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TURKEY PASSES CROWDFUNDING LEGISLATION

Turkey recently passed legislation to regulate crowdfunding, aimed at bringing together small investors to fund primarily idea-based projects. While crowdfunding has already been in limited use in Turkey, it only involved reward-based or grant-based crowdfunding, due to the lack of legislation regulating return-based crowdfunding activities. With this new legislative step, Turkey follows the United States and the United Kingdom to become the third country to adopt crowdfunding legislation.

Omnibus Code No: 7061 was passed on December 5th, 2017, which amended Capital Markets Code No. 6362 ("**CM Code**") to make crowdfunding that offers a return on investment (*e.g.* through shares) available in Turkey. However, the CM Code explicitly states that crowdfunding is not to be considered an investment activity for the purposes the CM Code and other relevant Turkish Capital Markets Board ("**CMB**") legislation. Therefore, while it is under the supervision of the CMB, crowdfunding will not be subject to the more costly and time consuming processes of public offerings or the issuance of debt instruments.

The procedural flexibility for crowdfunding in the CM Code was motivated by the idea that a liberal approach to this type of financing would encourage investment in start-ups, which could not otherwise bear the high costs, cumbersome procedural requirements, and long waiting periods for investment and financing, which are a relatively smaller burden for sizeable publicly held entities. The trade-off is in investment limits, which are used to balance the risks associated with procedural flexibilities in crowdfunding.

The brief Q&A below summarizes how what crowdfunding is and how it will work under Turkish law.

What is crowdfunding?

Crowdfunding is a relatively new way of raising venture capital to finance projects by bringing together a high number of investors who each contribute small amounts of money to a project and/or entity in need of third-party financing. These investors can include companies, non-profit organizations, and individuals. The basic idea is to mobilize capital through the collective effort of a large group of investors/individuals as opposed to traditional financing models that rely on a small group of institutionalized investors who each contribute large sums to a given project.

Who are the main groups concerned?

Crowdfunding is an ideal financing method for start-ups, which are more idea-based ventures than sizeable asset-based projects. This is a great tool to mobilize the capital of individuals who otherwise have no interest in investing in capital markets or traditional debt instruments by allowing them to support an idea with a limited financial contribution in return for a share of its success.

What do the investors get in return?

There are four different models of globally accepted crowdfunding: (i) grant-based crowdfunding, where nothing is given in return for the investment; (ii) reward-based crowdfunding, where most commonly a product is offered in return for an investment (e.g. a DVD of a documentary film that was financed through crowdfunding); (iii) share-based crowdfunding, where investors receive shares of the entity financed; and (iv) interest-based crowdfunding, where investors receive a percentage as revenue, as is the case with conventional lending.

While grant-based and reward-based crowdfunding models were already in limited use in Turkey prior to the new legislation, the lack of substantial returns made crowdfunding a less attractive form of financing start-ups from the perspective of investors.

Introduction of a return based model in the CM Code is a major step towards making crowdfunding more attractive to all parties concerned. An expectation of return should attract investors who believe in the viability of an idea, as well as project owners who will now be in a position to offer a more attractive investment tool. While the CM Code does not specifically name the investments tools to be used, it is expected that start-ups will be allowed to offer investors shares in return for capital and/or debt instruments with interest payments in return for loans.

What are the legislative requirements?

1. *Authorization requirements:* Crowdfunding can only be performed via crowdfunding platforms operating on the internet and which are licensed by the CMB. Specific rules applicable to their establishment, partnership structures,

and financing limits will be established later through CMB directives or communiqués.

2. *Procedural requirements:* In order to create incentives and not be overly restrictive, the CM Code makes clear that the crowdfunding does not qualify as a public offering of shares, thus it is not subject to the associated legislative requirements such as issuance of an offering circular.

3. *Investment limits:* While the CM Code does not set the limit, it authorizes the CMB to set the maximum limit of venture capital that can be raised for projects through crowdfunding. The secondary legislation to set these investment limits has not been set.

4. *Relationship between investors and project/venture capital owners:* The CM Code sets forth that the relationship between investors and parties benefiting from financing will be subject to the general legislation, which means either the Turkish Commercial Code in a share model or the Turkish Code of Obligations in a debt model will govern their relationship.

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