Marketing into Europe 2018
Special Report

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Challenges, opportunities and key considerations

With just five months to go until Brexit, and time rapidly running out to put contingency plans into action, it should come as no surprise that discussions surrounding the possible outcomes of the UK’s EU divorce form a central part of this HFM Marketing into Europe report.

The uncertainty Brexit is causing, however, gives those service providers within other European jurisdictions the opportunity to highlight their value proposition for those with an eye on redomiciliation or establishing new partnerships in the face of the loss of the marketing passport. Taken in the best sense, Brexit may in the longer term provide an opportunity for managers to take stock of their options and look beyond the UK for their future European business activities. The Brexit-centric pieces in this report lay out the difficulties many face, although they are not insurmountable.

One of the best options for those who wish to retain access to the European market in a cost-effective manner, is to opt for a third-party management company (Manco) option with some operational functions delegated back to the UK.

Amid the tumult Brexit is causing for fund managers, contributors in this report remind all that it is only one segment of UK-based firms’ businesses which are going to have to relocate elsewhere. And the contributors within reflect on how they are positioned to help with the transition.

Further, the contributors reflect on the challenges, opportunities and key considerations for those looking towards a ManCo option as a means of ‘Brexit-proofing’ their business operations.

Luxembourg is a very well-established domicile which includes a variety of enticing fund structures such as the Raif and the parallel fund structure. The parallel fund structure, in particular, becomes an interesting proposition for US and Asian fund managers with established vehicles in time-honoured offshore domiciles such as the Cayman Islands and Bermuda. Furthermore Luxembourg, with its familiar Anglo Saxon laws and amenable, efficient business environment, is an impressive entry-point into the European market.

The report also includes insight from Ireland-based service providers. Elsewhere in the report, the value of several other rising European domiciles are outlined alongside the rise of ESG funds.

Overall, this report is certain to give readers a keen sense of what is happening in Europe at this time, and what structural and locational options are available to meet the needs of all types of fund manager.

Ross Law
staff writer
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Why is Cyprus becoming a popular funds jurisdiction?

Despite the fact that it competes with well-established jurisdictions, Cyprus is fast becoming a preferred investment hub in the industry, offering a range of fund vehicles addressing the demanding needs of investors and fund managers. The country is experiencing an increasing interest and appetite from investors and fund managers searching for promising and emerging EU-regulated fund jurisdictions. Assets under management have tripled since 2008, which constitutes prima facie evidence of the country’s market potential.

Cyprus’ growing popularity as a funds jurisdiction comes down to three concepts: international orientation, flexibility and a well-regulated investment environment committed to continuous modernisation.

What are the benefits of domiciling in Cyprus?

The country’s strategic location at the crossroads of three continents, Europe, Asia and Africa provides a unique competitive advantage in terms of easy access to high-growth markets. Opportunities are reinforced by the national framework, which offers flexible structuring opportunities to funds and fund managers and is designed to accommodate market realities and conditions, while at the same time being fully aligned with the European Union regulatory framework. The advent of the European Union’s Alternative Investment Fund Managers Directive (AIFMD), is currently transforming the way the global alternatives industry functions. The AIFMD places Cyprus in a strong position to develop further in the alternative sphere, since its membership renders ‘passporting’ rights to its funds modelled on EU structures, hence allowing fund managers to instantly benefit from the EU internal market.

Further, as an EU member state, Cyprus is a trusted destination providing sterling reputability to its EU-compliant funds, as well as the...
appropriate financial infrastructure for fund managers wishing to domicile in Cyprus. With an emphasis on investor protection, fund vehicles are subject to efficient transparency mechanisms encompassing reporting and risk management requirements, as well as the necessary control functions.

This is further complemented by Cyprus’ local regulator, namely the Cyprus Securities and Exchange Commission (CySEC), which calls for a high level of compliance and governance, while at the same time remaining highly accessible, responsive and business-friendly, allowing it to cater for investors’ demanding needs.

Other benefits of domiciling in Cyprus include cost-effective set-up and operational costs compared to its rivals, the country’s stable political environment and strong legal framework based on UK common law. Cyprus’ positive outlook is supplemented by its favourable tax regime both at fund and fund manager as well as at investor level.

What is more, Cyprus offers a complete package of fund services ranging from licensing to ongoing administration. The country prides itself as a well-established services jurisdiction and forms the basis of a highly specialised multinational and multilingual workforce, with English being the main language of the financial sector. Today, fund administrators, custodians, lawyers and auditors are increasingly serving funds and fund managers domiciled in Cyprus with a demonstrable commitment to add even more value to the global asset management industry.

Q Are there any specific fund vehicles in Cyprus?
A Cyprus offers retail investment funds, such as undertakings for collective investments in transferable securities (UCits), but also provides for sophisticated structures for alternative asset classes. Considering the UCits regime is well-established and requires little introduction to international fund professionals, for the purposes of the present issue, only the latter will be analysed in detail.

The available structures for alternative asset classes as per the current legislation are the alternative investment funds (Aifs), the alternative investment funds with limited number of persons (AIFLNPs) and the registered Aifs (Raifs).

Aifs and AIFLNPs
The applicable legal framework pertaining to Aifs allows for the establishment of Aifs to be addressed to an unlimited number of persons, as well as for AIFLNPs which may accommodate up to 50 investors classified as professional or ‘well-informed’ as per the applicable legal framework. Aifs and AIFLNPs require prior authorisation by the CySEC, which is a fairly simple set-up process compared to more mature fund centres. In addition, both types may be set up as a standalone or as umbrella funds with multiple investment compartments, each one depicting different asset classes and investment strategies, hence allowing for a wide range of asset classes, such as hedge funds, private equity and real estate, thus providing for great flexibility in this regard.

Cyprus maintains the proper legislative framework, enabling Aifs and AIFLNPs to be either externally or internally managed (where the fund is formed as a company). With regards to the former option, an external manager of the Aif may be a full scope AIFM (in which case its units may be marketed to professional investors across the EU under the AIF-MD passport), a UCits management company or even a MiFid II compliant Cyprus investment firm. An AIFLNP being a non-EU structure cannot be externally managed by an AIFM.

Minimum initial capital requirements are imposed either at the level of the fund manager, or at the fund itself where this is internally managed and are €50,000 for an AIFLNP and €125,000 or €300,000 for an Aif, facilitating in this way the launch of start-up fund managers and funds in the industry. Last but not least, Aifs may be subject to investment restrictions depending on the investor type, the category of the assets to be held in their portfolio, and the overall investment policy to be adopted. On the other hand, AIFLNPs are not subject to investment restrictions or investment limits.

Raifs
A major advancement in the Cyprus investment funds industry that has been newly adopted is the ability of establishing a Raif, a revolutionary development which will significantly reduce the time and cost for establishing an Aif in Cyprus. Raifs do not require authorisation by the CySEC in order to commence operations; rather, the establishment of a Raif will need to be notified to CySEC which will then be recorded in a special register kept by the CySEC.

In terms of the key characteristics of a Raif where this is managed by an AIFM, there is no limitation in terms of its assets under management (AuM) and no minimum initial capital requirement. Further, a Raif may be formed as an umbrella fund structure with multiple segregated investment compartments and may benefit from ‘passporting’ rights for distribution within the EU. A Raif may be established as open or closed-ended, and appointment of a local depository is mandatory.

The supervision of a Raif takes place only at the level of the required AIFM managing the Raif; however, Raifs structured as limited partnerships may also be externally managed by managers other than AIFMs (i.e. investment firms, UCits, management companies), in which case the Raif must necessarily be closed-ended and invest solely in illiquid assets.

Q What do you think the tax framework is?
A Cyprus offers one of the most advantageous tax regimes in Europe, while it maintains an extensive network of double taxation treaties (DTTs). The country’s regulatory regime is in full compliance with EU tax directives.

Foreign investors and Cyprus
non-domiciled individuals enjoy no withholding tax on dividends. Further, fund management and administration services provided to investment funds are not subject to VAT, resulting to the value base of investment fund not being burdened with a non-recoverable cost. This, coupled with one of the lowest corporate tax rates in the EU at 12.5%, places Cyprus high on the list of preferred jurisdictions for international tax planners. There are also a number of exemptions and deductions which, along with the foreign tax credit provisions, may reduce significantly tax exposures. The island is also increasingly becoming a destination of choice for fund managers and management companies thanks to the following advantages:

• 35% cap on personal income tax
• exemptions for up to 50% of taxable income derived from emoluments for up to 10 years may apply to previously non-tax resident individuals that take on Cyprus-based employment
• exemptions may apply for dividend, interest or rent income for tax resident individuals who are not domiciled in Cyprus
• gains from trading in a wide range of securities including shares and units of investment funds are tax exempt.

In addition, variable employment income, which is effectively connected to the carried interest of the fund managing entity, may be subject to non-tax resident individuals taking on Cyprus-based employment
• interest received by collective investment schemes is considered ‘active’ interest income and taxed only at 12.5% corporate tax (no defence tax)
• no minimum participation on inbound dividends to qualify for tax exemption. The liquidation of open and closed end collective schemes is not taxable if the unit holders are not tax residents of Cyprus
• Cyprus does not impose any inheritance tax or estate tax which is very important for the investors.

In addition, investment into Cyprus tax-transparent funds and management from Cyprus of non-Cyprus investment funds do not create a taxable presence in Cyprus.

Q Has the recent influx of Asian fund managers making Cyprus their gateway into Europe led to any changes or advancement in the Cypriot funds landscape?

A As the EU’s south-eastern most outpost lodged between three continents, complemented by a favourable tax regime and advanced commercial infrastructure, Cyprus is a compelling destination for Asian funds. There is evidently an increasing trend for Asian funds to establish their European presence via Cyprus. This resulted in the number of investment funds and assets under management hitting record highs, according to the Central Bank of Cyprus.

However, it is not just Asian funds that Cyprus targets. As the UK gears up its divorce with the EU, the country’s defining and redeeming qualities exhibit it as a strong alternative for UK fund managers wishing to maintain a foothold in an EU jurisdiction.

Q How does the jurisdiction foster innovation on the technology front?

A There have been an increasing number of Cyprus-based companies active in the fintech and regtech fields with solid reputation. The local regulator appears to be heading towards the right direction and has been very proactive in furthering the future of the financial business sector of Cyprus. CySEC recently announced the establishment of an ‘innovation hub’, aiming to address and explore the rise of fintech and regtech developments. The innovation hub is due to go live very soon, hence the results of it in practical terms remain to be seen.

What is more important to highlight, is the government’s efforts and commitment to foster an innovation culture by creating, among others, platforms between innovative industries that operate in the fintech and regtech spaces to foster dialogue and facilitate the exchange of information. Fintech firms will have access to specialised regulatory expertise, industry and academic roundtables, and will be able to submit their views and suggestions in assisting the government to better understand the risks and benefits of new innovative investment products and platforms.

Conclusion

In a rapidly changing funds industry, there is an array of options and opportunities for the operation of funds in Cyprus, especially with regards to alternative classes of assets, which are definitely worth exploring by fund managers, investors and advisors.

Cyprus keeps and will continue to keep an open mind and be welcoming towards the new wave of interest in terms of fund domiciliation, while at the same time transparency and investor protection remains a priority in its agenda. It is therefore safe to say that Cyprus holds a promising future in the funds industry and will soon have a substantial share as a funds marketplace in Europe and beyond.
Let’s get to the point: we understand funds. Ogier’s specialists have been at the forefront of fund set-up, structuring and finance since the inception of the industry with many actively involved in drafting the key laws that underpin fund structures across our international jurisdictions. We act for banks, financial institutions, funds and promoters, working with blue chip clients with established track records and the most innovative and entrepreneurial new sponsors entering the market. We pride ourselves on providing responsive and practical advice, while our hands-on, partner-led teams ensure a consistent approach.
The European passport

Derbhil O’Riordan, of Dillon Eustace, remarks on the AIFMD and the challenges Brexit will present to UK fund managers

Directive 2011/61/EU on alternative investment fund managers (AIFMD), applies to the marketing and management within the EU of all non-Ucits alternative investment funds (Aifs) and creates a comprehensive regulatory and supervisory framework for managers of Aifs (AIFMs) at European level.

Application of AIFMD
In addition to EU AIFMs, the AIFM Directive applies to any non-EU AIFM that:
• manages one or more Aifs domiciled in the EU; and/or
• markets Aifs to investors in the EU (irrespective of the Aif’s domicile).

For example, a US-based fund manager managing Cayman-based offshore funds that are marketed to EU investors in a master-feeder structure would typically fall within the scope of the AIFM directive.

Under AIFMD, the activity of marketing includes “any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM, of units or shares in a fund it manages to or with investors domiciled in the EU”.

This definition does not include reverse solicitation, which should be considered to be outside the scope of the AIFM Directive.

Passporting under AIFMD
AIFMD introduced a single marketing “passport” within the EU for the marketing of EU Aifs by EU AIFMs. However, at the time of writing, such passport is not available to non-EU AIFMs or to EU AIFMs with non-EU Aifs.

Although AIFMD does envisage the extension of the passport to non-EU Aifs and non-EU AIFMS, at present only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU-domiciled Aifs. However, when the relevant provisions of AIFMD are “switched on”, in respect of a given jurisdiction, non-EU based managers based in the relevant jurisdiction will be permitted to apply to become authorised as an AIFM under the AIFM Directive and market its funds in the EU under the marketing passport.

Marketing without a passport under AIFMD
Under AIFMD, members have discretion to allow for the marketing of non-EU Aifs marketed by EU AIFMs and Aifs marketed by non-EU AIFMs on a private placement basis within their own border, provided the marketing is subject to:
• the member state’s own national private placement regime (“NPPR”).
• the transparency rules imposed by the AIFM Directive (the “transparency rules”).

Countries that intend to allow private placement must apply the minimum AIFM Directive standards to AIFMs marketing under the regime. In addition to the standard AIFMD requirements, each EU member state can impose its own additional NPPRs in relation to the marketing of the product.

EU-based AIFMs with non-EU Aifs
Each EU member state can allow an authorised EU AIFM to market a non-EU Aif to professional investors in that EU member state under that EU member state’s own NPPRs, without a passport, provided:
• The AIFM complies with basic depositary and custody requirements under the AIFM Directive.
• There is a cooperation arrangement between the regulator of the AIFM’s home member state and the supervisory authority of the non-EU country where the Aif is established.

Each EU member state can allow non-EU AIFMs to market a non-EU AIF to professional investors in that member state under that member state’s own NPPRs

• The non-EU country where the Aif is established is not listed as a non-co-operative country and territory by the Financial Action Task Force (FATF) on anti-money laundering and terrorist financing.
Non-EU AIFMs with non-EU Aifs

Each EU member state can allow non-EU AIFMs to market a non-EU Aif to professional investors in that member state under that member state’s own NPPRs provided:

- The AIFM complies with the Transparency Rules in respect of each Aif and (where applicable) with certain additional rules relating to acquiring control of non-listed entities.
- There is a co-operation arrangement between the regulator of the EU member state where the Aif is marketed, the supervisory authorities of the non-EU country where the non-EU AIFM is established and the supervisory authority of the third country where the Aif is established.
- The non-EU country where the Aif is established is not listed as a non-co-operative country and territory by the FATF.

The Transparency rules

The Transparency Rules impose specific obligations on AIFMs applicable to all Aifs marketed in the EU. AIFMs must ensure that in respect of all Aifs marketed in the EU, certain minimum disclosure requirements are met in respect of annual reports, disclosures to investors, and disclosures to regulators.

Annual report disclosure requirements include:

- material changes to the Aif during the financial year.
- the total amount of remuneration paid to AIFM staff for the financial year (fixed and variable), number of beneficiaries, and any carried interest.
- The aggregate remuneration (broken down by senior management and staff of the AIFM whose actions have a material impact on risk profile of the Aif).

Disclosure to investors must include:

- Remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created.
- Disclosure on cover for professional liability risks.
- Details of any preferential treatment of investors.
- The percentage of Aif assets subject to special arrangements due to their illiquid nature and details of the special arrangements.
- Any changes to the maximum leverage that the AIFM may employ on behalf of the Aif.

Periodic reporting to competent authorities must include:

- The principal markets and instruments traded on behalf of the Aif.
- The percentage of Aif assets subject to special arrangements arising from their illiquid nature, arrangements for managing liquidity, the risk management systems employed, and the results of stress tests performed in line with the AIFM Directive.
- An annual report of the Aif and on request, a list of all funds managed by the AIFM for the end of each quarter.
- Where substantial leverage is employed, information on the overall level of leverage employed.

United Kingdom and Brexit

It is expected that in March 2019 the United Kingdom will exit from the EU and the UK will become a “third country” under AIFMD. The UK may therefore lose certain rights that EU managers and AIFMs currently have.

In terms of managing EU Aifs, a UK AIFM will most likely have the same rights as a US AIFM (for example). However, as things stand at the time of writing a UK AIFM could no longer market its EU domiciled Aifs cross-border within the EU. Further, cross-border distribution will most certainly be affected.

UK managers that see the EU (even if only a few EU countries) as their target distribution base will need to ensure that they keep a foothold in the EU before enjoying the benefits of EU-regulated entities in the financial services industry.

The available options for UK managers include:

- Setting up an AIFM or Super Manco (that is, a regulated entity that can manage and market both Ucits and Aifs) in another EU member state.
- Using a third party AIFM established in another EU member state.
- Putting their fund on a third-party platform that is already established in another EU member state.

Conclusion

Before setting out to market an investment fund in the EU, managers of investment funds should consider the three regimes currently in force and weigh up the benefits and costs of each. Given the strict rules around marketing in the EU, relevant advices should be sought before approaching investors. As has always been the case, for those selling in the EU without the benefit of an EU passport, the legal requirements of certain jurisdictions will remain easier to navigate than others.
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Is a Ucits fund appropriate?

Patric Foley-Brickley, of Maitland, discusses starting a Ucits fund and the implications of a hard Brexit

Q What are the practical considerations to bear in mind when starting a Ucits fund?

A There are two fundamental questions I would typically ask a manager expressing interest in setting up a Ucits fund range. Firstly, I would ask ‘what’s your investment strategy?’ in order to determine whether it’s suitable for the Ucits environment. And then, a two-part question being ‘who are your target market investors and where are they?’

Ucits is primarily a retail vehicle, but, in the European institutional space, a Ucits fund also has the advantage of being a well-understood product and that the investments will be managed within a tightly controlled regulatory framework. From this standpoint, it’s relatively easy to market to the establishment of European retail and institutional investors.

However, there are other challenges and, from an investment strategy perspective, the rules governing a Ucits are quite prescriptive.

The appropriateness of a Ucits fund will depend on whether the manager can fit their investment strategy into those proscriptions. For a long-only equity/bond manager or predominantly long-only manager that uses some limited hedging and EPM techniques to produce alpha, such strategies will generally work well in a Ucits environment.

If the strategy is more aggressive, incorporating illiquid securities, short-selling, real estate or private equity investment, then a Ucits will not be an appropriate vehicle.

From a marketing perspective, it is important for the prospective manager to have identified both the intended target market investors and the jurisdictions in which those investors reside. Does the manager intend to market broadly across Europe and beyond, or keep their strategy confined to a particular European jurisdiction? It is important to be selective and to focus the marketing on a finite number of well-researched jurisdictions from the outset. Ucits funds benefit from the EU cross-border marketing passport, but there are varied and specific requirements in each jurisdiction which come with associated additional costs for fund registration and the translation of the fund documentation to meet local requirements. These additional expenses can have a marked effect on the overall running costs of the fund, particularly when the asset base is small.

In that respect, it’s also important that a new fund achieves critical mass within a relatively short period of time as the ongoing costs of running a regulated fund are not inconsiderable. Assets under management (AuM) of around $50m generally constitutes sufficient critical mass for the fund to operate without the ongoing charges figure (OCF) exerting an unacceptable level of drag on the overall performance. As an absolute minimum, $20m may be sufficient; but at this level of AuM, the fund manager may need to subsidise the OCF at the expense of their own profitability. However, an AuM of this amount will at least give them the opportunity to establish a performance track record and enable them to establish a toehold in the European market.

Commercially, managers need to be aware that, unless they can achieve that critical mass and an above-average performance track record, the money isn’t going to simply ‘flood in’. Europe is a relatively reactionary market and investors will tend to bide their time before deciding to invest with a new entrant, no matter their track record and reputation in other parts of the world.

The current thinking is that the EU marketing passport for Britain will go away

In summary, if a manager is trying to penetrate the European retail and institutional market, a Ucits fund is the perfect vehicle, provided the investment strategy can be accommodated within its guidelines; it ticks all of the right boxes both from a cross-border regulatory perspective and from the perspective of being well understood by European investors. But the perennial challenge remains: finding investors willing to invest with a new entrant in an already overcrowded market.

Q What is the current outlook on Brexit?

A The current thinking is that the EU marketing passport for Britain will go away. This has implications for not only UK managers who want to market into Europe, but also for European and other
external managers who want to market into the UK. Without the marketing passport, a manager inside or outside of the UK will almost certainly need two sets of funds: one for marketing in the UK, and one for the rest of Europe.

For UK managers, a hard Brexit would mean that they would need to set something up in an EU jurisdiction such as Luxembourg or Dublin. Similarly, EU fund managers who have been marketing Luxembourg or Dublin funds into the UK would almost certainly have to set up a UK range.

Q Might some managers choose to ‘ignore’ the UK market in the event of a hard Brexit?

A It may likely turn out the other way around. If you look at the demographics and markets that buy funds, the UK is head and shoulders above everyone else in this regard. The UK has the biggest ‘invested through funds’ savings market in Europe. In Europe the majority of European savers will tend to buy domestic funds through their retail banking provider as opposed to Luxembourg or Dublin UCITS funds marketed cross-border. While some larger managers are likely to focus on markets where they already have a footprint and who may already have a Luxembourg or Dublin umbrella, there’s also a group of managers who have relied on the passport to market their domestic UCITS funds cross-border. These managers will need to decide whether the cross-border opportunities are sufficiently large to justify the expense of running a duplicate range in another location.

Q Have you had experience of cross-border marketing with UCITS?

A Yes. In addition to using the marketing passport to distribute funds across the EU, we are starting to see clients making provision for the post-Brexit environment. Leveraging Maitland’s capabilities and presence in Dublin and Luxembourg, we have recently helped a UK-based client to launch a Dublin-based UCITS structure utilising the UCITS ‘Master-Feeder’ legislation brought in under UCITS IV. The client wished to access a predominantly continental European investor base with a non-UK domiciled fund range in anticipation of the brave new world, and we have a number of other clients who are looking closely at a similar strategy.

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To begin with, can you explain what ESG is?

ESG stands for Environment, Social, and Governance. In an investment context it is about ethically investing while still making a profit. It’s often referred to as norms-base investing or screening. Asset managers need to fulfill their prospectus on how exactly they are investing which is one of the reasons for ESG’s rise in popularity. ESG often functions as something of a second layer on top of the pre-existing fund layer. It’s not about philanthropic investing where the result of the investment is prioritized over performance, ESG investments focus on delivering a positive impact on the environment or society, while still making a profit.

There are a wide spectrum of causes that fit into these three categories. For some, an ESG fund could refer to poverty, housing, or water. And to someone else, it could stand for religious conservation and the environment.

Why are ESG funds becoming important to investment managers?

Millenials hold a strong demographic within the workplace now and they want to ‘do good’ with their money. While this is certainly a key driver for ESG-integrated styles across mutual funds and private equity funds, pension funds are arguably the largest driver. If you look at Dutch pension funds, they increasingly want to know not just how money is being invested, but how ethical standards are being met. The trend is probably most well developed in Europe but the US is certainly catching on. The United Nations Principles of Responsible Investment actually recently produced a report forecasting impact investing growth by $250bn annually.

There are pools of money out there for ESG, and ESG is growing, but I think it is important to dispel the myth that this is solely as a result of individuals wanting to allocate their money that way. While some are of the belief that ESG is irrelevant and that everyone just wants returns, I consider it to be far bigger than that.

What have Apex been doing in this space and how long have you been involved in it?

We are acutely aware that ESG and ESG reporting is increasingly important to our clients. Our approach has been one of education initially. We have run discussion seminars, firstly across the US and Europe, which will be replicated in Apac and the Middle East at the right time. In addition, we are developing a service for clients to enable them to access ESG reports as part of their fund administration service. Reporting is the big thing. If you are an investor, you want to know how your money manager is complying with not just the prospectus, but your definition of what your impact is going to be.

Another key focus for Apex is building out our own CSR policy and activities on a global basis. As the industry evolves, we need to evolve with it, and investors expect transparency and a real focus in this area not only from funds themselves, but from their service providers also.

How is an ESG programme different to a firm?

We look at things at a fund level. But whatever the case, there will be a reporting requirement and an expectation of transparency from allocators. This is where we can add real value to our clients through providing this solution where fund managers can quickly and simply look at the ESG performance factors of their portfolio companies.

How is the firm’s corporate and social responsibility defined?

With regards to ESG reporting, we look at the fund and its investments. It is not possible from a fund administration perspective to track whether a company is recycling or not, but of course it’s not about the recycling itself. It’s about the firm’s overall carbon footprint. There are innumerable ways in which a firm can dissect how socially responsible they are being and it can be very specific for each entity.

Fred Jacobs, of Apex, shines a light on ESG funds

Fred Jacobs is chief revenue officer. He joined Apex in April 2018 to lead the group’s sales function and drive revenue on a global basis. He has over 20 years’ experience in the asset management and fund administration space and has held senior positions at various institutional businesses such as SS&C Technologies and Butterfield Fulcrum. Jacobs is an accomplished sales professional with a solid background in creating and managing teams to build client relationships and to promote SaaS solutions for asset management companies. His experience has taken him across various regions including Asia, Europe, Latin America and the US.
What is the intended aim of Apex’s upcoming ESG reporting services?

As mentioned, funds must report their returns to their investors as standard practice. But ESG is almost like an extra layer of transparency – it demonstrates that additional level of awareness to investors and a certain comfort level as a result. It works within the parameters of two things: the portfolio and the investment criteria set around socially or environmentally responsible investing. The usual type of reporting we deliver to clients depicts the financial performance of their investments. It’s that extra level of reporting value that goes beyond just the financial numbers, and allows a manager to understand other factors relating to their portfolio, determining a different kind of performance. This is such a relevant topic in today’s world, where not only businesses but consumers are overtly aware of the impact they are having on the environment around them. Transparency and best practices in the asset management space are evolving along with that and it’s not enough to adhere to regulatory requirements. Now, funds must consider societal shifts and expectations to remain competitive and we are developing this product to ensure we support them in doing that.

The answer is yes, and some of them have produced great returns. It wouldn’t be becoming a mainstream strategy if this wasn’t the case. Again, this is another dimension of how a manager needs to consider their ESG fund.

What else are Apex doing to make people aware of ESG?

Apex has a great opportunity to reach a wide range of asset classes across all geographies. When the group was established, 15 years ago, we really started in the emerging manager space and our founding principles around delivering a local service to our clients remain a key part of our strategy moving forward. As a global provider with a diverse range of clients, Apex is particularly well-positioned to service asset managers looking to roll-out ESG funds or just dip their toe in the ESG water. A lot of this type of business is conducted in places such as Africa where we have extensive experience and service capabilities. We are looking to lead the way in the ESG space and utilise our global experience and detailed knowledge of the space to support our clients in doing this properly.

Are there any current specific trends in ESG in 2018?

This is a very big question. This segment is being driven by all kinds of things and can now really be seen as a mainstream strategy. In some ways, the trends over the past year lie with the market’s anticipation of investor expectations. With new types of investor coming into the market with a totally new agenda – the millennial investors – the likes of environmental, social and governance issues come to the fore for this segment.

Do ESG funds actually produce investment yield/return?
he Ucits-compliant fund market has proven increasingly popular among US asset managers seeking to expand to Europe. But there are a multitude of hidden factors firms should consider before diving in.

The Undertakings for Collective Investments in Transferable Securities (Ucits) directive is a pan-European regulatory framework initially designed to allow effective distribution of investment funds across the entire EU via the Ucits European passport. Ucits are regulated investment products established and authorised under a common EU legal and regulatory authority. The Ucits directive offers, to all type of investors (both retail and institutional), a wide offering of funds structures together with the highest level of investor protection. Ucits can be distributed to a very large proportion of the global asset management market and are available for distribution in non-EU countries such as Switzerland, Hong Kong, Singapore, Taiwan, South America, South Africa, Japan and many more.

The Ucits brand is very strong and distinctive and has been associated over time with the successful and steadily growing fund history in Europe and beyond. Unlike the Investment Company Act of 1940, which regulates mutual funds in the United States, Ucits are constantly evolving since the original directive in 1985. Ucits III was published in 2001, Ucits IV in 2009 and Ucits V in 2016.

Today it is quite straightforward to set up a Ucits fund and many US fund managers have already decided to set up Ucits funds to accommodate their existing strategies and tap into the second largest fund market in the world. The Ucits brand is the most attractive option for US fund managers to expand outside of the US.
**Complexity**
While it is still possible to offer investments in non-European vehicles in Europe, it has become increasingly complicated since the introduction of the AIFM directive, which offers the same passport to distribution.

The passport regime granted to UCITS represents a core foundation to the freedom of movement within the EU’s single market as opposed to a private placement regime, where typically foreign investment vehicles are utilised to raise capital in Europe.

**Choice of domicile**
The main challenge for US managers lies in the choice of the right domicile for the establishment of their UCITS structure.

UCITS funds can be domiciled in all 28 (soon to be 27) member states of the European Union. Certain EU domiciles remain less open than others to foreign investment vehicles.

The preferred domiciles for UCITS funds remain Luxembourg and Ireland. Both countries offer high-end infrastructures, easy access to experienced work force and language skills for the servicing and provide exemption on income and capital gains taxation at the fund level. Luxembourg was the first EU country to pass the UCITS legislation into national law in 1988 and remains a pioneer in looking forward to the long-term development of the brand.

Both Ireland and Luxembourg can demonstrate a significant expertise in establishing the widest possible range of international funds. Luxembourg is the largest European fund domicile and the second-largest fund centre in the world after the US, with about €4.2bn in assets under management with the presence of most top asset management firms.

Therefore, when selecting a domicile, it is important to consider the existing operations, structure and ambitions of the US fund manager.

**Legal framework**
The choice of fund structure is one of the key decisions to consider at the outset of the launch of a UCITS.

A UCITS fund can be set up as a single fund or as an umbrella fund structure with multiple compartments in the following legal forms:

- An FCP is a mutual fund (fonds commun de placement). The FCP has no legal personality requiring the appointment of a Luxembourg management company like Fuchs Asset Management.
- A Sicav is an open-ended investment company (société d’investissement à capital variable). A Sicav must either appoint a management company or designate itself as a ‘self-managed’ company where the manager needs to have the appropriate licences.

Historically, investment managers were either establishing a standalone UCITS fund structure or work with a third party management company offering an existing white-label UCITS fund platform. The most common approach is to set up a standalone UCITS structure with the appointment of a third-party management company. The main benefit for the latter option is that the US manager can fully concentrate on the management of the investment strategy and generate returns.

US managers have increasingly utilised third-party UCITS platforms as the primary drivers being the speed to market, lower costs and regulatory oversight. The only downside of such option would be reduced independence in the choice of the service providers.

**Choice of service providers**
In order to establish a UCITS fund, the managers must select different service providers: a depositary bank, a central administration, a management company, an audit firm and potentially independent directors.

A Luxembourg UCITS must appoint a Luxembourg depositary, which is responsible for the safekeeping of the fund’s assets and performs important oversight and monitoring functions.

The central administration among other services is responsible for fund management accounting services, valuation of the portfolio and pricing of the units/shares (including tax returns) and transfer agency services.

We at Fuchs Asset Management are responsible for the risk management, compliance and oversight of the appointed parties, the distribution and portfolio management function.

We exist to provide the required assistance with the investment strategy and to ensure that it is compatible with UCITS regulations. We can be your overall guide in selecting the right domicile and service providers, and advising against any potential legal pitfalls.

**Role of the fund manager**
The role of a fund manager is to decide upon the construction of the portfolio in line with a fund’s unique investment objectives. The portfolio of underlying assets must adhere to the UCITS law and the specific parameters as outlined in the fund’s prospectus.

The UCITS directive prescribes that the investment management function can only be performed by managers that are authorised or registered for asset management and subject to prudential supervision. In case a US manager is not regulated by the SEC there remains the possibility for him to be appointed as investment advisor to the management company.

**Conclusion**
As the implementation of regulatory requirements will continue and the appetite for cross-border investment grows, the UCITS world will continue to grow with the UCITS brand set to continue to be the gold standard of the global fund industry.

The European market still represents an attractive and negligible option for US fund managers. The UCITS fund industry represents an opportunity to leverage on a consolidated regime and increase assets under management with the expansion of the investors on a global base. The long-term benefits deriving from the connectivity to US markets should not be underestimated.
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*Stats as at June 2018

US$391bn total net asset value of regulated funds under administration

81% of fund assets in alternatives

1,020 regulated funds plus 128 Jersey Private Funds

Private equity  Venture capital  Real estate  Infrastructure  Hedge

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A year of change

Nick Blake-Knox, of Walkers, outlines the recent events, trends and regulatory occurrences which fund managers are dealing with in 2018 and beyond

Q What market trends have you seen recently?
A In terms of trends we are seeing an increasing role for Esma. This is particularly the case with supervisory convergence, which has been identified by Esma as an area of strategic importance and has been included in its 2019 Work Programme which sets out its priorities and areas of focus for 2019. Esma views supervisory convergence as a necessary step in achieving its overall mission to enhance investor protection and promote stable and orderly markets.

One of the key objectives of the supervisory convergence programme is to remove regulatory arbitrage and this is particularly relevant in the context of firms seeking to relocate as a result of Brexit. A Supervisory Coordination Network (SCN) has been established by Esma at which EU national competent authorities are afforded the opportunity to share and discuss details of Brexit related relocation applications that they have received in order to allow for the adoption of a common supervisory approach across member states. The SCN process has resulted in the expectations of certain NCAs, particularly those in relation to local substance, evolving over the course of the authorisation process, which in some cases can take more than 12 months to complete.

My sense is that the historical position where asset managers have established funds in certain jurisdictions and were potentially advantaged/disadvantaged by different applications of European rules will significantly reduce; we have seen this, for example, in relation to share class hedging where Esma has intervened and issued an opinion recently.

Q Are some market participants now paying more attention to the EU and jurisdictions they know they’re still going to be able to conduct business within post-Brexit?
A As things currently stand, there is still significant uncertainty around the status of any withdrawal agreement and the post-Brexit landscape for the distribution and management of funds. We have seen a bifurcated approach with a large number of firms seeking to put in place contingency arrangements irrespective of the Brexit outcome by proactively setting up structures in the EU27 in advance of Brexit, with a large group of managers still waiting to pull the trigger and implement their Brexit plans. This second group, which includes many smaller managers, is waiting for a clearer understanding of whether there is likely to be a transitional period or not. The latter approach is clearly a higher risk strategy given that the authorisation processes take time and these managers are unlikely to obtain new authorisations in advance of Brexit if they have still had no engagement with the regulators up to this point. We have been assisting clients to map out alternative options which can be implemented more quickly, such as the use of third-party management company solutions as an interim measure.

In terms of Ireland as a domicile, the Central Bank of Ireland has continued to receive a steady flow of authorisation applications from asset managers throughout 2018 seeking to establish Ucits management companies, AIFMs and Mifid firms which demonstrates the continued attraction of the jurisdiction. We have also seen firms seeking to establish fund management companies with Mifid top-up permissions which afford firms more flexibility to provide investment services to their non-fund clients.

There is still hope that a withdrawal agreement will be put in place whereby a transitional period will apply, potentially one which is further extended. Recent initiatives by the UK, whereby they’ve introduced a temporary permissions regime (TPR), which will allow for the continued sale of EU funds in the UK post-Brexit for a limited time period, have provided some further encouragement although the application of the TPR to funds which are registered post-Brexit remains unclear.

Q What other key developments have occurred in 2018 and will occur in the near future?
A On the regulatory front, there are a number of EU regulations which have either come into effect already during the course of 2018 (e.g. GDPR) or are due to come into effect shortly that will impact fund managers.

One of these is the Securitisation
Regulation, which will introduce a harmonised framework for securitisations across the EU, thus moving away from the current position whereby sector specific requirements are set out in the relevant sectoral legislation. “Securitisations” capture any transaction or scheme whereby the credit risk associated with an exposure or pool of exposures is tranched and can apply to a broad range of instruments including asset-backed securities and collateralised loan obligations.

The principal impact of the existing requirements under AIFMD, which are broadly similar to those under the Securitisation Regulation, has been that the AIFM is required to ensure that any securitisations which are acquired by the AIFs under its management comply with the 5% risk retention requirements.

Under the Securitisation Regulation, similar requirements will soon apply to UCIs in respect of securitisations issued on or after 1 January 2019. This is a significant development for many UCIS managers that invest in securitisations, particularly those who invest in US issued paper, which will not typically be structured in a manner to comply with these requirements.

For managers who invest in these products within their UCIS ranges, there are large compliance projects underway to ensure that they are ready for the introduction of these new requirements including identifying any legacy positions which may be brought into the scope of the Securitisation Regulation on or after 1 January 2019. UCIS managers are also assessing any potential impact on their ability to continue meeting their investment objectives and/or any adverse impacts to investment performance due to the narrowing of the investment universe in which they may invest.

It should be noted that the requirements introduced under the Securitisation Regulation also extend to non-EU AIFMs who manage or market AIFs within the EU. This is particularly notable because many AIFs which have been marketed under the Article 42 regime under AIFMD have fallen outside the scope of these requirements until now and so AIFMs of non-EU AIFs which are managed or marketed within the EU are now assessing the potential impact to their portfolios.

**Q** What further market trends have you recently seen?

**A** In terms of other trends, we’re continuing to see a focus on costs and charges, both by the regulators and in relation to the fee models that are being employed. Indeed, MiFID II significantly enhanced the requirements for fee transparency and also introduced new rules regarding inducements which are likely to continue to be disruptive in relation to traditional fee models and further incentivise the growth of ETFs.

We have also seen scrutiny by the Central Bank of Ireland in relation to UCIS performance fees and it recently carried out a thematic review of practices relating to the calculation and verification of performance fees. In addition, the Central Bank issued a “Dear CEO” letter on 4 September 2018 highlighting supervisory issues which were identified during this thematic review and requiring UCIS that charge performance fees to review their existing methodologies and confirm to the Central Bank of Ireland in writing by 30 November 2018 that such a review has been carried out.

We expect the focus on fees to continue to be front and centre of the regulatory agenda going forward.

We have seen a bifurcated approach with a large number of firms seeking to put in place contingency arrangements irrespective of the Brexit outcome by proactively setting up structures in the EU27
Making life easier for you

As a fund manager wanting to access European or cross-border investors, we can work with you and your advisors to structure an appropriate solution.

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What is the role of the depositary and key responsibilities for AIFs?

On 5 July 2013, Cyprus transposed the provisions of the EU Alternative Investment Fund Managers Directive (AIFMD) through the Alternative Investment Fund Managers Law, Law 56(I) of 2013 (AIFM Law) and introduced the Alternative Investment Funds Law, Law 131(I) of 2014 (AIF Law) which regulates AIFs.

The AIFM Law, in line with AIFMD, imposes general overriding obligations on the depositary, such as the duty to act honestly, fairly, professionally, independently and in the interest of the AIF and its investors.

For each AIF it manages, the AIFM must ensure that a single depositary is appointed, which must be evidenced by written contract between the depositary and the AIFM. The main functions of the depositary include cashflow monitoring, safe-keeping and oversight duties.

The cash monitoring function requires that cashflows are properly monitored and that payments made by investors for subscribing to the fund have been received and deposited in properly set-up cash accounts.

The safekeeping function concerns two types of assets: financial instruments that can be held in custody and other assets like private equity and real estate.

Financial instruments that can be held in custody are safeguarded by the depositary and registered in segregated financial instruments accounts opened in the depositary’s books. For other assets, the depositary verifies the ownership of the AIF of such assets, and maintains an up-to-date record of those assets.

The oversight duties refer to the following tasks:

- monitoring the flow and process of subscriptions and redemptions
- verification as regards the valuation of shares of the AIF
- carrying out the instructions of the AIFM, unless they conflict with national law or AIF rules;
- timely settlement of transactions involving the assets of the AIF
- monitoring income distributions of the AIF

These duties are the same for AIFs being managed by a full-scope AIFM or a sub-threshold AIFM, with the difference that, for AIFs managed by sub-threshold AIFMs, the depositary may be located outside of Cyprus, whereas for full-scope AIFMs, the depositary must be located in Cyprus.

Another option for sub-threshold AIFMs is the AIF with limited number of persons (AIFLNP), which can have up to 75 investors and is addressed to professional and/or well-informed investors. This is subject to a lighter regime.

An AIFLNP may not appoint a depositary if it meets one of the following conditions:

- its total assets do not exceed €5m ($5.9m)
- its instruments of incorporation limit the number of unit-holders to up to five persons throughout the duration of the AIFLNP
- its assets are not subject to custody

The depositary obligations when appointed for an AIFLNP are only the safekeeping duties, either for financial instruments that can be held in custody and/or for other assets.
How will the depositary duties change with the amendment of the AIF Law which will introduce the registered AIF?

These AIFs will be registered but will not need to be authorised by the Cyprus Securities and Exchange Commission (CySEC), thus significantly improving speed to market. These will be marketed to professional and/or well-informed investors, and managed by a full scope AIFM. The duties of the depositary will therefore remain the same as for full scope managers.

However in the upcoming amendment of legislation regarding AIFLNPs, one of the conditions that waives the obligation to appoint a depositary when its assets are not subject to custody is expected to change. The change would mean that AIFLNPs may not have to appoint a depositary, even if a percentage of their financial instruments are subject to custody under certain provisions.

What services does Bank of Cyprus offer the fund industry?

Bank of Cyprus (the Bank) is the largest financial institution in Cyprus and has a long history in servicing the investment management business through its wealth and markets division.

The much-awarded wealth and markets division of the bank has more than 20 years’ experience in private banking, institutional wealth management, brokerage and custody services. It provides its wide range of specialised, investment-related services to complement the bank’s traditional banking services, in order to offer value-added solutions to the Bank’s private high-net-worth and institutional client base, including funds and fund management companies.

The bank’s services that cater to the fund industry include:

Depositary services: Bank of Cyprus is one of the local credit institutions offering depositary services to AIFs and UCits. While historically offering global custody services for its clientele, for us to begin offering depositary services was a natural evolution as the Bank was already active in the business of safekeeping financial instruments that could be held under custody.

The depositary services are offered through the custody and trust department within the wealth and markets division of the Bank. The Bank acts as depositary for a number of AIFs and UCits funds, safeguarding the investments through global custodians. The Bank carefully reviews the profile of each AIF/UCits it provides services to in order to understand its activities, specific needs and to apply a personalised service. This process results in an efficient process flow and exchange of information between the fund and the manager. The Bank is also continuously searching for alternative ways of automating flows and enhancing its systems to be able to handle more demanding funds and deliver greater value to its clients.

Bank of Cyprus is fully committed and ready to deliver quality services to AIFs that invest either in private equity or listed instruments

Execution services: Complementing the depositary service, the Bank offers execution services to AIFs and UCits funds through its institutional wealth management team for listed instruments in global markets, as well as providing access to a large number of fund houses through a dedicated fund platform.

Licensing funds: The Bank offers services related to the setting up and licensing of AIFs, UCits and AIFMs or UCits managers in Cyprus. Through its wholly owned subsidiary, the Cyprus Investments and Securities Corporation (CISCO), it can provide advice and guidance on selecting the legal form, structure and fund characteristics based on clients’ specific needs, assist with the incorporation/formation of the fund, the drafting of the prospectus, and the completion of all key investor information documents and all other relevant documents required to be submitted to CySEC. The Bank coordinates with all involved parties during the processing of the application with CySEC, up until the licence is granted.

Fund management and supporting services: The Bank is also active on the fund management front, through a 100% owned subsidiary – BOC Asset Management (BOCAM). BOCAM offers a variety of services including the management of UCits funds, discretionary portfolio management and investment advice to institutional and high-net-worth clients in Cyprus. As a result of the increased interest in the AIF market in Cyprus, BOCAM is enhancing its service offering to be able to offer third-party funds services such as administration, risk management, accounting, distribution and regulatory compliance. By using such services, funds are potentially able to benefit from reduced operational expenses, improved efficiency of operations and the freeing up of resources to focus on the actual management of investments.

As regards depositary services, what is the first step when you onboard new clients? Do you tailor the functions they will require on a case-by-case basis?

While the depositary duties are commonly known and set by law, each fund is different in terms of their business, investment activity and profile. Even before onboarding, we engage in an in-depth analysis of the characteristics of the fund as we need to address the key areas and flows that will need our involvement. Understanding the frequency of transactions, the target asset classes and jurisdictions involved are essential parts to provide a customised service based on the funds’ needs. We also review the service providers of the fund and their procedures and processes as they are parties with which we will be cooperating. It’s important for us to establish a common understanding of the expectations one party has from the other. Each fund will have tailor-made processes in place as each is unique, and we have to look at each on a case-by-case basis.

Bank of Cyprus is fully committed and ready to deliver quality services to AIFs that invest either in private equity or listed instruments through a complete solution suite of depositary services and other complementary fund services.
Q **What is a parallel fund structure?**

Parallel funds are those which co-invest and divest alongside the main fund. They co-invest and divest at the same time and on similar terms. This is on a pro-rata basis per their commitments, so a manager has two or more funds side by side which invest and divest at the same time in a common portfolio of assets. The terms on which the parallel fund operates are similar to the terms of the main fund. This means that the parallel fund has a common investment policy, and common asset targets because they are investing in the same portfolio. The only differences between them are mainly due to regulatory or operational reasons.

The size of a main fund and some of its parallel funds may not be the same. For instance, the parallel fund may be larger than the main fund and, in most cases, the AuM of all funds will be aggregated to determine the size of the overall structure. This being said, what is quite complicated in a parallel fund is that the main and parallel fund are separate legal entities, and there will need to be a fine balance between the fact that different legal entities are being operated in different jurisdictions and yet these entities are part of the same global asset pool.

Q **Why are the Cayman/Luxembourg parallel funds structures generating such strong interest from US and Asian fund sponsors at this time?**
When you’re an initiator, you have to reconcile the concerns of different types of investors in different jurisdictions. You may need to structure a fund programme with one or more parallel funds which are co-managed by the initiator and that are targeting the same portfolio. Cayman is the natural choice for many US and Asian fund sponsors because they are used to this product and it’s efficient from a time to market perspective.

When Asian or US sponsors want to reach European investors, Luxembourg is considered as the EU equivalent in terms of comprehensible environment enabling the set-up of flexible structures, and this is why parallel structures in these jurisdictions pair well together.

Another important point is that when you create a parallel structure, you enable investors to choose between an offshore and onshore jurisdiction, while maintaining the same investment policy.

**Q Why do you think this might matter?**

**A** It might matter for several reasons: certain investors may have internal guidelines which restrict their ability to invest in an offshore vehicle, or there may be regulatory or tax implications arising from an investment in vehicle. Having the choice between on- and offshore jurisdictions is likely to meet the needs of a greater range of investors.

In terms of why Luxembourg, it’s clearly becoming one of the preferred jurisdictions for those seeking to access European capital by way of a parallel fund structure. This is due in no small part to Luxembourg’s extensive product toolkit.

One of the products which is important is the Luxembourg special limited partnership (SLP). This product has comprehensive functionality and is appealing to investors who are accustomed to Anglo Saxon partnerships. It really offers the same flexibility in terms of structuring that is available in a Cayman or UK limited partnership.

The Luxembourg parallel also provides access to the European passport for marketing purposes if the fund appoints an authorised AIFM. Further, in the context of Brexit, some Asian and US managers based in the UK are now choosing Luxembourg as their European base, and we have seen a lot of movement since the Brexit vote result.

**Q What makes parallel structures appealing?**

**A** They are very flexible. A parallel structure gives a lot of options to investors. Investors have the ability to choose the fund vehicle that will best suit their particular risk profile, regulatory requirements, tax appetite and more – all very helpful choices in practice.

To a certain extent, the parallel structure also helps overcome certain regulatory barriers. For example, the regulatory costs linked to AIFMD can be restricted in relation to the Luxembourg parallel fund with no financial impact on the non-EU main fund.

In terms of efficiency of structure, a larger investment pool means that funds can be managed more efficiently, and has the potential to escalate the speed at which managers are able to meet their investment objectives. The use of multiple domiciles can result in optimisation of the structure.

Finally, the other notable Luxembourg structure is the Raif – the reserved alternative investment fund. This is an unregulated product, and we say that it is a ‘hybrid’ product as it is indirectly regulated at the level of its manager. A Raif is required to appoint an authorised AIFM, subject to supervision by the European supervisory authority of the AIFM. If the initiator wants to have a product in which it can have an umbrella structure, a Raif is able to have segregated compartments, making it a good choice of vehicle if an initiator envisages several investment policies targeting different pools of investors.

**Q What are the main challenges of the set-up of Cayman/Luxembourg parallel structures in practice?**

**A** The operational component is a key challenge when you operate multiple co-investing parallel funds with cross-jurisdictional vehicles. In practice, there will be an additional administrative burden and a lot of complexity to deal with. For instance, there may be different base currencies and different reporting obligations of the different vehicles to navigate.

In terms of expenses, it’s also important to note that an adequate allocation of costs between the different funds in the structure will be required. You will also have to achieve a fair balance between the voting rights of different investors. Sometimes you may have to reallocate costs from one pool of assets to another, too.

Overall it’s vital that the cost and expense allocation mechanism, the voting rights and distribution waterfall, for instance are modelled at the structuring stage of the fund to ensure that they will work effectively in practice.

The next challenge may relate to the delegation model. In the offshore world, the sponsor will usually be remediated through an advisory or management fee. This will be the same in a Luxembourg fund but if you, for example, have a Luxembourg fund that needs to appoint an external authorised AIFM to access the European passport, it will have a third-party service provider that will be included in the fee and delegation structure. This may make things difficult because you will need to carefully monitor the flow of fees within both structures, and the delegation structure in each fund may not be the same.

The final key challenge is sustainability. Due to the costs that the structure will generate, it may be a sustainability challenge for smaller funds. This also needs to be carefully studied at the structuring stage of the parallel structure.
LOOK BEYOND THE HORIZON, WE REMAIN FOCUSED.
The viability of Cyprus

Marios Tannousis, of Cyprus Investment Funds Association (CIFA), outlines the benefits of domiciling a fund in Cyprus

What are the benefits of domiciling in Cyprus?
Cyprus offers investors a business-friendly and safe jurisdiction with an efficient tax and legal system and a highly competitive cost base. Cyprus has been a member of the EU since 2004 and adopted the euro in 2008, meaning that funds regulated here enjoy EU passporting rights. As a member of the commonwealth, Cyprus also has a familiar common-law legal system and has double taxation treaties with more than 60 countries. We are conveniently located at the crossroads of three continents, with excellent relations across the Middle East, Africa and Asia. We offer a highly educated, cost-efficient workforce, as well as an array of international schools and wonderful weather! This is why Cyprus is the preferred jurisdiction for a large number of international companies.

Are there any specific fund vehicles in Cyprus?
The Cyprus Securities and Exchange Commission (CySEC) regulates Undertakings for the Collective Investment of Transferable Securities (UCits) and Alternative Investment Funds (Aifs). The latest Aif law, passed in July 2018, introduces the fast-track Registered Alternative Investment Funds (Raif), as well as the Limited Partnership with a familiar common-law legal system, therefore making Cyprus an ideal business jurisdiction for global firms, including those in the UK affected by Brexit which are looking for a new base in an EU member state.

What’s the legal and tax framework?
Cyprus has the lowest corporate income tax rate in the eurozone, at a flat rate of 12.5% and there is no withholding tax for non-residents. The top rate of personal income tax is 35% and there is a general tax-free threshold of €19,500 ($22,355) which lowers the effective rate even further. Additional tax incentives exist for non-domiciled individuals, including a 50% personal income tax exemption by new entrants employed in Cyprus and earning over €100,000 ($114,651). The legal system in Cyprus is based on the English common law system, therefore making Cyprus an ideal business jurisdiction for global firms, including those in the UK affected by Brexit which are looking for a new base in an EU member state.

What does Cyprus do to facilitate cryptocurrency funds?
As witnessed by the newly launched Innovation Hub (see last question), Cyprus has been a pioneer in recognising the important role of financial innovation and in moving to ensure that the regulatory environment is both welcoming and protective of investors. Recognising that there is for the moment no specific EU regulatory framework governing trading in virtual currencies (with some limited exceptions), The Cyprus Investment Funds Association (CIFA) is working closely with the regulator, the Cyprus Securities and Exchange Commission (CySEC), the Ministry of Finance as well as EU authorities, in order to set the right regulatory framework in place.

Has the recent influx of Asian fund managers making Cyprus their gateway into Europe led to any changes or advancement in the Cypriot funds landscape?
Yes. We are seeing enquiries for domiciling funds in Cyprus from China, India and the Middle East, in addition to Europe. Generally, there is an increasing trend for funds from Asian countries such as China, India and even Japan, to establish a base in Cyprus as their gateway to the EU. Our ability to offer a tax-efficient friendly jurisdiction at a competitive cost is a draw for these cost-conscious funds.

How does the jurisdiction foster innovation on the technology front?
Cyprus formalised its ongoing support for financial innovation with the launch by CySEC of the Innovation Hub. The Innovation Hub aims to foster a more effective relationship between entities operating in this area and the way they are regulated. This initiative reflects the general innovation focus in the country. The Cyprus government approved the appointment of a National Research and Innovation Council to promote innovation and entrepreneurship, as well as the appointment of a chief scientist to advance research and development. Universities in Cyprus are also playing an increasingly important role in exploiting the results of research through innovation and start-ups.
brexit ‘deadline day’ is now less than six months away, and while the transition period following 30 March 2019 will give hedge fund managers some breathing space, there is still a degree of uncertainty in terms of what ongoing trade arrangements between the UK and EU will look like in the medium to longer term.

The results of a survey carried out earlier this year by the CFA Institute are a case in point. It found that just 17% of its membership of UK asset managers believe that any post-Brexit trade deal with the EU will result in a comprehensive trade deal covering both goods and services, and that 22% of EU asset managers believe the UK will exit the EU with no trade deal agreed by 29 March 2019.

Jersey has an opportunity play a positive role here, working with UK and other non-EU hedge managers looking to market into the EU. Jersey’s ability to market alternative funds into the EU through private placement arrangements is working really well, with more and more managers establishing funds in the jurisdiction to market to investors in EU member states.

However, marketing into the EU is only one part of a much broader picture. While the media focus has been largely on the potential damage of a bad trade deal to the UK’s alternative funds industry, the reality is that the EU has a lot to lose too, and Jersey can play just as vital a role in supporting EU managers looking to market funds into the considerable UK investor market.

Working with managers to bridge the Brexit gap

Geoff Cook, CEO of Jersey Finance, considers what fund managers in Jersey can do to mitigate some of the inherent difficulties of Brexit

With AIFMD having marked its fifth birthday this summer and with Brexit on the horizon, marketing into the EU is certainly being brought sharply into focus. At the same time, though, hedge managers, whether in or outside of the EU, are also needing to assess their models in a wider context and take a pragmatic approach to globally-focused strategies.

From Jersey’s perspective, the message is clear – it has the right environment and infrastructure to give the global hedge fund management community some much needed certainty when it comes to marketing into the EU and is ready to support managers pursuing a more global approach too.

The indications are that alternative fund managers are finding real confidence in Jersey. Figures show that the total net asset value of regulated funds in Jersey as at June 2018 stood at almost ($384bn), the highest level ever recorded, with the hedge fund sector growing 6.5% since the start of the year to represent almost a quarter of Jersey’s regulated alternatives business.

Positive trajectory
The EU investor market remains an important one for Jersey, and the jurisdiction has the ability to play a valuable role in helping hedge funds access the EU.

Firms in Jersey have a good deal of experience in linking managers with EU investors – around a third of Jersey’s funds activity touches the EU (Jersey’s Value to the EU, 2016). Jersey is already a third-country in relation to the EU (something the UK will become post-Brexit) and has all the infrastructure in place to enable hedge funds to continue to market seamlessly through its tried-and-tested private placement route into the EU.

A lot has been made of the AIFMD passport, but the passport solution may not necessarily be the only or best option. Private placement-friendly markets within the EU, such as the Netherlands, allow funds to access EU investors and avoid the burden of full AIFMD compliance. This has some unique and important advantages such as no remuneration reporting requirements, and no depositary requirements.

There is a growing number of managers recognising this opportunity and establishing alternative funds in Jersey to make use of the private placement option. The latest figures from Jersey’s regulator show that the number of alternative fund managers authorised in Jersey to market into Europe through private placement rose 23% as at June 2018 compared to 12 months previous.

Over the same period, the number of Jersey alternative investment funds being marketed into Europe via private placement also increased.
significantly to stand at more than 300, representing an 11% year-on-year increase.

These figures clearly highlight that the use of private placement continues to work well as a means of marketing funds into the EU. It’s stable, cost-effective and future-proof, and this positive trajectory is expected to continue.

Figures published last month by the European Commission as part of its proposed package of amendments to regulation surrounding the cross-border distribution of collective investment funds made for interesting reading in this regard.

By the Commission’s own admission, “about 3% of AIFs are registered for sale in more than three Member States”. While an AIFMD passport might well be the most appropriate solution for that 3% wanting to blanket market across the EU under full AIFMD compliance, for the vast majority of funds (97%), private placement could offer a much better, more efficient and cost-effective means of accessing investor capital in specific EU markets.

Better solution
While marketing into the EU is certainly being brought into focus in the lead up to Brexit, forward-thinking managers are assessing their operating platforms against the broader picture, with the ability to operate bespoke global strategies from a cost-effective platform set to become increasingly important.

According to Preqin, for instance, 40% of hedge managers planning to launch a fund in 2018 will do so as a new strategy based on seeing new opportunities in a changing global marketplace (Hedge Fund Manager Outlook H1 2018).

With fund performance being the single biggest issue for hedge fund investors in 2018 and managers expecting the global geopolitical landscape to have a much greater impact on hedge fund portfolios in 2018 (Preqin Investor Outlook: Alternative Assets H1 2018), seeking a platform that offers security, stability and cost-efficiency will be absolutely key this year, whether marketing into the EU or not.

Jersey can absolutely support managers in this respect, offering them the opportunity to consolidate their funds in one jurisdiction and provide them with seamless access to global investors, either into the EU through its private placement route or to the rest of the world outside the scope of the AIFMD and without the cost of full AIFMD compliance they would have to bear if they were based in an EU member state.

This is proving a compelling proposition to a growing number of managers in the US and Asia who are pursuing global strategies and are looking for a European time-zone hub, outside of the EU and AIFMD rules, with easy UK and EU investor access and superior standards of governance.

At the same time, it is also expected that Jersey will prove to be a better solution for EU managers looking to retain access to the key UK investor market as from April next year.

It’s notable that recent research commissioned by Jersey Finance (Analysis of the Jersey Alternative Funds Sector Investor Base, Q4 2017) found that Jersey is well-positioned in a time when globalisation is key. It showed that the five biggest sources of capital committed into Jersey alternative funds are the UK (34%), US (18%), Ireland, Luxembourg and Canada, and that after Brexit, almost three quarters of capital in Jersey alternatives will come from non-EU sources.

Forward-thinking
Market access into the EU will no doubt continue to dominate the column inches in the lead up to the UK’s departure from the EU next year, and Jersey has a vital role to play in giving non-EU managers, including those in the US, Asia and soon the UK, a means of marketing into Europe.

However, hedge fund managers will also be aware that this is part of a much wider picture. With investors placing greater emphasis on performance, geopolitical stability set to have a growing impact on portfolios and global strategies becoming increasingly important, being able to rely on a forward-thinking jurisdiction like Jersey can offer some much-needed certainty.

Jersey is ready to work with managers to help them bridge the Brexit gap and achieve real efficiencies whether marketing into the EU or elsewhere so that ultimately they can focus on doing what they do best – putting capital to work and generating returns.
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**MANAGEMENT COMPANY**

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Fuchs Asset Management specialises in risk & portfolio management. We offer a wide range of solutions, including governance, distribution, risk management, and compliance, as well as the capability to “front” the portfolio management function. These services include traditional and alternative UCITS strategies, as well as RIARF strategies, including hedge funds, real estate and private equity. Fuchs Asset Management offers services to managers looking for support in the set-up and the running of their EU-based funds. Fuchs provides reporting and distribution support. With the use of open architecture, Fuchs is able to adopt different approaches for each manager. This allows managers to focus on their core competencies of portfolio management. The firm currently provides its ManCo services to more than two dozen managers from Europe and the United States.

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**CYPRUS AS A FUNDS JURISDICTION**

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CIFA is the Association of professionals, businesses and organisations offering services and being involved in the investment funds sector in Cyprus. CIFA focuses on enhancing the high level of sophistication of the investments funds industry and addresses the broad range of needs and issues faced by service providers and businesses involved in the sector.

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Dillon Eustace is a leading Irish law firm with offices in Dublin, Cayman, New York and Tokyo, that specialises in advising investment funds. We advise all fund types across a broad range of areas, including establishment, regulatory authorisation, stock exchange listings and cross border marketing. The team acts for both Irish, and, through our Cayman office, Cayman domiciled funds. We represent international and domestic, institutional and privately owned asset managers, investment advisers, administrators, depositaries, distributors and other market participants.

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Active in the Cayman Islands for over 25 years, Ogier in Cayman focuses principally on investment funds – both hedge funds and private equity funds – as well as corporate and commercial, banking and finance transactions, high value corporate matters, restructuring and insolvency, and all aspects of trust and private wealth matters, as well as commercial and trust dispute resolution. We act for leading global financial institutions, investment managers and corporate entities and are offshore counsel of choice for leading international law firms, boutique advisors and other intermediaries. We are a registered listing agent for the Cayman Islands Stock Exchange (CIX) and frequently advise companies listing on other exchanges.

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Jennifer Fox - new Irish funds Partner

Walkers is delighted to announce the appointment of Jennifer Fox as a Partner in the Investment Funds team in our Irish office.

Jennifer has nearly twenty years’ experience, with eleven years as a partner in another leading Irish funds practice. Acting for a range of funds, fund sponsors and service providers, Jennifer has extensive experience in advising on the authorisation, distribution and operation of all types of Irish investment funds including UCITS and AIFs.

Nicholas Blake-Knox, Head of Investment Funds in Walkers, Ireland, said: “Jennifer is a significant addition to our already rapidly expanding team. With challenges like Brexit facing our clients, Jennifer’s extensive legal experience and industry know-how are major assets to offer our clients.”

Walkers is a pre-eminent financial services law firm and is regarded as a global leader in the investment funds industry.

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APEX GROUP HIGHLIGHTS | 2018

**STAFF**
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**Clients**
1,500

**Jurisdictions**
26

**Global Locations**
40+

**Languages**
20

15 YEARS IN BUSINESS

5TH LARGEST FUND ADMINISTRATOR GLOBALLY

6 AVERAGING MAJOR INDUSTRY AWARDS PER YEAR

**Asset Classes**
- Private Equity
- Real Estate
- Hedge Funds
- Hybrid Funds
- Managed Accounts
- Family Office
- Fund of Fund

**Service Capabilities**
- Fund Administration
- Middle Office
- Banking & Depositary
- Corporate Services

**TOTAL AUA**
$560BN

OPEN-ENDED FUNDS
$159BN

CLOSED-ENDED FUNDS
$308BN

CUSTODY & DEPOSITARY
$93BN

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