A NEW RESOURCE FOR START-UPS: DEBT-BASED CROWDFUNDING

Crowdfunding entered into Turkish law through Article 35/A that was added to the Capital Markets Law in 2017. The legal basis for crowdfunding was established through this Article, and the Capital Markets Board (the "**Board**") was authorized to make secondary legislation on this subject. Subsequently, the Communiqué on Share-Based Crowdfunding (III-35/A.1) (the "**Current Communiqué**") was published by the Board in 2019.

In the Current Communiqué, only share-based crowdfunding activity is regulated, whereas, debt-based crowdfunding activity, which is a very common practice throughout the world, is excluded from the scope. However, on 26 August 2021, the Board published the Draft Crowdfunding Communiqué (III-35/A.2) (the "**Draft Communiqué**") to amend the Current Communiqué, thereby sending a signal that debt-based crowdfunding activity which, in fact, has its legal grounds in Article 35/A of the Capital Markets Law, will also be brought into practice. If the Draft Communiqué comes into force, entrepreneurs and start-up companies will be able to raise funds in exchange for shares or debt instruments through crowdfunding platforms.

1. Definition of Debt-Based Crowdfunding

Debt-based crowdfunding is a type of peer-to-peer funding model that is widely used, especially in the United States, by start-ups who want to access cheap, quick and easy capital without having to navigate through the complicated procedures of banks. However, peer-to-peer funding model is not in high demand in Turkey due to various limitations in both private law and public law legislation.[1] Therefore, an important step has been taken towards

[1] In accordance with the consumption loan regulations of the Turkish Code of Obligations, it is possible to lend a certain amount of money in return for an interest rate to be determined by the parties provided that certain conditions are met. However, if the relevant interest rate exceeds certain thresholds, there is the risk of usury, which is a crime under the Turkish Penal Code.

popularizing the use of peer-to-peer debt instruments by including debt-based crowdfunding activities in the Draft Communiqué.

As per the Draft Communiqué, debt-based crowdfunding involves collecting money from the public through crowdfunding platforms in exchange for debt instruments to provide the funds needed by a project or start-up company. In the Draft Communiqué, a debt instrument is defined as a security that is issued by the entrepreneur or by the start-up company as a debtor and sold through platforms, based on the principle of repaying the nominal value to the investor on the due date or in instalments until the due date.

Debt-based crowdfunding appears as an alternative method that can be applied especially by technology-oriented entrepreneurs or start-up companies in Turkey.

2. Limitations Regarding Debt-Based Crowdfunding

The Draft Communiqué substantially limits the freedom of peer-to-peer lending practices in order to create a safe environment for debt-based crowdfunding activity. Prominent features among these limitations are as follows:

- Debt-based crowdfunding can only be affected through the purchase and sale of debt instruments defined within the scope of the Draft Communiqué. Contracts such as debt and loan agreements are excluded from the scope of debt-based crowdfunding activity.

- Maximum thresholds have been set for individuals who are not qualified investors in terms of investments to be made through debt-based crowdfunding. Namely, these individuals will be able to invest a maximum of TRY 10,000 in a single project through debt-based crowdfunding activity and will be able to invest a maximum of TRY 50,000 in a calendar year. The maximum investment amount that can be made in a calendar year can be increased up to TRY 200,000 provided that certain conditions are met. The funds collected from investors in exchange for the debt instrument must be paid in cash in its entirety.

- Interest, maturity and payment conditions for the debt instrument to be issued by the entrepreneur and/or the start-up company will be determined by the investment committee and the entrepreneur or the start-up company and will be announced on the information sheet on the platform. Funds cannot be collected at an interest rate that is lower than the one stated on this information sheet. The interest rate to be determined for the debt instrument cannot exceed 50% more of the weighted average of the interest rates determined for two government domestic debt securities that are the closest to maturity of the related debt instrument, one with a maturity shorter than the debt instrument, and one with a longer maturity than the debt instrument. The maturity of the debt instrument can be as many as three years.

- An entrepreneur or a start-up company may collect funds based on debt-based crowdfunding through a maximum of two campaigns in a calendar year. The amount of funds that can be collected in this period cannot exceed the issue limit, which is exempted from the obligation to prepare a prospectus and announced by the Board every year. In any case, the amount of funds to be collected by the start-up company cannot exceed 50% of the discounted value of the future cash flows included in the credibility report of the project whose financing is requested, at the date of signing the credibility report.

In addition, crowdfunding platforms are allowed to participate in individual participation investor networks, in practice known as "angel investor networks," which are accredited in accordance with the Regulation on Individual Participation Capital and established as joint stock companies. Thus, it is aimed to create an organic bond between start-ups and angel investors, so that the process of funding progresses quickly despite all of the limitations.

3. Conclusion

Peer-to-peer funding has been a highly preferred practical method of raising capital in some countries such as the United States, which has so far been the epicentre of numerous technology initiatives, as well as China, which has encouraged the rapid development of this industry. On the other hand, some other countries are distant to this method on the grounds that peer-to-peer funding activities are more risky than traditional funding activities. Yet, if the Draft Communiqué is accepted, peer-to-peer funding activity in Turkey will solidify within the context of crowdfunding and the peer-to-peer lending process will move to a regulated level.

Debt-based crowdfunding will enable enterprises that cannot provide funds easily and quickly due to the procedures imposed by banks, or which provide funds for the cost of paying high interest rates -as a result of the belief that start-ups, at the idea stage, pose a high risk- to access the funds more easily. In addition, since debt-based crowdfunding is carried out through crowdfunding platforms, it will be easier for the entrepreneur and the investor to meet, and a transparent bond will be established, as the investor can follow the entire funding process instantly through the platform.

On the other hand, although, according to the Draft Communiqué, the credibility of the entrepreneur will be investigated to ensure the maximum security, risks such as the failure of the entrepreneur and/or technical problems during the investment processes may still be experienced within the scope of the debt-based crowdfunding activity.

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