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CROWDFUNDING PLATFORMS UNDER TURKISH CAPITAL MARKET LAW WITH A SPECIAL REFERENCE TO INVESTMENT COMMITTEE¹

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ABSTRACT

Crowdfunding is increasingly an established form of alternative finance for start-ups and SMEs, relying on small investments. Crowdfunding represents an important type of intermediation where a crowdfunding platform operates a digital platform open to the public in order to match or facilitate the matching of prospective investors or lenders with businesses that seek funding. It is compulsory to form investment committee by the Board of Directors of the platform under Turkish Capital Market Law. Investment committee assesses the feasibility and creditworthiness assessment reports issued about project belonging to entrepreneur or venture capital firm and approves the crowdfunding information form prepared about campaigns.

Keywords. Crowdfunding Platforms, Crowdfunding Services, Entrepreneur, Investor, Investment Committee.

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Crowdfunding platforms, which intermediate the collection of money from the public based on shares (partnership) or borrowing and provide intermediation services electronically, were regulated under Turkish Capital Markets Law in 2017 by adding Article 35/A to the Capital Markets Law N.º 6362 (CML).³

In addition to Article 35/A of the CML and other relevant provisions of the CML regarding crowdfunding platforms and activities, the Capital Markets Board (Board) has issued Communiqué III-35/A.2 on Crowdfunding Platforms (Communiqué), which entered into force on October 27, 2021.⁴ The current legal regulation on the subject in the European Union (EU) Law is Regulation 2020/1503, which was published in the Official Journal of the EU on October 20, 2020 and started to be implemented in all EU member states as of November 10, 2021.⁵ Within the scope of Article 19/7 and Article 28/5 of the Regulation, in November 2021, the European Securities and Markets Authority (ESMA) published the Final Report on the technical standards that Crowdfunding Service Providers must meet⁶ and in December 2021, the European Banking Authority (EBA) published draft technical standards for the credit scoring, pricing, risk assessment and risk management requirements of Crowdfunding Service Providers.⁷ These texts were approved by

³ Art. 110 of Law N.º 7061 on the Amendment of Certain Tax Laws and Certain Other Laws published in Turkish Official Gazette (OG), 05.12.2017, n.º30261.

⁴ Communiqué, 27.10.2021 t. 31641 p. OG and entered into force on the day of its publication. The Communiqué repealed the Communiqué on Equity-Based Crowdfunding N.º III-35/A.1.

⁵ For the text of the statute see <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R1503>.

⁶ For the report, see https://www.esma.europa.eu/sites/default/files/library/esma35-42-1183_final_report_-_ecspr_technical_standards.pdf. The technical standards published by ESMA aim to ensure that the credit scoring process is adequate and efficient, and to this end, common standards have been set for crowdfunding service providers to determine the creditworthiness of project owners and projects without eliminating the ability of each project owner to develop its own methodology for measuring the creditworthiness of each project owner. Under the mandatory provision of Article 19(7)(d) of the Regulation, the draft technical standards also define management requirements for crowdfunding service providers to support the project assessment process.

⁷ The draft technical standards developed by the EBA aim to provide the necessary and sufficient information to investors in order to prevent information asymmetry

the EU Commission on July 13, 2022.⁸

Crowdfunding is the collection of money from the public through crowdfunding platforms without being subject to the provisions of the CML regarding investor indemnification within the principles determined by the Capital Markets Board in order to provide the funds⁹ needed by a project¹⁰ or a venture company¹¹ is a new source of finance, financing method that enables the project or venture company in need of funds to meet its funding needs (ARMOUR; ENRIQUE, 2018, p. 52; BUSCH, 2022, p. 53; RIDLEY, 2015, p. 58).

Crowdfunding platforms are joint stock companies that intermediate crowdfunding activities and provide services in electronic environment. The Board is authorized to determine the crowdfunding activities to be carried out through crowdfunding platforms by collecting money from the public based on partnership

between crowdfunding service providers and investors to the detriment of investors.

⁸ European Commission C (2022) 4828 Final, Commission Delegated Regulation of 13.07.2022 supplementing Regulation (EU) 2020/1503 of the European Parliament and of the Council with regard to regulatory technical standards specifying conflicts of interest requirements for crowdfunding service providers, C (2022) 4828_0.pdf.

⁹ CML art.3/1(z), Communiqué III-35/A.2 on Crowdfunding, art.4/1(m). Justification of the Article:

“Crowdfunding is a method by which entrepreneurs raise financing for their business ideas or projects by raising money from the public through crowdfunding platforms in order to realize their business ideas or personal projects. The partnerships that provide financing through crowdfunding are quite small in scale compared to a publicly traded partnership, and in this context, these partnerships are not expected to have the corporate structure of a publicly traded partnership.”

¹⁰ Article 4/1(ü) of the Communiqué defines a project as a business idea that requires resources for the realization of planned technology and/or production activities.

¹¹ Article 4/1(ğ) of the Communiqué defines a venture company as a joint stock company established in Turkey, which will continue its activities without the obligation to establish a joint stock company and which has the potential to develop and needs resources for its project, or limited liability companies that are obliged to transform into a joint stock company before the funds collected are transferred to the blocked account opened with the escrow officer.

or borrowing, and permission of the Board is required for the establishment and operation of crowdfunding platforms. The establishment, partners, share transfers, employees, the maximum limit of the money that can be invested by each fund provider or collected by project owners and venture companies, and other principles and principles that these platforms must comply with during their activities, as well as the principles regarding the control and supervision of the use of the collected funds in accordance with their declared purpose are determined by the Board (CML. art. 35/A/1 and 2).

Pursuant to Article 4/1 of the CML, without prejudice to the provisions of other laws regarding the collection of aids and donations, the collection of money from the public through crowdfunding shall be realized through crowdfunding platforms authorized by the Board and shall not be subject to the provisions of the Law regarding the obligation to prepare a prospectus or issue document.¹² Pursuant to Article 30/3 of the CML, Article 96 of the CML shall be applied by analogy for the unlawful activities and transactions of crowdfunding platforms. Crowdfunding and related transactions and crowdfunding platforms shall not be considered within the scope of Article 37 of the CML regulating investment services and activities and Article 38 regulating ancillary services to be provided by investment institutions and portfolio management companies, and crowdfunding platforms are not subject to the provisions of the CML regarding exchanges, market operators and other organized marketplaces (CML, art. 35/A/4).

Although crowdfunding platforms and activities, the legal framework of which is outlined above, are not included in the circle formed by the components of capital market law, they are kept within the scope of capital market law and the Board's regulations

¹² Justification of the Article: *"In order to facilitate crowdfunding and contribute to its rapid development, those who raise money through crowdfunding platforms are excluded from the definition of publicly traded partnerships and issuers in order to reduce the costs that entrepreneurs may incur as a result of crowdfunding and therefore not to be subject to the obligations stipulated for publicly traded partnerships and issuers in the Capital Markets Law N.º 6362."*

since they enable the entrepreneur/venture company to access the funding source by collecting money from the public (investor) based on shares or debt instruments, which we can express as the tangent point to the circle, and are aimed at providing crowdfunding services in accordance with their purpose and protecting the investor.

Under Turkish Capital Markets Law, crowdfunding platforms are required to establish at least one investment committee [Communiqué, art.5/5(c)]. The investment committee is established by the platform's board of directors. The task of the committee is to evaluate the feasibility or creditworthiness reports of the entrepreneur or venture company and to approve the crowdfunding information forms prepared for the campaigns [Communiqué, art.4/1(z)(dd); Regulation, art. 24].

The investment committee to be formed by the platform's board of directors must consist of at least 3 members, the majority of the members must have at least 5 years of experience in finance, entrepreneurship, legal consultancy, technology, industry and trade, one member must be a member of the platform's board of directors and this member must hold an individual participation investor license,¹³ at least one member must hold a Capital Markets Activities Level 3 License, and all members must meet the conditions set forth in Article 6/1 of the Communiqué. At least one member of the investment committee of platforms conducting debt- based crowdfunding activities must hold a credit rating license, and the majority of the members must have at least 5 years of experience in any of the fields of statistics, risk assessment and management, financial analysis, rating and valuation in addition to the experience requirement.

Platforms may establish more than one investment committee. If at least one member of the investment committee of development and investment banks, participation banks and broadly authorized

¹³ Article 6/3 of the Communiqué: *“At least one board member of the platforms must hold an individual participation investor license as defined in the Regulation on Individual Participation Capital published in the Official Gazette dated 15/2/2013 and numbered 28560.”*

intermediary institutions holds an individual participation investor license, it is not required that one member be a member of the board of directors.

The investment committee shall establish an evaluation policy including objective evaluation criteria and methods for the approval of the information form¹⁴ and for the examination of the feasibility report, the minimum elements of which are specified in Annex-2 of the Communiqué for equity-based crowdfunding, and the creditworthiness report, the minimum elements of which are specified in Annex-3 of the Communiqué for debt-based crowdfunding, and this policy shall be resolved by the platform board of directors and disclosed to the public on the platform's website. The investment committee may approve the information form only if the majority of the total number of its members so decide. The platform may determine a higher quorum than the one specified in this paragraph.

Members of the investment committee may not participate in the negotiations of the investment committee regarding the evaluation of the campaign applications of the projects in which they, their spouses, descendants and lineal descendants are directly or indirectly related in terms of capital, supervision and administration, and may not vote. This prohibition shall also apply in cases where the investment committee member's non-participation and non-voting is a requirement of good faith. In cases of doubt, the board

¹⁴ Pursuant to Article 4 of the Communiqué, an information form is a form prepared by the entrepreneur or venture capital firm, announced on the campaign page in order to raise the funds required by the project, and the standards of which are determined by the Board. The purpose of the information form is to enable potential investors to make an informed investment decision about the project and the entrepreneur/venture company. This issue is explained in Article 23/1 and Paragraph 50 of the preamble of the Regulation. The information form is a public disclosure document. Article 32 of the CML does not limit the types of public disclosure documents with a restrictive enumeration, and it should be accepted that the information form is a public disclosure document due to its nature. Manavgat, while the Regulation was in draft form, stated that the information form is a public disclosure document within the scope of Article 16 (Article 24 in the published text). (MANAVGAT, 2019, p. 771). For another opinion that the information form is a public disclosure document, see Hacıömeroğlu (2020, p. 303).

of directors shall decide whether the relevant investment committee member may participate in the deliberations and vote. If the relevant investment committee member is also a member of the board of directors, the relevant member may not participate in this vote.

Investment committee members may not receive any economic benefit from venture companies or entrepreneurs in return for their activities within the scope of the Communiqué and may not provide more than 5% of the targeted funding amount to the campaigns they evaluate (Communiqué, art. 9).

Crowdfunding platforms may reject the campaign applications of venture companies or entrepreneurs before they are submitted to the investment committee. Campaign applications submitted to the investment committee may be published on the platform upon the approval of the investment committee. This approval is linked to a report containing the evaluations made by the investment committee in terms of each criterion in the evaluation policy established to include objective evaluation criteria and methods for the examination of the feasibility report, the minimum elements of which are specified in Annex-2 of the Communiqué in terms of equity-based crowdfunding, and the creditworthiness report, the minimum elements of which are specified in Annex-3 of the Communiqué in terms of borrowing-based crowdfunding, and this report is published on the campaign page of the relevant project together with the information form. In the event that any member of the investment committee puts an annotation against the decision to publish a project's campaign on the platform, the explanations regarding this annotation and the reason for the annotation shall be published on the campaign page of the relevant project together with the information form.

For the approval of the information form by the investment committee, it is mandatory to determine that the information contained in the information form is consistent, understandable and complete according to the information form standards determined by the Board.

In order to run a campaign on the platform, the information form must be approved by the investment committee and published on the campaign page. The information form shall be signed by the real person entrepreneur, the officials of the legal entity entrepreneur or venture company and the members of the investment committee of the platform.

Platforms are obliged to obtain sufficient information and documents from venture companies or entrepreneurs during the evaluation process of the investment committee regarding the approval of the fact sheet and to keep the documents, records and reports that form the basis for the decision of the investment committee for 5 years following the end of the campaign period (Communiqué, art. 11).

Platforms may not carry out campaigns for the crowdfunding of venture companies or legal entity entrepreneurs or projects belonging to them, in which the members of the investment committee and their spouses, descendants and descendants, individually or jointly, hold shares representing 20% or more of the capital or voting rights or privileged shares giving the right to be represented in the board of directors. The platform is responsible for carrying out the controls regarding these issues (Communiqué, art. 12).

In addition to the obligations set forth in Article 11 of the Communiqué, platforms conducting debt-based crowdfunding activities are required to establish an effective and transparent credit rating system and policy to assess the risk status of the project. This policy shall be resolved by the platform's board of directors and disclosed to the public on the platform's website. Platforms shall provide sufficient information to enable the assessment of the risk status of the project. In case of fund raising as a venture company, the nature, past activities, debt repayment performance and projects of the venture companies as well as the size, sector and collateral structure of the requested fund are taken into consideration in the assessment of the risks related to the project. The platform calculates

the credit score of the project and submits it to the investment committee together with the creditworthiness report (Communiqué, art. 24).

In the EBA's regulatory draft technical standards for credit scoring, pricing, risk assessment and risk management requirements of Crowdfunding Service Providers, it is stated that appropriate, reliable and regularly updated information should be provided to the investor about the method(s) used in determining the credit score of the project/entrepreneur, this information should be easily accessible to the investor on the crowdfunding platform service provider's website and distinguishable from the information regarding the campaign/marketing of the project, the information should be provided in a way that facilitates the understanding of the information by the investor and should be easy to read (EBA Draft Text, art. 1).

Article 2/4 of the EBA Draft Text states that in case of outsourcing the calculation of credit scores and the evaluation of crowdfunding projects, the investor should be provided with sufficient information about the methods used by the third party. Article 3 of the Draft Text stipulates that the investor should also be informed about the data sources provided for credit scoring models, and in particular, the information provided by the project owner, information obtained from credit records/registries about the project owner, information obtained from publicly available sources and information obtained from other sources should be shared with the investor and information should be provided on the reliability and quality of the data obtained. In addition to the financial factors used in determining the credit score, such as the cash flow to be generated by the project, the project owner's receivables, debt history, repayment capacity, the existence of guarantees and collaterals, the macroeconomic conditions of the location where the project will be realized, the level of competition, the efficiency of the project, the knowledge, experience and reputation of the project owner in the relevant field should also be disclosed.

When conducting credit risk assessment of crowdfunding projects and project owners, crowdfunding service providers should also assess the crowdfunding platforms in relation to the business model and strategy of the crowdfunding project, the knowledge and experience of the project owner, the feasibility and sustainability of the business plan associated with the crowdfunding project, the possible risks that may arise from the project and the opportunities it offers, the degree of competition in the business area where the project will be realized, the geographical location and the target customer base (EBA Draft Text m. 15).

In the event that changes or new issues that may affect the investment decision of the investors arise during the campaign period, this situation shall be immediately notified to the platform by the venture company or entrepreneur together with the parts of the information form containing the issues foreseen to be changed or added. The parts of the fact sheet that include the amendments or new additions shall be approved by the investment committee within two business days from the date of notification and shall be immediately published on the campaign page. The investment committee may cancel the campaign process by evaluating the nature and potential impact of additional developments (Communiqué, art. 26).

The members of the board of directors of the platform are responsible for the fulfillment of the obligations stipulated for crowdfunding platforms, the members of the investment committee and the members of the board of directors of the platform are responsible for the fulfillment of the obligations stipulated for the investment committee, and the members of the board of directors of the funded company are responsible for the fulfillment of the obligations stipulated for the funded companies. Natural and legal persons who sign the information form are jointly and severally liable for any damages arising from false, misleading or incomplete information contained in the information form (Communiqué, art. 29). Since the information form is signed by the natural person entrepreneur, the authorized officers of the legal person entrepreneur

or venture company, and the members of the investment committee of the platform, the members of the investment committee will be held liable under Article 32 of the CML. In addition, the members of the board of directors of the platform are also liable under Article 553 of the Turkish Commercial Code.

In borrowing-based crowdfunding, the control and audit of the use of the funds collected in accordance with the purpose announced in the information form is carried out by the investment committee by preparing an audit report. In the event that it is determined in the aforementioned report that the funds collected are not used as announced in the information form or that activities are carried out that prevent the necessary examinations from being carried out, the platform shall immediately inform the Board about the matter. If it is determined in the report prepared by the investment committee that the funds collected are not used in accordance with the declared purpose and notified to the Board, the Board may file a criminal complaint within the framework of the provisions of Law N.º 5237 Turkish Penal Code (Communiqué, art. 22).

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ANNEX 1: Feasibility Report (Communiqué Annex-2)

MINIMUM ELEMENTS OF FEASIBILITY REPORT

- 1) Introductory information about the venture company or project.
- 2) Introductory information about the managers of the venture company or the entrepreneur and his/her team.
- 3) The business model canvas for the current and future core activities of the venture company.
- 4) Information on the current fields of activity of the venture company, the products it produces/produces and/or the services it offers/provides, if any, or the products and/or services that are the output of the project.
- 5) Information on market research and analysis for products and services and previous studies, research and other studies, if any.
- 6) Concrete and foreseeable forecasts of the demand for the target audience, products and/or services.
- 7) Technical and design analysis of products and services, estimates and assumptions about the research, development, production, sales and marketing programme.
- 8) Funding sources, estimated financing structure and financial and economic analysis of the project.
- 9) Income-expense projection based on concrete and foreseeable assumptions for a reasonable period to be determined according to the duration of fund utilisation.
- 10) Information on the locations of fund utilisation, the targeted fund amount including additional sales, if any, the nature of each expenditure item and the dates and periods of planned expenditure.
- 11) Information on the budget allocated for research, development, consultancy, licence, patent, labour, marketing, fixtures, equipment, financing and similar expenses and other unforeseen expenses.
- 12) Risk factors that may prevent the project from achieving its expected objective.

ANNEX 2: Creditworthiness Report (Communiqué Annex-3)

MINIMUM ELEMENTS OF THE CREDITWORTHINESS REPORT

- 1) Introductory information about the venture company or project.
- 2) Introductory information about the managers of the venture company or the entrepreneur and his/her team.
- 3) Information on the capital of the venture company and the last capital increase, if any.
- 4) Business model canvas prepared for the current main activities of the venture company and the future main activities of the funded company.
- 5) Information about the current fields of activity of the venture company.
- 6) Rating information received from organisations other than the platform for the venture company, if any.
- 7) Financial statements of the venture company for the last 2 years prior to the date of application to the platform.
- 8) Information on the purpose of the project, the use of the funds obtained within the scope of the project, the nature of each expenditure item and the planned expenditure dates and periods.
- 9) Information on the products and/or services that are the output of the project, if any, and market research and analysis for these products and services, and information on previous studies, research and other studies, if any.
- 10) Concrete and foreseeable forecasts of the demand for the target audience, products and/or services.
- 11) Technical and design analysis of products and services, estimates and assumptions about research, development, production, sales and marketing programmes.

- 12) The discounted value of the project's future cash flows based on concrete and foreseeable assumptions at the date of signature of the creditworthiness report.
- 13) Information on the budget allocated for research, development, consultancy, licence, patent, labour, marketing, fixtures, equipment, financing and similar expenses and other unforeseen expenses.
- 14) Information on the planned interest and similar returns, maturity and payment terms of the debt instrument to be issued.
- 15) Risk factors that may prevent the project from achieving its expected objective.
- 16) Information and documents certifying that the entrepreneur or venture company will be able to repay the investors regularly within the scope of the project to be carried out.
- 17) Risk and cheque reports obtained from the Banks Association of Turkey Risk Centre of the entrepreneur or venture company that will raise funds through borrowing-based crowdfunding.

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