The scope, outcome and lessons learned from the Cyprus Funds Summit

By Mr. Marios Tannousis
Member of the Board of CIFA, Secretary

The Cyprus Investment Funds Industry holds great potential for further development, much to the benefit of the local economy. This was the main message that was passed during the Cyprus Funds Summit, held on October 9 at the Filoxenia Conference Centre in Nicosia, Cyprus.

Stressing the significance of the funds industry, CIFA President Mr. Angelos Gregoriades revealed that, in addition to encouraging further cross-border investment into the island, it may also facilitate the creation of new jobs in the local market as it continues to grow, evidenced by the impressive figure of newly recorded funds on the island.

Though the country’s regulatory environment is perceived to be both efficient and responsible by Fund managers, continued benchmarking and improvement is needed both on a legal and fiscal basis.

The event’s scope was to update the gathered professionals on the developments within the industry, the work CIFA is currently engaged in and its prospects for the future. International leading experts on funds from the big four accounting firms as well as from the world’s leading law firms, among other expert speakers that specialize in the funds industry, shared their insight and thoughts on the most important issues concerning investment funds, asset management and the investment fund industry in general. Indeed, with an impressive attendance of in excess of 380 local and international delegates, the interest into the local industry gave the industry professionals much optimism as we continue to devote resources to its development.
Growth and development of the Funds Industry in Europe and internationally as a catalyst for growth

The European industry has been in a continuing and strong growth trajectory throughout 2014. EFAMA’s Eighth Annual Review of Asset Management published in April 2015 highlights an increase in the Total Assets under Management (AuM) in Europe by approximately 15% in 2014 reaching EUR 19 trillion. Worldwide investment fund AuM also experienced an important growth by 18.9%. This reinforces the position of the asset management industry as a key player in the wider financial system and stresses the prime position the sector holds in channelling savings towards investments through direct capital financing.

From the regulatory side, the last months have seen highly intensive work to finalise the regulatory reforms in financial services, the implementation of which will heavily involve and impact the industry.

At the same time, it seems that the EU is now ready to take a step further and focus on the necessary actions to build a Capital Markets Union in order to mobilise capital and channel them to all companies, in particular SMEs, infrastructure and long-term sustainable projects. In this changing landscape asset managers have an important role to play and they stand ready to contribute on the debate on how to ensure and strengthen Europe’s efficient and attractive investment environment.

CIFA being a member and aligned with the positions of EFAMA is also fully supportive of the Commission’s stated objective to carry on cumulative impact analysis in order to assess the benefits and the impact of the implemented measures prior to any further reforms on the financial services legislation. This is necessary in order to ensure all regulatory pieces regulating financial services in Europe are fully consistent and create a level playing field among similar retail investment products.

Other outcomes of the Funds Summit

It is clear that CIFA’s primary goal was achieved. The event greatly assisted in the promotion of the industry, rendering Cyprus as a competitive investment fund and asset management jurisdiction. It further assisted CIFA members in the best utilisation of related international trends and developments, while encouraging professionalism and best-in-class standards in the services offered by industry professionals.

Another outcome was to emphasize the importance of a strong legal, tax and regulatory framework so as to offer an attractive product that is competitive in comparison to that of other established jurisdictions. There is a clear need to keep working closely with the government and regulatory authorities in the shaping of the related legal and regulatory framework to improve the competitiveness of Cyprus.

Creating a modern institutional framework with best practises that will enhance the development of Cyprus as a reputable investment fund centre is also of extreme importance. This is being achieved with the current project in collaboration with King & Wood Mallesons (KWM) law firm which is aimed at implementing an action plan for the promotion of Cyprus as a financial service and investment funds centre. The enhancement of the sector will strengthen Cyprus, and provide the framework for
the provision of new financial products to investors, satisfying their changing needs. KWM was selected as it is one of the top 10 global firms by lawyer numbers, with an international presence in Australia, Europe, the Middle East and North America, and this network will facilitate CIFA in its promotional activities. More particularly, their significant experience in this sector is of invaluable support to CIFA.

The Funds Summit also informed delegates about the latest regulatory EU framework updates and the latest global trends and opportunities whereas it also highlighted the advantages of Cyprus as an investment funds jurisdiction of choice. In particular, the Summit explored the role that the fund industry sector can play in capital raising for investment purposes and consequently, in generating new jobs and wealth; the overall health of the AIF industry and how asset managers need to adapt to an increasingly complex regulatory environment, as well as the role that Cyprus can play due to its proximity to the Middle East and North Africa, while being a Member State of the EU.

Moving forward from here

With the modernisation of the regulatory and legal framework of Cyprus, the implementation of the completed action plan will further contribute to the rapid development and positioning of Cyprus as an investment funds jurisdiction of choice. It will allow Cyprus to attract significant investments and increase demand for professionals in this sector, thus creating new jobs and providing opportunities to high-calibre employees, specifically young professionals, to live and work in Cyprus.

Cyprus should follow the example of other European economies, where the sector of investment funds constitutes one of the main pillars of the economy and it is constantly developing, especially as assets under management are increasing worldwide. For Cyprus to be successful though there is a need for streamlining actions by all stakeholders such as those of the Government and the Regulator so as to act in an orchestrated manner to support the development of this important sector.

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Unregulated funds, the new product Cyprus should embrace for AIFMs and investors?

By Mr. George Rologis
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On the 27th of November 2015 the Luxembourg government adopted the Reserved Alternative Investment Fund (“RAIF”) Bill of Law with the expected date of passing the law itself to be in the second quarter of 2016.

The adoption of the Law was received with great joy by the funds managing and servicing industry in Luxembourg as it is expanding the options of managers seeking to invest through a Luxembourgish vehicle. Someone would argue that Luxembourg already offered a variety of options to Alternative Investment Fund Managers (“AIFMs”) including regulated (i.e. SIF, SICAR) and unregulated structures (i.e. SOPARFI, ScSp). The RAIF, pretty much like the Unregulated Collective Investment Scheme (“UCIS”) of the United Kingdom is the medium route.
Many questions must have already been created from the above:

- What is an unregulated fund and why did Luxembourg go to great lengths to introduce it?

  By definition it is a fund not subject to regulation itself and hence to the restrictions and burdens and possibly costs imposed by such legislation.

- Why would reputable fund jurisdictions like Luxembourg and the UK take a risk with an unregulated structure?

  Despite what the name implies, and although the fund entities are indeed not regulated themselves, there are still requirements to be fulfilled by those managing and administering such structures ensuring that investor protection is conserved within the structure.

- Who would be interested in an unregulated structure?

  There are many occasions under which AIFMs and investors would particularly require an unregulated structure, such examples are:

  - Unregulated funds acting as Funds of Funds i.e. mirroring the performance of other funds, possibly regulated in other markets;
  - Where the investors are already familiar with the AIFM through previous collaboration and where investors are ready to place reliance on the form of management exercised by the AIFM, while at the same time saving cost and time to set up and maintain the structure;
  - Unregulated funds acting as parallel vehicles of investment to target investments already invested in by similar and possibly regulated structures of the same or other AIFM;
  - Cases where the set up timing of the structure is crucial to its intended use;
  - In structuring low return investments where increased costs could be a show stopper;
  - Experienced investors who can evaluate the targets risks and returns and can by themselves evaluate on whether a vehicle is heading for success or failure in advance of joining, irrespective of whether the vehicle is regulated or not.

Currently in Cyprus, although the legislation is not explicit, companies and partnerships incorporated in Cyprus under the respective Companies Law Cap. 113 or the Limited Partnerships Law Cap. 116 and meeting the definition of an Alternative Investment Fund ("AIF), are indeed not required to receive licensing from the Cyprus Securities and Exchange Commission ("CySEC"). The Managers of such unregulated funds, if domiciled in Cyprus, are required to either register or receive authorisation from CySEC, subject to whether the unregulated fund falls above or below the AIFM Law thresholds. Self-managed unregulated funds are similarly required to register or receive authorisation with CySEC as AIFMs (not AIFs). Managers of unregulated funds not domiciled in Cyprus are not required to perform any actions related to registration or authorisation with CySEC.

In the elaborate review of the Cyprus funds industry recently prepared by King & Wood Mallesons (KWM), the creation of a similar category of unregulated funds in Cyprus is amongst the firm’s recommendations, considered as one of the important steps of building up the Cyprus funds industry.

Amongst others, the recommendations for developing the unregulated fund structure, KWM propositions to CySEC are:

1. Not to require authorisation, registration or regulation of AIFs structured as ordinary companies or partnerships, therefore continue to allow the set up and maintenance of unregulated funds in Cyprus;

2. Further clarify the AIF Law so that is perfectly clear that unregulated funds are not required to authorise or register with CySEC;

3. To continue not to require authorisation or registration of managers of AIFs domiciled outside the Republic (within the EU or otherwise, exempting certain MiFID investment services) which again makes sense for entities
already regulated in other jurisdictions avoiding
duplicate regulation for managing an
unregulated fund in Cyprus.

4. Should the gathering of statistics be required on
the unregulated entities, it is proposed that the
administrators of the entities gather and report
directly to CySEC, bearing in mind that
the administrators will be running the day to
day operations of the fund.

Finally, for the consideration of CySEC it is proposed
that when a fund is not managed by a regulated
manager, a licensed administrator (another
recommendation from KWM) should be appointed.

Considering the previously mentioned, maintaining
and facilitating the setup of unregulated funds,
apart from another arrow for Cyprus’ bow in
becoming a hub for Private Equity and Real Estate
structures; it is what the global alternative industry
currently requires. Specifically, in Luxembourg, the
RAIF structure was the result of a year’s think tank
considerations and interviews with the local and
global main players in the two industries.

The main argument against unregulated funds is
that investor protection could be hindered by
allowing funds to operate in an unregulated
environment. This is where the fund’s administrator
would play an instrumental role, being a third party
to the structure running the day-to-day
administration of the fund, coordinating the various
parties involved, assisting the AIFM with local
requirements and ringing the bell when intended
actions fall outside the scope communicated to
investors. The administrator’s role in such
structures is crucial and going a step further from
the recommendations of KWM, a licensed fund
administrator requirement should be considered
irrespective of whether unregulated funds are
managed by a regulated manager or an unregulated
manager.

The above combined with mandatory and clear
disclosures to investors that the fund operates in an
unregulated manner for raising investor awareness
on the fact, are adequate measures for unregulated
funds to operate in an informed and, as much as
possible, “controlled” environment without
regulation.

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Risk management - Beyond framework: function & form

By Mr. Demetre Katsabekis,
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A risk-management framework may be defined
as the process – put into
effect by the Board of
directors, senior
management and risk
specialists – designed to provide reasonable
assurance regarding the achievement of objectives
in terms of: effectiveness and efficiency of
operations, reliability of financial reporting and
compliance with laws and regulations. The process,
however, does not involve just one policy or
procedure performed at a certain point of time at a
firm but it does continually operate at all levels of
the organization and involves all staff (see Figure 1).

Function

The Risk Management Function may be exercised
by a suitably credentialed Risk Officer with the
authority to delegate all risk management tasks
within the risk management department. whose
mission is to identify, measure, manage, monitor
and report on the risks to which both the Company
and the investment portfolios under management
are exposed to over time, always within the
boundaries imposed by the applicable legal and

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in Marketing of financial services.
Figure 1. Component Relationship of the Risk Management Framework

1. Charter Commitment by the Board of Directors to manage risk

2. Design of framework for managing risk
   - Establish risk management context
   - Establish risk management policy
   - Assign authority and accountability
   - Integrate into organizational process
   - Allocate sufficient business resources
   - Establish internal & external communications
   - Establish internal & external reporting mechanisms

3. Implementation of risk management
   - Implementing the framework for managing risk
   - Implementing the risk management process
   - Implement the risk management program
   - Implementing the risk management plan

4. Continual improvement of the framework

5. Monitoring and review of the framework

regulatory framework, the existing portfolio management agreements and the related decisions taken by the Board of Directors and the Investment Committee at any Company. The Risk Management function must be permanent in nature, is usually exercised in a hierarchically and functionally independent manner from the Portfolio Management function of the Company and is always subject to different remuneration criteria than the Portfolio Managers and Market Traders that may be employed by the Investment Company.

The Board of Directors may set up this dedicated corporate risk management function, which is appropriate and proportionate in view of the nature, scale and complexity of the investment company’s asset and portfolio management business, operating with appropriate safeguards against conflicts of interest so as to allow an independent performance, in order to:

- coordinate and perform risk management activities;
- enforce the corporate risk policies, programs and plans following the established process and procedures of the risk management mechanism;
- ensure compliance with portfolio risk limit system, including statutory limits concerning global exposure & counterparty risk in accordance with law;
- provide advice to the board of directors as regards the identification of the risk profile of each managed portfolio;
- provide regular reports to the Board at least annually and, where it exists, the supervisory function, on the:
  - consistency between current levels of risk incurred by each managed portfolio and the risk profile agreed for that portfolio;
  - compliance of managed portfolio with relevant risk limit systems;
  - adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies;
- provide regular reports to the senior management outlining the current level of risk incurred by each managed portfolio and any actual or foreseeable breaches to their limits, so as to ensure prompt, appropriate corrective action;
- review and support, where appropriate, the arrangements and procedures for the valuation of OTC derivatives.

In order to ensure its effectiveness, the market risk management function has:

- clearly defined responsibilities and sufficient authority to perform its tasks;
- a direct reporting line to the Board and any relevant, committee/s;
- independence from the risk-taking and operational units (e.g., trading unit and settlement unit) that it reviews;
- direct access to information from risk-taking and operational units in order for it to carry out the risk management and control function;
- access to all required data required to perform its activities efficiently and support from an effective risk management information system;
- adequate resources and competent personnel to perform its duties.

The risk management function is generally responsible for:
- Ensuring that all relevant risks of the Company are identified, well understood and adequately measured and assessed continually;
- Designing or the selection of the Company’s risk management system;
- Testing and implementation of the Company’s risk management system;
- Overseeing the efficiency of the Company’s market risk management system;
- On-going review and changes to the Company’s market risk management system;
- The monitoring of the use of risk limits and ensuring that quantifiable risks are within the boundaries of approved limits;
- Analyzing and preparing of daily/periodic reports based on the output of the Company’s internal market risk models used in risk measurement and assessment, including evaluation of the relationship between market risk exposure measures (e.g., value-at-risk, stress tests) and trading limits;
- The prompt reporting of market risk exposures to the senior management and specialized committees as well as alerting the Board and the senior management to any other matters that may have a significant impact on the Company’s financial position and risk profile;
- Conducting regular validity checks to verify the accuracy and reliability of the Company’s internal models used for risk management purposes;
- Creating and maintaining a comprehensive and clear documentation set of the Company’s internal models (e.g., theories, methodologies, techniques) and internal policies, procedures and controls relating to the operation of the internal models with the risk management system;
- Ensuring adequate implementation & compliance to the Company’s market risk management framework and all related policies & control procedures;
- The active involvement at an early stage, in the Company’s decision-making on business strategies and development of new products that may have implication for the risk management of the Company.

**Form**

The risk management form (format) follows a Company’s organizational chart, in order to encompass the full range of corporate business activities that are exposed to potential risks, continually and/or at times, which the risk management function will attempt to:

1. **Identify,**
2. **Assess,**
3. **Manage,**
4. **Monitor,** and
5. **Communicate**

   to the Board of Directors and the Risk Committee overseeing and monitoring the function.

The organization chart is usually divided in two halves, where the upper side focuses on corporate governance and the lower side on the line/support management and operations. Indicative committees in which the Risk Officer may participate in a firm are usually the:

- Audit Committee: Independent Director, Non-executive Director, Risk Officer;
- Risk (& Compliance) Committee: BOD member, Risk Officer, Head of Compliance;
- Management Committee: General Manager, Portfolio Manager, Risk Officer.

Periodic reporting by the Risk Management function will be usually going to the Investment Committee – typically comprised of the General Manager, Portfolio Manager, and Independent Member/s - with the Risk Officer participating whenever risk management issues are to be discussed.

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The European Long Term Investment Funds and the role of the EU asset management industry

By Ms. Agathi Pafili
Senior Regulatory Policy Advisor, European Fund and Asset Management Association (EFAMA)

The European Long Term Investment Funds (ELTIFs) Regulation, which has become applicable on 9 December 2015, is bringing into life a new type of investment funds aiming at directing investments into projects and companies that have difficulties raising funds on stock markets or securing loans from banks. Moreover, ELTIFs is a core priority for the Capital Markets Union and the efforts at the EU level to encourage a shift from locked or poorly used capital in the EU to the financing of long term infrastructure projects and SMEs.

ELTIFs are closed ended funds (with a pre-determined lifetime defined already at the time of the launch of each ELTIF) invested mainly (at a minimum of 70%) in illiquid assets and in particular real estate, infrastructure projects and listed or non-listed SMEs. They can be open either only to professional or also to retail investors and will be able to be marketed on a cross-border basis. Their manager will have to be an authorised asset manager under AIFMD with an additional authorisation to run a concrete ELTIF.

Although there are already existing investment funds (at national level) that have similar characteristics to ELTIFs – i.e. illiquid portfolio and a long-term investment strategy - the main added value of ELTIFs lies on:

- The EU passport the Regulation provides to the ELTIFs label for cross border marketing;
- The possibility of mid-size investors such as mid-tier pension funds and insurance companies, as well as local and regional entities, to invest in infrastructure and SMEs projects. Such projects are currently accessible mainly to large-scale institutional investors who have the resources and expertise to invest directly in them. The ELTIFs can provide the extent of investment analysis and research that is necessary from a product development point of view and thus offer to those mid-scale investors the possibility to invest in larger projects and diversify their portfolio beyond cash and highly liquid securities;
- The priority ELTIFs are granted for receiving financing via the new European Fund for Strategic Investments (EFSI) and the EIB.

Asset managers have an important role to play in the current changing landscape, as they can identify the growing investors’ interest—both at retail and institutional level - in opportunities for long-term investments, based on a long experience and
understanding of managing collective investment schemes adapted to different investors’ interests.

For the European asset management industry, the new ELTIFs framework has the potential to unlock important capital and to encourage a shift towards investments in longer term projects. However, in order to achieve this goal, the new regulatory framework needs to ensure that the interests and needs of different types of investors are met, the right incentives are in place and that their structure is efficient, well-balanced and sufficiently attractive to different long-term investors.

In that respect, there are a number of elements that are critical for the market success of ELTIFs. The first of them would be to facilitate the participation of particular groups of investors. Apart from institutional investors, other types of investors, amongst them specific mid-tier investors and retail investors, have a growing interest and are seeking for new and diversified sources of risks with good returns and long term prospects. These could be certain mid-tier institutions (pension funds, local entities and foundations) that although are not deemed as professional investors, still possess significant larger resources and more enhanced expertise compared to the retail investors. Giving them the possibility to invest in those ELTIFs open only to professional investors will be critical for further opening up the investment target groups of ELTIFs. Moreover, the Regulation rightly imposes a number of safeguards for marketing such long term and illiquid in nature funds to retail investors – in particular the ones foreseen in MIFID II. Still, there are other additional restrictions that do not present any concrete added value (such as the minimum investment threshold of 10,000 euros) that could become artificial barriers for the entry of retail investors in that particular market.

Another key element is the flexibility concerning the portfolio diversification rules and the marketing and transparency requirements for professional investors. It should be kept in mind that this category of investors has already in place a range of instruments and funds with far less restrictions than ELTIFs. Therefore, for ELTIFs to be attractive to professional investors, a flexible structure ready to meet their investment needs is necessary.

An additional factor for the market success of ELTIFs is related to the requirements foreseen for pension funds and insurers, both of which can be key investors in ELTIFs. The capital requirements foreseen for both types of investors in the case of illiquid assets (in concrete in Solvency II and IORP) need to be rightly calibrated in view of encouraging investments in ELTIFs.

Last but not least, the development of fiscal incentives can significantly enhance shifting investments towards ELTIFs, as new products with a concrete positive impact to the real economy.

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Positive VAT developments for the Cyprus Funds Industry

By Mr. Chrysilios Pelekanos
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Cyprus is becoming one of the fastest growing investment fund centres in Europe through the prompt response to regulatory developments and its strong financial services sector.

The Cyprus VAT regime, which provides for exemption of fund management services to mutual funds, is considered conducive and supporting to the growth of the investment fund sector in Cyprus. That is, because substantial VAT savings can be
achieved as a result of the applicability of the above mentioned exemption.

In an effort to further enhance the modernization of the regulatory framework for investment funds the Cyprus Tax Authorities have issued a new VAT circular which aims to give clarity and certainty on the VAT treatment concerning funds and the provision of fund management services.

Specifically, the new VAT Circular:

- broadens the definition of funds which are eligible for the VAT exemption;
- clarifies the type of functions that fall under fund management;
- provides guidance in relation to the VAT treatment of sub contracted fund management services;
- extends the applicability of the VAT exemption to self-managed funds and to umbrella funds;
- confirms the VAT taxable person status of funds.

We briefly analyse below the Cyprus VAT framework concerning the Cyprus funds industry.

**Eligible funds**

The exemption from Cyprus VAT applies to fund management services provided to the following eligible funds:

- Open ended or closed type UCITS regulated by the Cyprus Securities and Exchange Commission;
- UCITS registered in other EU member states which have adopted Directive 2009/65/EEC;
- Non UCITS funds approved by the Cyprus Securities and Exchange Commission;
- Collective investment schemes that have been approved by the Central Bank of Cyprus during the period that the Central Bank of Cyprus was the Regulatory and Monitoring Authority of the International Collective Investment Schemes;
- International collective investment schemes that were recognised and regulated by the Central Bank of Cyprus in accordance with the provisions of the International Collective Investment Scheme Law (N.47 (I) of 1999);
- Alternative Investment Funds (AIFs) which are set up and operate under the Cyprus Alternative Investment Funds Law;
- AIFs set up outside Cyprus which are managed by a qualifying alternative investment fund manager;
- Defined contribution pension funds.

**Definition of fund management services**

The new VAT circular provides a definition of fund management services and specifically clarifies that the following functions fall under such services:

(a) Investment management and risk management services;

(b) Administration services such as:

1. legal and fund management accounting services;
2. customer inquiries;
3. valuation of the portfolio and pricing including tax matters and returns;
4. regulatory compliance monitoring;
5. maintenance of unit-holder register;
6. distribution of income;
7. unit issues and redemption;
8. contract settlements (including certificate dispatch);
9. record keeping;

(c) Marketing.

The above list of functions is not exhaustive and therefore additional functions, essential to the management of the fund, could qualify for the VAT exemption.

For the purpose of optimizing the operational efficiency and effectiveness of the management of the fund, distinct parts of the fund management functions can be subcontracted to specialist service providers. Such subcontracted functions which as a bundle are intrinsically connected to the
management of the fund and form a distinct whole and are specific and essential for the management of the fund, can also qualify for the VAT exemption.

**Self-managed funds**

Funds which are self-managed (i.e. managed internally by their Board of Directors) can also benefit for VAT exemption with respect to sub contracted fund management functions and the remuneration of their Directors to the extent that it is attributable to the management of the fund.

**VAT taxable status of funds**

In line with relevant European Court of Justice case law, funds are considered to carry out economic activities for VAT purposes and thus have the status of a taxable person. This means that they need to monitor their VAT compliance obligations in Cyprus, as depending on the nature of the transactions they carry out, they may become obliged to register for VAT in Cyprus or they may have the right to voluntarily register and recover input VAT suffered.

To conclude, funds and fund managers need to be aware of the required conditions and structure their activities appropriately in order to achieve VAT efficiencies and benefit from the above favourable updated VAT regime.

**Disclaimer:** This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

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