Positioning Cyprus as an International Pensions management centre and the role of the Cyprus Funds industry

By Mr. Philippos Mannaris, FCAA, AIA
Partner, International Retirement & Investment Practice, Aon Hewitt

Overview
The fundamental objective of pension provision is to provide an Adequate, Safe and Sustainable income to people in retirement. As life expectancy projections continue to be revised upwards, policy makers have a responsibility to ensure the pension system is sustainable and the costs of increasing longevity are shared fairly between generations.

Given the anticipated pressures on the long-term financial sustainability of the state social security system as well as the need to maintain income adequacy at retirement, policy makers need to take decisive measures to reform the pension system to improve sustainability and ensure the system’s adequacy.

Across the world, pension systems and their reforms are in a constant state of flux. Since the early 1990s, the outlook on global pension systems and their reforms has changed markedly. The most recent reassessment is triggered by the on-going global financial crisis and its implications for funded and unfunded pensions.

Reforms should ensure that the Pension System helps people to save for their retirement, while supporting the most vulnerable in a fiscally sustainable way. Securing an adequate retirement income for citizens should be a priority for policy makers.

The need for Reform
In most countries, pensions currently represent a very large and rising share of public expenditure. Although spending on public pension varies widely by country, all countries are projected to face sharp increases in pension cost expenditure in the future, due to the worsening of the demographic environment.

The recent financial and economic crisis has made it harder for almost all national pension systems to deliver on pension promises. It has thus become more urgent than ever to develop and put in place comprehensive strategies to adapt pension systems to changing economic and demographic circumstances.

The introduction of a multi-pillar pension system with a significant shift from publicly managed, unfunded defined benefit (DB) schemes to privately managed, fully funded defined contribution (DC) schemes has been one of the key structural reform trends.

The importance of ‘Funded’ Pensions for the Funds industry
Total EU pension assets are close to €3 trillion. At the moment, employees are covered under pension funds established in their own countries. The European Pensions Directive has created opportunities to establish cross-border pension funds, where pension funds can cover employees located in multiple EEA countries. A number of financial services providers are also using the EU pension directive to begin to offer retirement products on a multi-country basis.

Multinational companies as well as financial services providers are stepping into this new market now. They are making use of the opportunity to increase efficiency in employee pension arrangements, respectively to tap the envisioned
growth in the European market for pension asset management, insurance, administration and consulting services.

Further, Global Defined Contribution pension assets are currently valued at around $15 trillion of which $5 trillion is outside the US, and are expected to grow by around 10% - 15% a year.

Opportunity for Cyprus

Positioning Cyprus as an international hub in the institutional pension market could be an attractive alternative to the declining market for the traditional financial services business as well as an enhancer for the efforts to promote Cyprus as a Funds’ jurisdiction. The asset management industry will be able to tap into a larger market. The Pensions market is a fully onshore activity, transparent and backed up by EU legislation. The pension institutions would support growth in high quality employment on the ground in Cyprus i.e. asset managers, insurers, administrators, pension consultants, actuaries, fiscal advisors, supervisors and regulators.

We anticipate that major benefits for Cyprus will arise from Cypriot based financial institutions offering occupational pension arrangements in multiple jurisdictions, and potentially attracting other large institutions to Cyprus for the same purpose. Furthermore, there will also be significant benefits from multinational companies establishing their own multi-country pension trust using Cyprus as a home country and as a point of entry into the EU for non-EU parties. A Cypriot plan can accommodate employers all over the EU and even beyond, including Russia, CEE and the Middle East. In all cases, the additional business will serve to strengthen the Cypriot professional services market, and enhance Cyprus’ reputation as a leading financial services center and contribute to economic growth.

Mr. Philippos Mannaris, graduated from the London School of Economics and Political Science with a BSc (First Class Honours) in Actuarial Studies. He is a qualified actuary and a member of the Association of Actuaries of Cyprus and the UK. He joined Aon Hewitt in 2003 and is currently the Managing Director for Cyprus with additional responsibility for actuarial and investment services of the Group for the Middle East. He is a partner of Aon Hewitt’s International Retirement and Investment Practice, and works with institutional clients on the full range of actuarial and investment issues, including investment and funding strategies, pension planning and retirement planning.

manager selection and investment governance. He is also a non-executive Board member of the Central Bank of Cyprus since October 2013.

OECD BEPS Action 6 and impact on Collective Investment Funds

By Mr. Petros Krasaris, Senior Manager, Head of International Tax Services, Ernst & Young Cyprus Limited

Background on BEPS: What is BEPS?

Base erosion and profit shifting (BEPS) refers to actions undertaken by the OECD to tackle tax planning strategies that exploit gaps and mismatches in tax rules to make profits ‘disappear’ for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

What does the BEPS Action Plan say?

It sets forth 15 actions to address BEPS in a comprehensive and coordinated way. These actions will result in fundamental changes to the international tax standards and are based on three core principles: coherence, substance, and transparency. While the OECD steps up its efforts to address double non-taxation, it will also continue work to eliminate double taxation, including through increased efficiency of mutual agreement procedures and arbitration provisions.

Action 6 - Prevent treaty abuse

Action 6 proposes to develop model treaty provisions and recommendations on the design of domestic rules that would:

- Prevent the granting of treaty benefits in inappropriate circumstances (tackle “treaty shopping”);
- Clarify that tax treaties are not intended to be used to generate double non-taxation; and
Identify tax policy considerations that countries should take into account when determining whether to enter into a tax treaty with another country.

OECD releases public discussion draft on follow up work on treaty abuse under BEPS Action 6

On 21 November 2014, the OECD released a Discussion Draft in connection with Action 6 on treaty abuse under the BEPS project. The document entitled Follow Up Work on BEPS Action 6: Preventing Treaty Abuse (the Discussion Draft or the Draft) describes the follow-up work the OECD intends to do after the issuance of the OECD’s 16 September 2014 report entitled Prevent the granting of treaty benefits in inappropriate circumstances (the Report).

The Discussion Draft under Action 6 describes follow-up work with respect to the Limitation of benefits (LOB) provision, in particular regarding the treaty entitlement of collective investment vehicles (CIVs) and Non-CIV funds, the principal purpose test (PPT), and other issues involving the proposed new treaty tie-breaker rule, the treatment of permanent establishments in third countries, and the interaction between tax treaties and domestic anti-abuse rules. Written comments should be submitted to the OECD on or before 9 January 2015. The OECD has indicated its intention to have a public consultation on the Draft.

1. CIVs: application of the LOB provision and treaty entitlement

The Discussion Draft notes that the draft LOB provision in the Report includes a placeholder for CIVs as “qualified persons,” with its inclusion and specifics to be determined based on the treatment of CIVs in the particular treaty and in the particular treaty countries. The decision whether or not to include a specific CIV rule in the LOB provision would thus be left to the treaty countries. The Draft further points out that the Commentary to the LOB provision in the Report includes a discussion of how CIVs could be dealt with and provides several alternative options that are based on the 2010 OECD report “The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles.” The Draft indicates that the OECD intends to review these alternative approaches and examine whether it would be possible to suggest a single preferred approach for the treaty qualification and LOB treatment of CIVs. Comments are specifically invited as to whether the recommendations of the 2010 CIV Report continue to be adequate for widely-held CIVs and whether any improvements should be made to the conclusions included in that Report.

2. Non-CIV funds: application of the LOB provision and treaty entitlement

The Discussion Draft notes that the Report did not address comments that had been received on certain non-CIV funds such as Real Estate Investment Trusts (REITs), sovereign wealth funds (SWFs), alternative funds and private equity funds, and pension funds.

i) SWFs and alternative funds/private equity funds

The Discussion Draft states that SWFs and investments made by SWFs through home-country subsidiaries could generally qualify for treaty benefits under the government and “ownership/base erosion” provisions of the LOB rule, respectively. However, the Draft observes that SWFs may not qualify for treaty benefits when investment is made through a third-country entity, such as when investments in State S are made by a resident fund in State R through a State T entity. In this regard, the Draft also notes that SWFs often invest in alternative funds and private equity funds which may be established in third countries.

With respect to alternative funds and private equity funds, the Discussion Draft notes that the LOB provision creates the same issues as arise for CIVs because their investor base typically is geographically diverse and they may not qualify under the active business test. The Draft further notes that these funds also face treaty qualification issues like those addressed in the 2010 OECD Report on CIVs.

The Discussion Draft indicates that the OECD intends to examine how these issues related to the treaty qualification of non-CIV funds can be addressed in a way that would not create treaty shopping opportunities. Comments are invited as to whether the Draft accurately describes the treaty entitlement issues of these funds and how to address such issues without creating opportunities for treaty shopping.

ii) Pension funds

The Discussion Draft notes that the LOB provision in
the Report includes specific rules providing benefits for pension funds and investment entities of pension funds. However, the Draft states that pension funds may not qualify for treaty benefits when investment is made through a third-country entity, even if all the participants in the fund are residents of the pension fund’s residence country. Moreover, the Draft further notes that pension funds are often investors in alternative funds and private equity funds, which may be in third countries.

Also noted in the Draft is the requirement that more than 50% of the beneficial interests in a pension fund be owned by individual residents in one of the two treaty countries, which may create difficulties for some European Union (EU) pension funds. The OECD will examine this issue as part of planned follow up work on alternative LOB clauses for EU countries. The Draft further references suggestions regarding revisiting the application of the treaty resident definition to pension funds and potentially addressing the treaty issues for pension funds through the provisions related to source taxation of pension income. Comments are invited, inter alia, as to whether the Draft accurately describes the treaty entitlement issues of pension funds and how to address such issues without creating opportunities for treaty shopping.

Implications

The Discussion Draft identifies issues the OECD will address in connection with its recommendations made with the Report on Action 6. The OECD is seeking extensive input on these issues and stakeholders should consider providing suggestions as to potential approaches for addressing these treaty qualification issues.

Investment funds and companies should continue to monitor the developments with respect to this Action, evaluate how any proposed changes may impact them, stay informed about developments in the OECD and in the countries where they operate or invest, and consider participating in the dialogue regarding the BEPS project and the underlying international tax policy issues.

The views and opinions expressed in this article are those of the author and under no circumstances is Ernst & Young Cyprus Limited responsible for the content or such views.

Mr. Petros Krasaris is a senior manager at EY Cyprus leading the International Tax Services. He joined Ernst & Young Cyprus Ltd in 2001 and is currently based in Nicosia. He also worked in New York (July 2008 – March 2009) as the Cyprus and Malta Foreign Tax Desk. Mr. Krasaris is specialising on Cypriot corporate tax matters focusing on international tax, transaction tax and other tax advisory services. He has extensive experience in a wide range of assignments including tax due diligence, tax structuring, tax advisory and tax compliance matters, serving a number of clients in the financial services industry ranging from private equity houses, insurance companies and investment banks.

Skill set needed to make Cyprus a Strong Fund Jurisdiction

By Dr. George Theocharides, Associate Professor of Finance at Cyprus International Institute of Management (CIIM)

Despite the current financial crisis and recession that we are experiencing, one industry that stands out, is resilient, and is growing is the Financial Services. Despite the reputational damage that we suffered following the events of March 2013, many of the benefits that made Cyprus an attractive investment destination are still there and not lost. What are these benefits? The strategic location, the fact that we are an EU-member state and thus fully aligned with the EU legislative framework in regards to financial supervision, highly-skilled and educated workforce providing financial and professional services, as well as a “benevolent” tax system (despite the recent enforced increase, still the lowest corporate tax rate in the EU at 12.5%, zero capital gains tax, and no withholding tax on dividends and interest distributed, as well as double tax treaties with around 50 countries).

An exciting and promising area within the financial services spectrum is the funds industry. Significant progress to develop and promote the sector has been made on this front in recent years from the various parties involved (the regulators and the government authorities, as well as the private sector). However, more needs to be done and one important area we should improve that could provide us with a competitive advantage is to make sure industry participants and service providers have the necessary skill set in order to make Cyprus
a strong funds jurisdiction. If we want to administer but also manage these funds that could register with our Securities and Exchange Commission (CySEC), general but also specialized knowledge is paramount for industry participants.

To my mind, they should have a clear understanding of the principles of finance – the concept of the time value of money, risk and return, the structure of the global fund industry and industry participants, the various asset classes, the way risk is measured and managed, and the valuation of different types of securities, among others. Another area that they should study relates to the concept of ethics in financial services. This has been increasingly important these days across the globe, given the recent financial crises that we have experienced. They should also command basic knowledge of economics (at the micro and macro level), the understanding and use of statistical techniques (that includes the ability to use computer programmes to analyze data), as well as the main accounting principles (reading financial statements, and constructing the relevant financial ratios). Beyond these basic concepts, they should possess more specialized knowledge. One area relates to the field of portfolio/asset/wealth management. They should understand how a portfolio of various asset classes and securities is constructed, and how its performance is measured. Another area relates to the administration and structuring of the fund, as well as issues related to compliance requirements, anti-money laundering regulations, financial reporting, taxation and legal procedures.

In terms of qualifications, market participants should obtain the relevant licenses from CySEC (currently there are two exams offered – the basic and the advanced). These licenses are for individuals engaged in the reception, transmission, and execution of client orders, but also for those that deal on a proprietary basis, manage portfolios, offer investment advice, underwrite financial instruments, and perform the activities of collective portfolio management and risk management for collective investment schemes (either UCITS or AIFs).

Academic qualifications are important, such as relevant Undergraduate and Postgraduate degrees. At CIIM, we recently introduced a Masters in Financial Services that aims to address the specific needs of the industry and provide candidates with the skill set necessary to succeed in their careers. Apart from academic degrees, it’s also important to have professional qualifications. The Certificates offered by the Chartered Institute of Securities and Investments (CISI) are such appropriate qualifications. CISI is the largest and most widely respected professional body for those who work in the securities and investment industry in the UK but also in a growing number of financial centres globally. They offer specialized certificates in numerous fields in finance (wealth/investment management, collective investment scheme administration, risk management, among others). Another excellent professional qualification is the Chartered Financial Analyst (CFA) credential, probably the most respected and recognized investment designation in the world. To become a CFA Charterholder, candidates need to complete the three levels of the programme (exams) plus they will need to have four years of qualified investment work experience. The CFA Society of Cyprus, although still small, is growing fast in numbers and I believe is another professional body that can play a vital role in promoting the fund industry in Cyprus. The Executive Education Department of CIIM, offers preparatory seminars for a number of CISI Certificates (Risk in Financial Services, Global Securities, Wealth and Investment Management), the CFA Levels I and II, a specialized course on Fund Management, as well as an Advanced Certificate in Fund Administration (awarded in association with the University of Manchester Business School and CLT International).

Dr. George Theocharides is an Associate Professor of Finance at Cyprus International Institute of Management (CIIM) in Nicosia, Cyprus. He is also the Programme Director of the MSc Financial Services and Certificate in Financial Services. Recently he served as a member of the Interim Board of Bank of Cyprus and currently he is a board member of the Cyprus Securities and Exchange Commission (CySEC) and a member of the Training/HR Committee of the Cyprus Investment Fund Association (CIFA).
Capturing Chinese Outbound Investment: A Strategic Assessment

Summary of Thesis entitled “Analysis and Recommendations for Cyprus as a Jurisdiction for Chinese Investors”, prepared by a group of students enrolled in the MBA program of University of Cyprus with the guidance of Professor George Nishiots* 

Cyprus is in the midst of a new beginning as an emerging investment fund centre in Europe, in light of its recent efforts to upgrade its legislative and regulatory framework as well as its strong network of financial and professional service providers. Much has been said about the potential advantages of Cyprus as an investment funds domicile. Given these new beginnings and potential advantages however, the Cyprus Government and the Cyprus Investment Promotion Agency must focus their efforts on promoting the country as a jurisdiction to target markets of high growth potential, in order to maximize the growth of the funds industry. Amidst these circumstances and motivations, we carried out an analysis of Cyprus’ strategic position in the global funds industry with respect to the largest and fastest growing population of new investors in the world, in China.

Acknowledging that Cyprus is competitive with its tax rates, double tax treaties, workforce and services, we noted that the major drawbacks confronting Cyprus are mainly attributed to the relatively new market comparing to other EU countries, where the market is mature. Due to the recent admission of the country to the funds market, Cyprus has a limited number of internationally reputable custodians and a limited range of popularity for its benefits as a funds jurisdiction.

Consequently, the government agencies overseeing fund setup and management in Cyprus must be streamlined for efficiency and cost-effectiveness, including the Cyprus Securities & Exchange Commission (CySEC), the Registrar of Companies, and the Cyprus Stock Exchange (CSE). Fostering the ease of entry and operation in the Cyprus jurisdiction are paramount to establishing Cyprus as a location of choice for funds and investors who are seeking a secure and advantageous fund solution. To facilitate this interest, we provide in our report a series of recommendations to CySEC. To begin, a formal procedure for registering a fund must be established and published to provide clarity, and supervised to achieve a short time to market. Furthermore, the expertise of qualified financial service providers should be developed by offering frequent seminars and trainings. Experts from abroad should be recruited for Cyprus agencies to help build the skills of existing personnel and moreover amplify capabilities through collaborations with consultants and other experts from well-established fund domiciles.

Incorporating such improvements into the relevant government agencies must happen while considering target markets with high growth potential, such as China, which has been forecasted to provide 85% of the growth of the middle class in the world economy by 2030. China has 4 million millionaires and 12 thousand billionaires at present, and almost 90% of these are “self-made.” Published surveys reveal that they are seeking to safeguard their wealth from risks associated with the business cycle, and plan for their families’ futures – 19.8% invest for asset diversification, 19.4% for their children’s education, and 16% for hopes of emigrating from China. These observations correlate with our own survey of Chinese nationals in Cyprus, who prioritize low risk over good returns (89% of respondents), invested in Cyprus for hopes of benefiting from its quality of life (78%), and invested only in Cyprus for immigrating (89%). From these findings, our report details recommendations also for the Cyprus investment funds community, to focus on fund structures that enhance international wealth-management services. Begin with a structured promotion method that stresses Cyprus’ benefits and competitive advantages such as taxation and costs, in order to target top fund managers, and follow with Cyprus’ climate and quality of life. Engage in face-to-face meetings with brokers in Beijing and Hong Kong to bring attention to put Cyprus on their radar, including placing representatives in those areas to provide support and be familiar and up to date with the needs of Chinese fund market.

As a new and small market, Cyprus cannot focus on all areas of funds. It seems that Cyprus can support AIFs better than UCITS and should focus on market segments and specialized funds, promote listing on the Cyprus Stock Exchange for cost savings advantage, and provide an exit strategy to investors. And crucially, Cyprus should build up a wider range of custodian banks to choose from, including more with high name recognition. And then close out the deal with incentives for
reputable fund service providers to establish in Cyprus. Each of these are explained in detail in our report. 

Cyprus can become a hotspot for new investment funds and capitalize on a market that it has not sought to develop until recently. But it must take decisive steps to create ease of entry and operation into Cyprus as a funds domicile. Moreover, Cyprus must promote itself and generate word-of-mouth in growing investor markets.

*The complete report is an Applied Business Project conducted by Chrystalla Poulika, Vasiliki Koina, Xiaoping Chen, Aristoklis Patounas and Daniel Rhoads in the MBA program for the University of Cyprus. We, the authors of this report, would like to thank CIFA and CIPA for their support in writing this report, and Marios Tannousis in particular. We would also like to thank our advisor, George Nishiotis, for his invaluable advice and direction, as well as Alex Kartalis, Andreas Yiassimides, Constantinos Neophytou, and Irini Pidia for meeting with us to gain insight into the investment funds industry in Cyprus.

Mr. Aris Patounas is a 14-year veteran of the banking industry at Bank of Cyprus, with experience in Corporate Finance, Human Resources and Credit Risk. He studied Accounting and Finance from ESSEX University and Shipping Trade and Finance (MSc) from Citi University Business School (CASS) and is currently the manager for SME Support & Quality Control of Advances in the Limassol region for Bank of Cyprus. He can be contacted at patounas.aristoklis@ucy.ac.cy

Ms. Chen Xiaoping is currently a translator and customer service professional for a FOREX company in Limassol, serving Chinese via call centre. She is also a Registered Nurse with extensive clinical experience in Cyprus particularly in child psychology and support. She can be contacted at xiaoping.chen@ucy.ac.cy

Ms. Chrystalla Poulika is a veteran of the pharmaceutical industry in Cyprus with nearly 8 years of experience in the drug regulatory affairs domain while working for Novartis Pharma Services Inc. and Demetriades & Papaelias Ltd. She studied Medical Physics (MSc) at the University of Surrey and Physics (BSc) at the University of Cyprus, and has established herself as an expert in regulatory compliance. She can be contacted at poulika.chrystalla@ucy.ac.cy

Mr. Daniel Rhoads has 7 years of experience in project management, B2B sales, and innovative R&D in the biopharma and medical devices domains. He studied Molecular Medicine (PhD) at Cornell University and worked with the University of Cyprus and Scientronics Ltd. Currently he is seeking work in the financial services or biopharma industries. He can be contacted at rhoads.l.daniel@ucy.ac.cy

Ms. Vasiliki Koina is an expert in tax policy with 4 years of experience in Value-Added Tax and Social Insurance for the Ministries of Finance and Labor & Social Insurance, respectively. She studied Methodology and Teaching Mathematics (MA) at the University of Cyprus. She is currently seeking to advance her career in tax services to support the financial services industry. She can be contacted at koina.vasiliki@ucy.ac.cy

Mr. Marios Tannousis
Member of the Board, Secretary
E-mail: mtannousis@investcyprus.org.cy

Severis Bldg, 9 Makarios Ill ave., 4th Floor, Lefkosia 1065, Cyprus
P.O.Box 27032, Lefkosia 1641, Cyprus
Tel.: +357 22 44 11 33, Fax: +357 22 44 11 34
E-mail: info@cifacyprus.org