crowdfunding is a more efficient model which will enable start-ups to reach out to those people who are willing to invest in new ideas (rather than convincing bankers and PE officials) and to brainstorm with potential investors to refine the business model and the product. In this regard, it is expected that the Communiqué will introduce a good alternative fundraising method for the Turkish start-up ecosystem.

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