This Briefing Note aims at highlighting the key rules and procedures regarding the establishment of Movables Pledge and Capital Market Instruments Pledge under Turkish Legislation.

A. Taking and Enforcing Pledge on Movable Assets

General Preamble

In the emerging markets, the role of small and medium enterprises (SME) are especially important as they have a major role in boosting the economic growth and in order to enhance the contribution of the SMEs to the economy, Turkish policymakers have supported and keeps supporting the financial growth of the SMEs by way of facilitating their access to the financial sources such as bank loans. To promote the bank borrowings of SMEs, lawmakers, in particular, had allowed the commercial enterprises to be pledged for the repayment of the bank debts under a specific code named as Commercial Enterprise Pledge Code No. 1447, which got abolished by the Movable Pledge in Commercial Actions Code (hereinafter will be referred to “Law”) No. 6750 published in the Official Gazette dated October 28, 2016 and entered into force on January 1, 2017. It shall be noted that the commercial enterprise pledge was brought as an exception to the movables pledge and had enabled the commercial enterprise pledge to be established by way of registration to the Commercial Enterprise Registry rather than transfer of possession. With the new Law, commercial enterprise pledge continues to be established by way of
registry to a registry system, and further to this, the scope of the movables subject to pledge by way of registry has been widened and further regulated.

**Deviation from the Principle of “Physical Transfer”**

This Law aims at wide spreading the usage of movables pledge as collateral, opening the pledged movables to the public by way of founding a registry system (hereinafter will be referred to “TARES”) and providing alternative methods during the liquidation processes of these pledged movables.

One of the prominent novelties of the Law is the opportunity to establish pledge on the movables without any requirement to transfer the movables’ possession to the Pledgor – i.e. physical delivery of the movable goods. Prior to the implementation of the Law, movables could solely be pledged via the transfer of their possession from the Debtor to the Creditor. With the implementation of the Law, Creditors (hereinafter may interchangeably be used with “Pledgee”) started to benefit from establishing pledge on its Debtor’s (hereinafter may interchangeably be used with “Pledgor”) movables by solely registering the pledge in its own name under TARES rather than physically receiving the movable goods.

The rationale behind the TARES registration system relies on the fact that any movables pledge duly established shall be available to the knowledge of all third persons, in order to avoid misapprehension of a third person acting in good faith when acquiring a movable good. In this respect, we may say that although the Law deviates from the principle of “Movable pledges shall be subject to delivery”, it continues to protect third party benefits by requiring pledge registration in a publicly available platform, TARES.

Further to the above, with the TARES system, Debtor may use the pledged movable and thereby, pledged movables may still generate economic value.
Execution of the Pledge Agreements

In addition to the Law, Ministry of Trade, published a regulation titled “Pledge in Commercial Transactions and Rights Under Default” on October 28, 2016, (hereinafter will be referred to “Movables Pledge Regulation”) which also entered into force on January 1, 2017. In the Movables Pledge Regulation, the entities or persons who are eligible to be Pledgor and the Pledgee are listed in numeros clausus basis and such persons may establish pledge over their movables subject to the Law. According to Article 10 of the Movables Pledge Regulation, credit institutions, merchants or artisans are eligible to be deemed as Pledgors; and traders, artisans, farmers and self-employed professionals are eligible to be deemed as Pledgees. Contrary to this, the entities, save for the ones listed above, may establish pledge over their movables only pursuant to the pledge principles envisaged under Turkish Civil Code No. 4741, rather than the Law.

Pledge Agreement shall be executed in writing either before the Notary Public or TARES executive and pledge will be duly established upon registration under TARES. Further to this, Law allows the pledge agreements to be executed electronically as well provided that those are signed by the parties with secure electronic signature. As regards to the scope of the pledge agreement, the following issues are specifically required to be addressed under the Pledge Agreement; i) subject-matter of debt, ii) amount of debt, iii) if the amount of debt is not known at the execution date of the Pledge Agreement, the amount for which such pledge constitutes security, iv) currency of payment and v) maximum limit of the pledge.

Eligible Assets to be Pledged under TARES system

Movable pledge may only be established over the eligible movable assets enlisted under Article 5 of the Law, such as receivables of the creditor (whether the receivables are born or expectant on the date of the pledge’s establishment), business enterprise, intellectual property rights, rental incomes, all kinds of machinery and stocks, excluding the following from the scope of these eligible assets; i) capital markets instruments, ii) pledge contracts covering the financial agreements pertaining to derivatives and iii) cash deposit.
For commercial enterprise pledges, it should be noted that TARES registration automatically covers all the assets forming the enterprise; and in such cases, if certain items of the business enterprise are subject to specific registries (such as registry of motor vehicles), TARES completes the notification of such registries on its own accord.

**Protection of Pledgee’s Rights**

Certain precautionary principles are adapted to the Law and Movables Pledge Regulation in order to protect the rights of the Pledgee against the risks such as the disposal of the pledged movable to a third party or depreciation of the value of the pledged movable.

- Transfer of the pledged movables’ ownership and/or possession (unless otherwise decided under the Pledge Agreement) to any third party do not infringe the rights of the Pledgee pertaining to Article 28 of the Movables Pledge Regulation – in other words, the liabilities of the Pledgor and the pledge itself endures despite the disposal. Further to this principle, it is possible to enforce the pledge against the prior or new Pledgor in case the Pledgor transfers the ownership of the movable to a third party provided that such third party agrees to undertake the pledge liability and the Pledgee notifies the prior Pledgor regarding that it reserves its right to enforce the pledge against it within one (1) year as of the transfer of ownership.

- To avoid the depreciation of the value of the pledged movable, Pledgee is entitled to take the necessary pre-emptive measures via court decision against the movable’s possessor as follows.
  
  i. Creation of additional securities in favor of the Pledgee or if the security is insufficient, compensation of its receivables
  
  ii. Restitution of the pledged movable to its initial state.

Besides, Pledgee, may only require partial compensation or partial security from the possessor unless the movable’s possessor is negligent.
Valuation of the Pledged Movable

Pledgor and Pledgee may assess the value of the movable before the pledge on such movable is duly established. In accordance with the Regulation titled “Valuation of the Movables in Commercial Transactions”, (hereinafter will be referred to “Valuation Regulation”) published on December 31, 2016 by Ministry of Trade, and entered into force on January 1, 2017, there are two (2) valuation methods:

i. **Contractual Valuation:** Before establishing the pledge, the parties (Pledgor and Pledgee) may bilaterally and freely determine the value of the movable without applying to a court.

ii. **Judicial Valuation:** Pledgee and if any, third person who will give the movables in his/her possession as a pledge may apply to the court for the movable’s value assessment before execution of the Pledge Agreement. In case the parties fail at agreeing on the value of the movable, then as a second resort, the parties may submit a request to the relevant court for the appointment of a competent expert for its valuation. Once the expert issues a report and one of the parties objects to the value assessed by the expert, then this objection shall be submitted to the court within three (3) business days following the report’s delivery. Upon objection, the court appoints a second expert and this time, the second value will be deemed as the definite value and may not be subject to re-valuation for the coming two (2) years.

TARES Registry System

The Ministry of Trade enacted a Regulation on December 31, 2016 named “Pledged Movables Registry Regulation” (hereinafter will be referred to as “TARES Regulation”) regulating certain issues such as the operation of TARES system and procedures for application to this system.

According to TARES Regulation, all items registered under TARES are open to public. Therefore, these items may be observed by persons not party to the Pledge Agreement. It should however be noted that as per Article 26, third persons, in request to receive a copy of the registered agreement are required to prove their interest/relativity to the requested transaction. It should also be highlighted that TARES officials are authorized and tasked with reviewing the Pledge Agreement in order to control its compliance with
the applicant rules, and complete its registration upon confirming that it is not in lack of any of the terms that are held mandatory to be agreed upon by the parties in the Pledge Agreement.

According to Article 24 of the TARES Regulation, movables pledge may be established either with “Fixed Rank System” or “Proceeding Ranking System”; and in case the system is not selected by the parties during the registration, then “Proceeding Rank System” becomes applicable.

✓ In the “Proceeding Rank System”, the pledges get ranked pursuant to the date of their registrations. In other words, a pledge cannot be placed in a rank that is higher than a pledge that was previously established. The movable constitutes the collateral of the pledgees in its entirety. Additionally, in case a pledge at the upper ranks is released, then the remaining ranks automatically and respectively place the higher ranks. Therefore, under this system, it is not practically possible for the Pledgor to reserve a rank that does not contain a pledge or establish a new pledge in the released rank.

✓ In the “Fixed Rank System”, the pledge consists of ranks with specific assigned nominal values. Each pledgee’s rank is determined as per the rank they are established in, rather than their dates of registration. It is not obligatory to determine pledge covering in its entirety, and accordingly, such pledge may be established limited with the nominal value of the assigned nominal values. In case a pledge at the upper degree is released, then the ranks do not automatically replace such released rank. Accordingly, under this system, the Pledgor may reserve a rank that does not contain a pledge and may establish a new pledge in such released rank.

Enforcement of the Pledge over the Movables

In the event that the Pledgor is in default under and in accordance with the terms of the pledge agreement, Pledgee may enforce its pledge by resorting to one of the following methods pursuant to Article 14 of the Law and Articles 40 and 41 of the Movables Pledge Regulation.

i. Transfer the title of the movable to itself by way of filing an execution order via enforcement offices within seven (7) days as of the date of default, if the Pledgee is a 1st ranking creditor, or
ii. Transfer its receivables to an asset management company operating pursuant to Banking Code No. 5411 or a third person, or

iii. Lease and license the pledged movables whose title or possession is not transferred to any third person.

On a separate note, the Pledgee is required to remove the pledge from TARES within three (3) business days as of the debt (forming the legal basis for the pledge) terminates. If the Pledgee fails to remove the pledge within the afore-mentioned time, as per Article 15 of the Law, the Ministry of Trade imposes an administrative fine equal to 1/10th of the Pledgor’ debt upon notification of the Pledgor.

B. Taking and Enforcing Pledge over Capital Market Instruments

In this section, we will provide a general outline on how capital markets instruments are pledged as per Capital Markets Law No. 6362 (hereinafter will be referred to as “CML”). It is worthwhile to firstly define certain terms that constitute the basis of the capital markets legislation.

i. **Capital markets instruments:** are defined under CML and these consist of:
   - **Securities,**
   - **Derivatives,** and
   - **Other instruments** accepted under capital markets legislation.

ii. **Securities:** are also defined under CML; as –among others– that consist of
   - **Shares** and
   - **Debt Instruments.**

Securities are a sub-group of negotiable papers and are subject to the pledge provisions under CML. However, other types of negotiable papers such as checks, bonds and bills of exchange are not accepted as Securities and may be pledged either by was of delivery or delivery and endorsement in accordance with Article 956 of the Turkish Civil Code No. 4721.
Dematerialization of Capital Market Instruments

Capital market instruments are issued and maintained in dematerialised form without certificates and are monitored at the Central Registry Agency with all their rights (hereinafter will be referred to as “CRA”) and such rights may be claimed against third persons as of the date such rights are registered at the CRA.

On August 7, 2014, Capital Markets Board published a Communiqué No. II-13.1 named, “Procedures Regarding the Dematerilization of Capital Markets Instruments (hereinafter will be referred to as “Communiqué”) which brings rules procedures and principles about dematerialization. The Communiqué also includes further detailed rules regarding the pledge of capital market instruments.

Registration and enforcement of Pledge under CRA

Pledge agreement pertaining to capital market instruments is required to be executed in written form and parties of such pledge agreement are required to provide a sample of such agreement to CRA via a CRA member bank or a financial institution. Upon receipt of such agreement, CRA member immediately records the pledge under either the sub-account of the Pledgor or the Pledgee in the CRA depending on which party maintains the instrument’s ownership pursuant to the executed Pledge Agreement; and as of that moment, any right pertaining to such pledged instrument is monitored through such sub-accounts.

Article 47 of the CML openly enables the parties to freely transfer the ownership of the pledged capital market instrument to the Pledgee under the Pledge Agreement – as explained above, a legal mechanism not recognized under Turkish Civil Code or the Law.

Furthermore, the same Article, brings forth new methods for, enforcement of the pledge over capital market instruments. Pursuant thereto, in the event of default or any other reasons stipulated under the executed Pledge Agreement, if;
i. The Pledgee is the proprietor (the ownership is transferred to the Pledgee via the Pledge Agreement) of the pledged instrument, without facing any prerequisites, the Pledgee may sell the pledged instrument to value equal to or above its market value to compensate its outstanding receivables.

ii. The Pledgor is the proprietor (the ownership stays with the Pledgor via the Pledge Agreement) of the capital market instrument, then Pledgee would be endowed with two (2) options explained hereinbelow and after the receivables are covered, shall return the outstanding amounts to the Pledgor.

- Sell the pledged instrument to value equal to or above its market value if the said instrument is traded in a stock market or in another regulated market,
- Take over the ownership of the pledged instrument.

It is worth to note that, for the 2nd option above, it shall explicitly set forth under the apledge agreement that the Pledgee may take over the ownership of the pledged instrument and also, if the said instrument is not traded in a stock market or another regulated market, the valuation method of the instrument shall be determined in the Pledge Agreement.

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1 Please see Article 939 of the Turkish Civil Code No. 4741.

2 Credit institutions are defined as i) Banks and other financial insitutions operating as per Banking Law No. 5411, ii) Financial insitutions operating as per Financial Leasing, Factoring and Finance Companies Law No. 6361, and iii) other public and private companies yielding loans and guarantees.

3 This definition includes companies (legal entities) and real person traders – which are defined under Turkish Commercial Code No. 6162.
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