

Convertible Investments in Türkiye

10 Nov 2023

I. Introduction

Due to the growth and development of the entrepreneurship ecosystem and the evolving needs of investors and entrepreneurs, the necessity to develop solutions has become inevitable. In the United States, the utilization of SAFE (Simple Agreement for Future Equity) and KISS (Keep It Simple Securities) structures has been rapidly increasing to meet the demands of the flourishing entrepreneurship ecosystem.

Essentially, convertible agreements involve the investor providing financing through a loan to the company. The debt granted by the investor is then converted into shares in the company once the predetermined conditions and triggering events, such as future investment rounds, outlined in the agreement are met. If the conditions and triggering events specified in the convertible loan agreement fail to materialize, the company is obligated to repay the debt to the investor along with any applicable interest.

With the momentum gained by the entrepreneurship ecosystem in Türkiye, similar practices are frequently implemented. Under the Circular on Capital Movements dated 2 May 2018 ("**Circular**"), as from 15 May 2020, a legal framework enabling foreign exchange convertibles provided by foreign venture capital funds to Turkish resident legal entities is provided for the first time. The Circular currently stands as the only regulation enabling a convertible loan transaction and constitutes an exception for foreign venture capital funds to finance the companies through such transactions made with foreign currency.

Besides the Circular, the convertible transactions in the market are not regulated under any specific legislation and are concluded subject to the general principles of contract law. If such structures involve foreign currency investments, limitations under the Circular Law on the Protection of the Value of Turkish Currency numbered 1567 ("**Law**"), persons who violate the obligations set forth in the Law, Circular, Decision on the Protection of the Value of the Turkish Currency numbered 32 ("**Decision**") and Communiqué on Decision on the Protection of the Value of Turkish Currency numbered 32 (2008-32/34) ("**Communiqué**") also need to be considered while structuring the investment.

This article aims to provide information on the specific terms and conditions governing the execution of convertible investments in Türkiye, especially those within the scope of the Circular.

II. Convertible Investment Structures Under the Circular

Below section only aims to give a general overview on the legal framework provided for foreign venture capital funds being the lender of the convertible debt transactions.

A. Execution of Convertible Agreements with Foreign Venture Capital Funds

1. Parties of the Convertible Agreement

Within the scope of Article 6/12 of the Circular, agreements on the loans denominated in foreign exchange that can be converted into shares ("**Convertible Agreement**") can be executed by and between the foreign venture capital funds established abroad and Turkish resident legal entities. Accordingly, the parties to the Convertible Agreement

under the Circular are the Turkish resident legal entities and the foreign venture capital funds.

2. Content of the Convertible Agreements

According to the Circular, the Convertible Agreements should be explicitly provided that:

- i. the loan utilized with the Convertible Agreement will be converted into equity within 12 months at the latest;
- ii. the debt will be converted into equity (and will not continue as a loan) unless in cases of termination or liquidation of such Turkish legal entity; and
- iii. the entire loan will be converted into equity.

3. Closing of the Transaction (Procedures to be Followed After the Execution of the Convertible Agreements)

(a) Submission of the Relevant Documents to the Bank

Following the execution of the Convertible Agreement, the Turkish resident legal entity is obliged to submit the following documents to the bank to which the foreign exchange transfer within the scope of the Convertible Agreement is made:

- i. the Convertible Agreement;
- ii. a written statement that it has not previously utilized any funds without converting them into capital; and
- iii. a letter of commitment that the foreign exchange specified in the Convertible Agreement will be injected into the capital within 12 months;
- iv. documents proving that such foreign legal entity is a venture capital fund in accordance with the relevant applicable laws.

Accordingly, the bank will assess whether the convertible loan agreement meets the requirements listed above.

In addition, the Turkish resident legal entities, which are privately-held companies, are also obliged to submit the letter of the trade registry office with regards to registration of the capital increase within the scope of the Convertible Agreement within 12 months following such capital increase to the bank.

Moreover, publicly-held legal entities residing in Türkiye which accept the principal capital system are obliged to submit the following documents regarding the capital increase to be made within the scope of the Convertible Agreement to the bank within 12 months:

- i. Letter of application, which also specifies the Capital Markets Board ("**CMB**") document registration date, submitted to the CMB for the approval for the amendment text of articles of association with regards to the capital increase;
- ii. Letter of approval of the Ministry of Commerce and the general assembly meeting minutes with regards to such capital increase;
- iii. Letter of application, which also indicates the CMB document registration date, submitted to the CMB for the approval of issuance certificate;
- iv. The result notification letter issued by the CMB to the legal entity residing in Türkiye within 30 days following the approval of the issuance certificate by the CMB and documents proving that the capital increase has been carried out; and
- v. In the event that the CMB's examination procedures regarding the capital increase of publicly-held companies take longer than 3 months, a letter from the CMB stating that the evaluation of the application still continues.

Additionally, publicly-held legal entities residing in Türkiye which accept the registered capital system are obliged to submit the following documents regarding the capital increase to be made within the scope of the Convertible Agreement to the bank within 12 months:

- i. Letter of application, which also specifies the CMB document registration date, submitted to the CMB for the approval of issuance certificate with regards to the capital increase;
- ii. The result notification letter issued by the CMB to the legal entity residing in Türkiye within 40 days following the approval of the issuance certificate by the CMB and documents proving that the capital increase has been carried out; and
- iii. In the event that the CMB's examination procedures regarding the capital increase of publicly-held companies take longer than 3 months, a letter from the CMB stating that the evaluation of the application still continues.

If the aforementioned documents regarding the capital increase are not submitted to the relevant bank within 12 months from the date of the foreign exchange transfer, a notification will be made to the Ministry of Treasury and Finance ("**Ministry**") by the bank and such amount will be added to the Turkish legal entity's loan balance and reported to the Risk Center of the Banks Association of Türkiye ("**Risk Center**"). In addition, the amount converted into such loan will be notified to the Central Bank of the Republic of Türkiye's General Directorate of Statistics ("**General Directorate of Statistics**") by the relevant bank.

(b) Capital Increase

Following the execution of the Convertible Agreement and submission of the aforementioned documents to the relevant banks, in the event of the occurrence of the triggering event stipulated under the Convertible Agreement, a capital increase will be carried out by the Turkish resident legal entity and with such capital increase, the foreign venture capital funds will acquire shares of the Company in return for its receivables from the Turkish resident legal entity arising from such Convertible Agreement.

(i) Procedures regarding capital increase for the privately-held companies

Pursuant to Article 6/3 of the Circular, the procedures to be followed with regards to the capital increase to be realized by the privately-held companies following the execution of the Convertible Agreement are as follows:

- at least 25% of the nominal value of the subscribed capital shall be deposited into the bank account of the Turkish resident legal entity, which is a joint stock company, by the foreign venture capital fund and the other real person investors or legal entities that subscribe to the capital increase before the registration of the general assembly or board of directors' resolution regarding such capital increase, in a way that only the Turkish resident legal entity can use;
- the blockage letter indicating that such amount has been deposited and the other related documents shall be submitted to the trade registry and the general assembly or board of directors' resolution regarding the capital increase shall be registered before the relevant trade registry; and
- following the registration, the foreign exchange provided by the foreign venture capital fund shall only be paid by the bank only to the Turkish resident legal entity, upon the submission of the trade registry letter regarding the registration of the capital increase.

Moreover, as per Article 6/14 of the Circular, the outstanding amount of the nominal value of the subscribed capital must be paid by such foreign venture capital fund and the other real person investors or legal entities within 24 months following the registration of such capital increase. The amount subject to such capital increase can be freely used by the Turkish resident legal entity following the deposit of such amount to the relevant bank.

Additionally, If the general assembly or board of directors' resolution regarding the capital increase is not registered within 12 months as of the resolution date, such foreign exchange amount shall be returned to the foreign venture capital fund and the other real or legal persons that subscribe to the capital increase by the bank, upon submission of the trade registry letter stating that the general assembly resolution has not been registered to the bank.

(ii) Procedures regarding capital increase for the publicly-held companies

Pursuant to Article 6/5(a) of the Circular, the procedures to be followed regarding the capital increase to be realized by the publicly-held companies adopting the principal capital system, following the execution of the Convertible

Agreement are as follows:

The Turkish resident publicly-held company is obliged to:

- make an application to the CMB within 30 days from the date the foreign exchange is deposited into the company's account, in order to obtain approval for the amendment text regarding the amendment to be made in Article of the Articles of Association of the company regarding the share capital;
- submit the petition regarding the application for the amendment of Articles of Association (along with the registration date of the CMB documents), which is submitted to the CMB, to the relevant bank and notify the relevant bank regarding such application process;
- obtain an approval from the Ministry of Commerce for the amendment text of the articles of association, upon the approval from the CMB;
- convene the general assembly to decide on the capital increase within the 5 months following the approval to be obtained from the Ministry of Commerce and submit the approval letter of the Ministry of Commerce and the date of the general assembly regarding the capital increase to the relevant bank; and
- apply to the CMB for the approval of the prospectus or issuance certificate within 30 days following the general assembly regarding the capital increase and submit the petition regarding the application for the prospectus or issuance certificate submitted to the CMB with the registration date of the CMB documents to the relevant bank.

In case the capital increase is realized without a public offering, the Turkish resident publicly-held company is obliged to (i) convert the foreign exchange amount into capital within 30 days following the approval of the issuance certificate by the CMB; and (ii) make a notification to the relevant bank regarding the process along with the result notification letter and its date as well as the documents with regards to the capital increase.

In case the capital increase is realized through a public offering, the Turkish resident publicly-held company is obliged to (i) convert the foreign exchange amount into capital until the end of expiry date of the purchase right for new shares announced on the company's Public Disclosure Platform ("**PDP**") page or the public offering period of the shares subject to the sales announcement to the savers; and (ii) make a notification to the relevant bank within 30 days from the conversion regarding the process along with the date of the announcement on the PDP and the documents with regards to the capital increase.

In line with Article 6/5(b) of the Circular, the procedures to be followed regarding the capital increase to be realized by the publicly-held companies adopting the registered capital system, following the execution of the Convertible Agreement are as follows:

The Turkish resident publicly-held company is obliged to;

- apply to the CMB for the approval of the prospectus or issuance certificate regarding the issuance of shares to be issued through the capital increase within 30 days from the date the foreign exchange is deposited into the company's account;
- notify the relevant bank regarding such application process; and
- submit the petition regarding the application for the prospectus or issuance certificate submitted to the CMB with the registration date of the CMB documents to the relevant bank.

In case the capital increase is realized without a public offering, the Turkish resident publicly-held company is obliged to (i) convert the foreign exchange amount into capital within 20 days following the approval of the issuance certificate by the CMB; (ii) apply to the CMB for the approval of the amendment text of the Articles of Association within 10 days following the capital increase; (iii) ensure the registration of the capital increase before the relevant trade registry and (iv) make a notification to the relevant bank regarding the process along with the result notification letter and its date as well as the documents with regards to the capital increase within 10 days following the registration of the capital increase.

In case the capital increase is realized through a public offering, the Turkish resident publicly-held company is obliged to (i) convert the foreign exchange amount into capital until the end of the expiry date of the purchase right

for new shares announced on the company's PDP page or the public offering period of the shares subject to the sales announcement to the savers; and (ii) make a notification to the relevant bank regarding the process along with the date of the announcement on the PDP and the documents with regards to the capital increase within 10 days following the capital increase.

4. Sanctions

According to Article 6/12 of the Circular, if the foreign exchange amount transferred to the Turkish resident legal entity within the scope of the Convertible Agreement executed with the foreign venture capital fund is utilized without being converted into the capital, the Turkish resident legal entity will not be able to procure any further convertible loans.

Additionally, pursuant to Article 3 of the Law, persons who violate the obligations set forth in the Law, Circular, Decision and the Communiqué will be imposed with administrative fines from TRY 31,680 up to TRY 264,294 for the year 2023.

Alongside with possible sanctions, it should be kept in mind that the parties who do not comply with the provisions of the Circular within the convertible transactions that they intend to engage in, can encounter other inconveniences such as those arisen during the money transfers before the banks or registration applications before the commercial registries.

III. Conclusion

As it currently stands, convertible investments are somewhat limited with the foreign exchange rules and thus, not have the broader opportunities and advantages provided to companies and investors under the KISS and SAFE structures. Within the scope of the Circular, the Decree and the Communiqué, if the above-mentioned conditions are fulfilled, a Convertible Agreement through foreign currency can be completed by and between Turkish legal entities and the foreign venture capital funds.

Besides those specifically regulated under the Circular, there is no detailed legislation under Turkish law for investments involving convertible structures. Despite the limited practice area of the exceptions and prohibitions on the foreign exchange borrowing under the Circular, convertible loan transactions are popular mechanisms for entrepreneurs to receive fast financing to their companies. Accordingly, in practice, other types of structures are commonly used within the scope of boundaries of general principles of contract and the foreign exchange regulations. In order to eliminate the risk of sanctions and set a strong investment structure, convertible mechanisms and the conditions how the investments will eventually be converted to into capital should be carefully examined and drafted by the parties, together with the expertise of the legal and financial consultants.

Related Practices

- [Corporate](#)
- [Commercial Contracts](#)
- [Foreign Investment and Business Set-up](#)
- [Securities and Capital Markets](#)

Related Attorneys

- [C. HAZAL BAYDAR, LL.M.](#)
- [SEV? ?SLAMAGEÇ](#)