

A NEW FINANCIAL MODEL: “THE EQUITY-BASED CROWDFUNDING”

This Briefing Note seeks to summarize the principles regarding equity-based crowdfunding in Turkey as regulated under the Communiqué on Equity-Based Crowdfunding No. III-35/A.1 of Capital Markets Board of Turkey.

I. Introduction

Crowdfunding is a trending alternative financing method mainly utilized by startups, SMEs or individuals for meeting the financial needs of their projects and companies and this financing method targets small size investors when compared to other conventional alternative financing methods such as angel investors, venture capitals, private equities or public offerings; and creates more breathing room to the entrepreneur by cutting down the additional liabilities and costs associated with the cited conventional models. In this method, which also falls within the scope of microfinance methods, the funds collected for the entrepreneur’s project through online platforms correspond to the small amounts of monies invested by a large group of investors, the crowd.

Contrary to conventional financing models, funding needs do not only evolve from business ideas of entities or individuals. Such that, a charity may raise funds through donation-based crowdfunding, or a local artist may raise the funds required for its next album through reward-based crowdfunding and invite its investors to his/her concert afterwards. In addition to these, there are two more crowdfunding models, namely lending-based crowdfunding which establishes a peer to peer network for consumer

loans or other needs, and equity-based crowdfunding where the investors become a shareholder in the promising business.

2. Crowdfunding Model in Turkey

Dating only a decade back, crowdfunding in Turkey was only based on donation and reward-based models both of which were not regulated by the Capital Markets Board of Turkey (“CMB”), however, these were put into practice subject to general laws and regulations. In November 2017, CMB was authorized with the *Capital Markets Law No. 6362* (the “Law”) to regulate this field of financing. CMB opened the way for equity based crowdfunding model and issued a regulation that took effect on 3 October 2019, *Communiqué on Equity Based Crowdfunding No. III-35/A.1* (the “Communiqué”). This Communiqué provided a legal basis for crowdfunding of technology and production oriented ventures by shedding a light on the rules and principles including (i) eligibility criteria for crowdfunding platforms, (ii) campaigns, (iii) investment threshold, (iv) funders’ membership procedures to platforms, (v) fundraisers and (vi) use of the collected funds.

Speaking of the crowdfunding models, donation-based and reward-based models are left outside the scope of the Communiqué and therefore, such models continue to be practiced subject to the general laws and regulations as before whereas, real estate related crowdfunding is expressly forbidden under the same Communiqué. On the other hand, lending-based crowdfunding which generates the largest funding volume in global crowdfunding industry, is not even covered in the Communiqué yet.

In the equity-based crowdfunding model adopted by CMB, the party that intends to raise funds for its project/innovative idea (Fundraiser) can either be an individual or a legal entity operating in such areas. Fundraiser is matched with a pool of investors (Funder) through crowdfunding platform, which offer online services for the fundraisers and funders to meet with one another. Funders may participate in the projects by subscribing to crowdfunding platforms and invest within the legal limits as prescribed by the Communiqué.

3. General Process of Equity Based Crowdfunding

Crowdfunding activities are to be operated via crowdfunding platforms. The crowdfunding platforms shall be authorized and listed by CMB to carry out crowdfunding activities. Such platforms are required

to be incorporated as joint-stock companies with a share capital of at least 1 (one) million Turkish Liras all-paid up, as well as other requirements prescribed in Article 5 of the Communiqué.

Fundraiser initiates the crowdfunding by making an *(i)* application to the platform, followed by *(ii)* execution of a platform agreement between the Fundraiser and the platform, *(iii)* approval of the project by the platform investment committee, *(iv)* launch of a crowdfunding campaign, *(v)* collection of funds from Funders, *(vi)* capital increase and finally *(vii)* transfer of all collected funds.

3.1 Crowdfunding Campaigns

Crowdfunding is launched via campaigns on the crowdfunding platforms. These campaigns initiate the process of collecting funds for eligible projects approved by the platform itself. Each campaign publishes the information form that contains the details of the project as well as a report that reveals the purpose for which funds will be used. It is to be noted that, crowdfunding requires high level of disclosure, as also outlined in the Communiqué.

Once the project is approved by the platform investment committee, the campaign kicks-off for the respective project. The platform publishes the campaign for 60 (sixty) days at most. During this 60 days' period, funders electronically subscribe to the platform and deposit the fund through the platform to the escrow agent. Notwithstanding, investors are entitled to withdraw their contribution to the campaign within 48 (forty-eight) hours as of the day the payment order is served without any reason.

Non-qualified investors can invest a maximum amount of TRY 20,000 within one calendar year. However, this limit may be increased by up to 10% of an investor's declared net income, in any case, this investment limit is capped with TRY 100,000. These limits are supervised by Merkezi Kayıt Kuruluşu A.Ş. (central securities depository, "MKK") and are not applicable to qualified investors.

As part of the campaign, the fundraiser is required to open an account at an escrow agent, so that the collected funds are transferred to such account and blocked until completion of the campaign. Once the campaign gets successful and the investment target is reached, *(i)* if the project owner is a legal entity, such shall conduct a share capital increase in the amount of fund collected during the campaign to issue the shares representing the collected funds or *(ii)* if the project owner is an individual, such shall initially establish a company and then conduct a share capital increase to issue the shares representing the

collected funds. Upon such share capital increase, investors will become the shareholders of the start-up pro rata to their contributions. The issued shares are dematerialized at MKK and transferred to the respective accounts of the investors while the funds blocked at the escrow agent are transferred to the company.

3.2 Public Disclosure and Independent Audit Requirement

Fundraiser is required to prepare a report providing information on what purpose the collected funds will be used and in case the project is approved by the investment committee, this report will be published on the campaign page during the campaign.

If an investment target is reached, the deal is closed between the pool of funders, the fundraiser, and the platform. Upon successful closure of the campaign and the issue and distribution of the shares to the investors, current financial status of the project and details on usage of funds are periodically published in the crowdfunding platform's website for the following 5 years of the calendar year the campaign is closed as prescribed in the Communiqué. Further to the disclosures, an independent audit company authorized by CMB inspects the usage of funds and evaluates whether the collected funds are utilized in line with the project's goals. For this, independent audit company prepares a special purpose audit report until the date the funds are completely used, to check and control whether funds are used in compliance with the purpose of the project and in case of any misuse, this will be reported to the CMB.

4. Activities of Foreign Crowdfunding Platforms

Parallel to the reverse solicitation principle established under Communiqué on the Principles of Investment Services and Ancillary Services No. III-37.1, the Communiqué prohibits foreign crowdfunding platforms to market their services towards Turkish residents by opening work places in Turkey, having a website in Turkish or marketing through Turkish resident persons or companies unless these are licensed by the CMB. However, in the absence of the afore-mentioned actions performed by the foreign crowdfunding platform, Turkish resident investors are free to participate in the campaigns published by the foreign crowdfunding platform based on their own will (reverse solicitation principle).

5. Conclusion

With this Communiqué, equity-based crowdfunding, as an alternative source of capital, has become a regulated activity for Turkish capital markets players. This way, Turkish market is introduced to a new alternative financing source and this funding, plays an important role to financially include the companies with growth potential. Still, given the strict requirements and minimum regulatory standards of the new regulatory framework for crowdfunding, the market players may need some more flexibility from the authorities to promote the use of this model.

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