

## Reform in the non-possessory movables pledge regime in Turkey

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Turkey has introduced a new regime enabling non-possessory pledges - pledges without the actual delivery of the possession of the pledged goods. The new regime which constitutes major legislative reform to the existing pledge and assignment regimes for commercial transactions has been introduced under the Law on Pledge on Movables in Commercial Transactions (the Law) and entered into effect on 1 January 2017. Subsequently, a range of secondary legislation has also been issued, setting forth the detailed procedures and principles as to creation of movable pledges, establishing a central registry of moveable pledges, valuation of movables subject to pledge, as well as structuring and executing pledge agreements have been detailed under the legislation.

The updated legislative regime allowing non-possessory pledges aims to facilitate access to finance for small and medium-sized enterprises and boost competitiveness in the market, by way of providing an easier and faster way to establish pledge over movables as security.

### Provisions of The New Regime

The main piece of legislation applicable to movables pledges is the Turkish Civil Code. While the new Law does not repeal the possessory pledge agreements which will continue to be in effect under articles 939 to 949 (possessory pledge), articles 950 to 953 (a lien) and articles 954 to 961 (pledge over receivables) of the Turkish Civil Code, it creates an alternate method for non-possessory movables pledges in commercial transactions. Whereas, with entry into force of the new Law, the previous Law on Commercial Enterprise Pledge Act (Law 1447), which had been applicable to creation of pledges over commercial enterprises, in whole has been abolished.

This article summarises the notable changes to the former regime with the new Law and its impacts on commercial transactions.

### Abolishment Of The Commercial Enterprise Pledge Regime

With the new Law for establishing pledges over businesses as commercial enterprises applicable from 2017 onwards, former Law 1447 on commercial enterprise pledges has now been abolished. The new Law imposes the following changes to the former regime:

Unlike the former movables pledge regime, which only allowed the pledge of commercial enterprises in whole (together with commercial title etc.), creating a pledge over movable property without having to grant a commercial enterprise pledge over the whole business, is now possible. Each single movable within a business can now be pledged separately, without having to pledge the commercial title or name of the business or commercial enterprise or deliver the possession of the movable machinery or goods to the pledgee.

Formerly, the commercial enterprise pledge agreements had been drafted and executed by the notary public of the place where the business was located. Then, such agreement had to be registered in the related commercial registry office. The new regime allows creation of commercial enterprise pledges by any notary in Turkey, thus relieving the

parties from the necessity to travel to the location of the business or commercial enterprise itself.

One of the most criticised aspects of the new Law is that foreign banks are not able to establish pledges, because the legislation does not specifically allow foreign credit institutions to be a party to a pledge agreement. While this is not a major setback for such agreements which can still be concluded through the traditional methods under the Turkish Civil Code (by delivery of the possession of the assets); major problems have been encountered in terms of commercial enterprise pledges. Foreign banks who were able to establish commercial enterprise pledges in accordance under the now abolished Law 1447 have suddenly become unable to be a party to commercial enterprise pledge agreements in accordance with the new Law. An imminent solution to this problem is awaited by foreign banks and credit institutions.

## Movables Pledge Registry

Under the former regime, pledges over movables could not be registered in a registry, save for commercial enterprise pledges, which were subject to the Law 1447 and recorded in the registry kept by the commercial registry offices. Under the new regime, movables pledges created under the Law can be registered in the new Pledge Registry kept electronically by the notaries. Thus, the issue of publicising pledges on moveable property is eliminated and records have become publicly accessible. Any third party who can prove their relevance is able to make queries in the Pledge Registry. Queries are made either through registries (held at the notaries) or electronically.

That said, the Pledge Registry System, which is referred to as the TARES, is still quite new and there is certainly room for further development. Maintenance works to provide full integration of the TARES with the former Commercial Enterprise Registry is underway, which means that commercial enterprise pledges created before the new Law cannot be directly accessed from the TARES for the time being.

## Perfection Of Pledge (Non-Possessory Pledges)

Delivery of the physical possession of the pledged movable property to the pledgee (or to a third-party custodian) is a prerequisite for the perfection of a movables pledge under Turkish Civil Code. This requirement has been perceived as somewhat impractical for movables, since actually delivering the pledged movables such as goods or machinery was not preferred for debtors who prefer to keep using their goods or machinery for their ongoing operations. Whereas, the Law allows creating a pledge without actual delivery of the pledged goods to the pledgee by simply executing a pledge agreement and registration thereof in the Pledge Registry.

## Receivables Pledges

The Law allows creation of pledge over the movable goods which are not yet purchased as of the date of the pledge agreement by creating and registering a pledge agreement with the Pledge Registry. Furthermore, it is possible to establish a pledge over future receivables that arise out of a specific agreement. However, agreements enabling pledge of all future receivables of a pledgor without any limitations is invalid, since this would be incompliant with the principle of determinability of the security interests.

## Ranking In Movables Pledges

A pledge degree system allowing movable pledges to be ranked has been adopted under the new Law, which was not possible under the former legislation. Accordingly, it is now possible to establish priority ranking pledges with either progressive ranking (allowing advancement to a higher degree if there is an empty degree) or a fixed ranking.

## Enforcement Procedures

In case of default under the Law, the pledgee can demand transfer of ownership of the pledged movable which constitutes a quite important change, as the *lex commissoria* principle preventing transfer of ownership had governed the pledges under Turkish law.

Under the Law, the pledgee can now apply to execution offices to initiate an enforcement procedure within seven days following an event of default, demanding transfer of ownership of the pledged movable in accordance with Article 24(3) of the Law 2004 on Enforcement and Bankruptcy, by way of delivery of a request to send payment order.

The procedures and principles to be carried out by the enforcement offices (such as issuance of the payment order, calculation and valuation of the amount of the debt and ranking of other creditors) have been detailed under the legislation.

## Conclusion

While the new Law and its secondary legislation provide many progressive instruments and procedures that may be handy in the world of secured financing, currently the system is mainly being used by the small and medium-sized businesses and real persons. Many provisions in the legislation bear the risk of creating disputes, since the application of the new regime is not tested yet and certain new rules conflict with the existing legal practice on movables pledges. Since the new Law altered the classical approach to the securitisation of movables and introduced a brand-new enforcement procedure, larger creditors are still cautious in terms of application of the new non-possessory pledge method. Most problematic issues can be summarised as follows:

The legislation provides an exception to the *lex commissoria* rule governing possessory movables pledges in Turkey, preventing transfer of ownership of the pledged asset to the secured creditor. It allows transfer of the pledged collateral to the secured creditor, which is a major change to the existing legal system. The purpose of the *lex commissoria* rule is to prevent abuse of the debtors by preventing an ease of collecting the secured collateral directly and the new regime will shift this balance to the benefit of the creditor. Also, the legislation is vague in terms of determining any other encumbrances other than pledge (i.e. attachments), as those encumbrances are not registered to the pledge registry. Thus, the secured creditor will bear the risk of having transferred the ownership of an asset that had been previously attached by a third party.

Further, the new Law provides a different approach as to amendment of the pledge agreements. Accordingly, it provides that the changing of the asset with a new asset is deemed as an amendment of the original pledge and the pledge shall be deemed established over the new asset as of the date of the original pledge. This is highly problematic, considering that this enables the debtor and the creditor to collusively shift the pledge over a new asset to the detriment of the third-party creditors who had previously applied attachment to that asset, depriving third-party creditors of the sale value of that asset.

## How To Create A Movables Pledge Under The New Regime

Pursuant to the new Law and its secondary legislation, establishing a non-possessory pledge over movables are subject to procedures and principles summarised below:

Parties — The pledge agreement under the new Law can be executed between:

- Financial institutions on one side and merchants, tradesmen, farmers, producer organisations, self-employed real and legal persons on the other; or
- Merchants on one side and tradesmen on the other side.

Goods which can be pledged — A non-possessory pledge under the new Law can be created over the following movable goods:

- Receivables
- Trees which can give fruits for multiple years
- Intellectual and industrial property rights
- Raw materials
- Animals
- All kinds of income and revenues
- Rental income
- Right to rent (kirac?l?k hakk?)
- Machine and equipment, tools, construction equipment, electronic devices including electronic communication devices
- Consumables (sarf malzemesi)
- Stocks and inventories
- Agricultural products
- Commercial title and/or enterprise name
- Commercial enterprise or tradesman enterprise
- Commercial vehicle license plate
- Commercial projects
- Railway cars
- Movable assets, rights and joint ownership rights which are in the possession of third parties in relation to the assets listed above
- Other licenses and certificates whose registration with another registry is not stated in the applicable law

Content of the Pledge Agreement — The Law and secondary legislation requires a minimum amount of legal content for the pledge agreement, including:

- The mutual intent of the parties to enter into a non-possessory pledge over movable property to secure the payment or enforcement of a debt, which must be clearly identified in the pledge agreement.
- Identification of the parties, subject of the debt which will be secured by the pledge, amount to be secured, specifications of the property to be pledged and division of costs, as well as the rights in case of default must be included in the pledge agreement.

Execution and Registry — Pledge agreements can be executed either:

- Electronically (signing via secure electronic signature); or
- In writing (signing before the registry officer or a notary public).

After its execution, the pledge agreement is registered and recorded in the Pledge Registry.

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