A Message from the Chairwoman of the Cyprus Securities and Exchange Commission

By Mrs. Demetra Kalogerou,
Chairwoman of Cyprus Securities and Exchange Commission

The Cyprus Securities and Exchange Commission (CySEC) is an independent public supervisory Authority assigned the responsibility for the overall supervision of the securities market and of the transactions in transferable securities carried out in the Republic of Cyprus.

The mission of CySEC includes ensuring and maintaining a fair, reliable, efficient and transparent securities market in Cyprus, in which investors enjoy the highest standards of protection, contributing to the orderly development and increased competitiveness of the Cyprus securities sector and contributing to upgrading the reputation and credibility of Cyprus as an attractive international financial centre.

In the past three years, in collaboration with the Ministry of Finance, CySEC has worked towards the enhancement and completion of the national legal framework concerning investment funds in order to facilitate and expand the investment funds industry in Cyprus. In this context various improvements and upgrades have been implemented in the supervisory and regulatory framework which are directly related to the development of an investment funds industry in Cyprus.

In particular, in June 2012 the Law regulating the Open-ended Undertakings on Collective Investment came into force. This has brought the national legal framework in line with the European Directive UCITS IV and made substantial additional innovations to the existing national legal framework in order to facilitate the establishment and operation of UCITS Funds and UCITS Management Companies in Cyprus.

Furthermore, the Law on Alternative Investment Fund Managers, which came into force in July this year as a result of the harmonisation of the national legal framework with the Alternative Investment Fund Managers Directive (AIFMD), introduced a number of important regulating changes. It is now possible for entities that want to engage in the Alternative Investment Fund Management Industry to operate in Cyprus under a common EU legal framework and benefit with the passport opportunity provided by the AIFMD to market the AIFs they manage within EU and to third countries. Furthermore, under the new legal framework, an Alternative Investment Fund Manager authorised in Cyprus may manage AIFs established in other EU Member States and Third Countries. For this purpose, the CySEC has also proceeded with the signing of bilateral MoUs with 35 non-EU authorities, as the existence of co-operation arrangement between the EU and non-EU authorities is a precondition of the AIFMD for allowing managers based outside the EU to access the EU markets or perform fund management by delegation from EU managers.

In addition to the above, the legislation on collective investment undertakings, other than UCITS, known as the Alternative Investment Funds Law is being prepared. This piece of legislation will regulate the establishment and operation of Alternative Investment Funds in the Republic. These investment schemes are currently regulated by the International Collective Investment Schemes (ICIS) Law and are supervised by the Central Bank of Cyprus. By virtue of the new legislation that is
being prepared, the supervision of these funds will be undertaken by CySEC. The new Law on Alternative Investment Funds will modernize the existing legal framework by opening the market to the registration of new types of funds, other than private collective investment schemes. Under the new legal framework, the existing ICIS will be able to keep their structure and continue to operate as Alternative Investment Funds with limited number of persons, or be transformed into Alternative Investment Funds without any limitations as to the number of investors. The new draft Law also provides for the establishment of funds marketed to professional and to retail investors according to their type of authorisation.

Finally, it must be noted that the different pieces of legislation described above are closely linked with the EU legal framework of investment funds and, therefore, we believe that they will form a new, innovative and competitive national legal framework that will enhance the development of the investment funds industry in Cyprus.

Mrs. Demetra Kalogerou is the Chairwoman of CySEC as of September 2011. Her previous work experience includes the position of Senior Officer in the Cyprus Stock Exchange (CSE), responsible for the registration of companies in the CSE. Her responsibilities extended in the areas of transactions in transferable securities, the various markets of the CSE, research and development of new products, promotion of financial markets, monitoring the compliance of listed companies with their ongoing obligations, such as the preparation of Annual Financial Statements and compliance with the International Financial Reporting Standards (IFRS), as well as with the Code of Corporate Governance. Mrs. Kalogerou holds a Bachelor’s degree in Economics and Business Administration (University of Wales, UK), a Master’s degree in Economics of Public Policy (University of Leicester, UK) and a Graduate (MPhil) in Finance (City University Business School, UK).

How the Cyprus Fund Industry can help promote economic growth

By Mr. Andreas Yiassimides, Principal, Fiduserve Fund Services

Troika’s second review indicated that the Cyprus adjustment programme is on track, the structural reforms are progressing while the fiscal targets are met. Additionally, significant progress was evidenced in relation to the recapitalization and restructuring of the financial sector, something which will enable the gradual relaxation of the capital controls.

In the statement of Troika it was also emphasized that tourism and the financial services sector proved to be resilient and can support the Cyprus economy in the attempt to return into growth.

The real economy still faces significant challenges and problems. The Gross Domestic Product is expected to shrink in 2013 by 7.7% while the unemployment rate has already surpassed 17%. That indicates the need for identifying the sectors that can help reboot the economy. Tourism - considering the potential granting of a casino license - the shipping, construction and energy industries are some of the areas with high prospects.

The financial services sector, and specifically the fund industry, provides great prospects of economic growth for Cyprus. It is important to highlight that despite the events of March 2013 and the subsequent restructuring of our banking sector, Cyprus still retains its major advantages as a financial centre. The small increase in corporation tax can be easily absorbed by the tax deductions provided by the legislation. In addition, any profits on disposal of shares or other instruments that fall within the definition of securities are tax free while no withholding taxes are imposed on interest and dividends distributed.

The well educated professionals and the high quality of services provided, at relatively low cost, further make Cyprus an attractive investment destination.
The attractiveness of the Cyprus fund sector is also boosted by the harmonization of the national legislation with European Union Directives. UCITS and AIFM legislations provide the opportunity to offer new products and services to potential clients. In order to build a strong financial centre you need to provide flexibility to investors and a variety of financial instruments.

Funds can be used as a vehicle to invest in Cyprus or through Cyprus. It is envisaged that large projects on the island and the privatization plan will attract foreign capital and investors. Collective investment provides diversification of risk while having the potential for a return for a dividend or profit from the sale of the units of the funds.

The recently enacted legislation governing AIFMs together with the proposed AIF law (which is to replace the existing ICIS law) provides to the professional the marketing tools for attracting clients. The Cyprus Securities and Exchange Commission (CySEC) makes continuous efforts to support the fund industry and responds quickly and efficiently to the changes in the economic environment. To that end CySEC shall be further supported both in terms of budget and personnel, since the work load is substantially increasing.

A prerequisite for advanced financial centres is a developed stock market. We welcome the intention of the Cyprus Stock Exchange to increase the types of financial and other products that can be traded, such as commodities, but it may be necessary to consider creating a special market for funds. This will increase liquidity, provide an exit strategy to investors and enhance the interest in the Cyprus fund industry.

In relation to the structuring of investments through Cyprus, Troika, during its last visit in Cyprus, was surprised by the fact that foreign companies remained in Cyprus, even after the decision of the Eurogroup in March for bail in.

The strong tax and legal system in Cyprus provides confidence to foreign investors, while the professional services provided are of high quality. Our country has a wide network of double tax treaties that will be further enhanced in 2014 as the revised double tax treaty with Ukraine and the new treaties with Spain, Estonia, Finland and Portugal will come into force.

Issues raised after the ranking of Cyprus as non compliant by OECD will be dealt with after the meeting that the President of Cyprus recently had with all professional bodies. Since the end of 2012 - year for which OECD assessment was conducted - several measures were taken and procedures have been improved. However the effort shall be continuous so as to ensure no such issues are raised during the next assessment in September 2014.

The greatest challenge for the Cyprus economy is to keep the percentage of shrinkage of the economy and unemployment rate at the lower possible level. The fund industry provides an opportunity for attracting foreign investment, new capital and creating new jobs.

Mr. Andreas Yiassemides is a Principal of Fiduserve Fund Services, a member of the Board of CIFA, a member of the Board of the Bank of Cyprus Group, and Chairman of the Cyprus Investment and Securities Corporation Ltd (CISCO). He previously worked for the Bank of Cyprus, holding various positions, including most recently Head of the Custody and Trust department. He is a member of the Institute of Chartered Accountants in England and Wales and the Institute of Certified Public Accountants of Cyprus.


By Mrs. Maria Chrysostomou, Assistant Manager, Risk Assurance Consulting, PwC

On 5 July 2013 Cyprus transposed the AIFMD by means of legislation, the Law 56 (I)/2013 (“AIFM” Law). By 22 July 2013 the EU Regulation was uniformly applicable in all EU Member States, including Cyprus. It is noted that Cyprus is the second member state to harmonize its legislation with the said Directive, which came into force on 21 July 2011. One of the cornerstones of the Directive is the introduction of a 'single market framework' to regulate the offer or placing of shares or units in an AIF. It introduces a European 'passport' under which
authorized AIFMs can market EU AIFs to professional investors throughout the EU, subject to a notification procedure.

The Law regulates the setting up and operation of Alternative Investments Fund Managers (AIFM) who manage all types of investments which are not UCITS and form part of the Alternative Investment Funds (AIF) category. An AIFM is any legal person whose regular business is managing one or more AIFs, regardless if these are open-ended or closed-ended entities, whatever the legal form of the AIF and whether or not the AIF is listed.

According to the Law, fund managers whose total assets under management are above €100.000.000 with leverage or above €500.000.000 without leverage and their investors are not allowed to redeem their investment for a period of 5 years, fall within the scope of the Law and should obtain a license to operate as an AIFM.

A licensed AIFM in Cyprus may:

- manage AIFs registered in Cyprus and/or in another member state or a third country;
- market the units or shares of the AIFs they manage in other member states or third countries.

AIFMs managing AIFs with total assets not exceeding the above levels will only be required to register with the competent authorities of the member state where they are established.

The proposed legislation applies to:

- AIFMs established in Cyprus;
- AIFMs established in an EU member state;
- AIFMs established in a third country which manage AIFs established in an EU member state; and
- AIFMs established in a third country that promote AIFs in EU member states.

**Main Provisions of the Law**

The Law is focused on the regulation of the alternative investment fund manager rather than the fund vehicle itself.

The main provisions of the legislation include:

**Organisational and Operating Conditions**

- **Role of the Board of Directors and Senior Management in implementing the AIFMD**

The governing body of an AIFM has the responsibility for the allocation of functions internally so as to ensure that senior management and, where appropriate, the supervisory function, correctly implement the AIFM’s obligations under the AIFM Law. The governing body will have an ongoing responsibility for monitoring compliance of the AIFM with its obligations under the Law.

- **General principles applicable to the AIFM**

The AIFM Law contains a broad set of general principles that the AIFM must comply with. Certain general principles apply to an AIFM both in relation to the way that its business is organized and controlled, and in relation to the way it conducts its business.

- **Conflicts of interest**

An AIFM is required to take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, prevent, manage and monitor and, where applicable, disclose those conflicts. This requirement is to prevent them from adversely affecting the interests of the AIF and the AIF’s investors and to ensure that the AIFs it manages are fairly treated.

- **Delegation**

In general, an AIFM should be able to demonstrate that delegation is done for the purpose of more efficient conduct of the AIFM’s management of the AIF, for such reasons as optimizing of business functions and processes, cost saving, for the expertise of the delegate in administration/specific markets/investments or access of the delegate to global trading capabilities.

**The EU Marketing Passport**

Access to the EU marketing passport permits an AIFM to market units or shares of any AIF that it manages to professional investors in the European Union. Marketing is defined by the Law as any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of managed AIFs to investors domiciled or with a registered office in the EU.
**Transparency Requirements**

Significant transparency is required by the Law including both extensive qualitative and quantitative disclosures.

*Mrs. Maria Chrysostomou specializes in the Financial Services industry, primarily working on Internal Audit, Regulatory Compliance and Internal Control projects. She holds a BSc in Economics from the University of Cyprus and an MSc in Financial Economics from the University of Leicester (UK). Furthermore, Mrs. Chrysostomou holds the Certificate of Professional Competence issued by the Cyprus Ministry of Finance, for the services of Reception and Transmission of Orders and Portfolio Management. She is also a member of the Cyprus Institute of Internal Auditors.*

**Letter from Paris on AIFMD**

*By Mr. Kyriakos Rialas, Chief Executive Officer Argo Group Ltd and its subsidiary Argo Capital Management (Cyprus) Ltd*

I have recently attended as guest of our administrator the annual GAIMops International conference which brought together leaders from the Alternative Asset Management Industry (AIFM) to present and discuss the rapid changes occurring in our industry. For the Hedge Fund industry, this is one of two prestigious annual events taking place in Paris in November and in Monaco in spring. The conference covered best practices in due diligence, compliance and risk management for the AIF Industry with key speakers including regulators from France, Ireland and the UK.

Although the law is supposed to be the same across Europe in practice it is not and regulatory arbitrage is likely to occur. This is the question I posed to the Irish regulator on the panel who gave a clear signal in which direction regulation is heading. From his answer it appears that ESMA will dictate future guidance and eventually might act as a super regulator in order to achieve harmonisation, in a way that the ECB is proposing to regulate European Banks. The UK regulator on the other hand, since they have a big local industry to protect, tried to stress its independence from Brussels directives and emphasised that they are ahead of the game in their regulation. I was particularly impressed by the flexibility the FCA is willing to show in applying the principle of proportionality to smaller firms, something that should also apply to Cypriot firms which are really small.

Similarly the USA Hedge Funds do not show any appetite for marketing in Europe, firstly because as they say, there is no money to source in Europe and secondly the current regulation of delaying the application of the marketing passport past 2015 makes it tedious for them to market their non-EU funds country by country. AIFMs need to get a license by June 2014 although jurisdictions like France have already licensed 100 companies as part of any easy transitional process for existing fund managers. France is also examining a few passport applications of Irish Funds.

Other key speakers comprised industry service providers which had the opportunity to network with Fund Managers but also to present their services. In fact, service providers outnumbered Hedge Fund managers, which is probably a sign of the crisis and the confusion surrounding AIFMs. It has been mentioned that many small funds are either disappearing or merging or converting to family offices in order to absorb or avoid the additional costs of compliance. A large part of the conference was spent on small fund operations and how to survive this regulatory onslaught with increased compliance costs and competition from other products such as UCITS and ETFs.

Hedge fund managers are increasingly turning to specialists to help with basic fund management tasks, which needless to say increases the cost of doing business. This is an opportunity for service providers of competitive pricing such as Cypriot firms to specialise in providing functions that can be contracted out such as administration, custody, risk management, compliance and others. AIFMD requires the appointment of a depositary to hold fund assets and provide a supervisory role and funds must now be properly audited on an annual basis. Small funds will be using the same full-service facilities as the big players. Concrete policies and limits on leverage, regular stress testing to measure liquidity risk and the complete separation of valuation and risk management from portfolio management functions are also pushing managers to find outside service providers for middle-office
and back-office operations. There is still much confusion however and lack of clear guidance from regulators (including ESMA) for issues such as depositories, marketing and deferred remuneration and its taxation implications.

This legislation came at a time when investors have more or less disappeared, with only US institutional investors remaining a dominant force in investing in Hedge Funds. Regulatory arbitrage is also likely to occur between Europe and the USA with the loosening of US regulations governing Hedge Fund advertising (JOBS Act legislation). While the floodgates for hedge fund communication have opened on one side of the Atlantic, the EU is expanding rules governing investment risk and the amount of information that must be provided to regulators and potential investors. Funds are required to disclose an abundance of technical information to regulators and also disclose this information to investors. In effect, fund fact sheets now should include return attribution, leverage and portfolio allocation exhibits, and details that in the past typically had not been disclosed unless demanded. These rules govern all non-UCITS funds except where a non-EU manager is running a non-EU alternative investment and not marketing that fund in the EU. ‘Marketing’ in this case includes third-party agents soliciting interest within the EU countries.

Just a few years ago, the general consensus was that a manager needed $45 million in AUM to break even. Anything less than that would erode fund assets more rapidly than investment performance could make up and the 2% management fee wouldn’t cover the costs of running the management company. Nowadays management fees are typically being reduced to the 1% range (particularly for seed investors and large clients) and the manager’s 20% performance bonus is often attached to a hurdle (and is becoming increasingly difficult to attain in any event). Compliance requirements at all levels have added significantly to the manager’s operating costs. To be a profitable business, minimum fund size is now closer to $100 million.

The minimum capacity requirements of Institutional Investors are skyrocketing. Even a fund with $250 million in assets is considered too small for most institutional investors these days. Large pension funds, sovereign wealth programs and other major financial institutions generally require a prospective investment vehicle to be able to absorb a $100 million inflow without a ripple of effect. Hedge-fund managers overseeing at least $5 billion of assets have absorbed $127.5 billion of new capital since 2009; eight times the amount attracted by companies with less than $100 million, according to Hedge Fund Research Inc. Companies with $500 million to $5 billion of assets saw a combined $65.8 billion net outflow during those years. The largest managers controlled 68 percent of global industry assets of $2.5 trillion as of September, 10 percentage points higher than in October 2008, according to the Chicago-based data provider.

I have touched on three distinct yet undeniably related issues: increasing cost pressure on small to medium-sized alternative investments, concentration by the largest institutional investors on the largest vehicles, and waning interest of the general investor in hedge funds.

What does this mean for Alternative Investments? Big Funds will continue to get bigger and there will be increasing consolidation among the smaller funds.

Mr. Kyriakos Rialas has over 28 years of professional investment and managerial experience in the financial services sector. Prior to joining Argo, he was General Manager of Emporiki Bank IBU in Cyprus until 2003. Mr. Rialas has also previously worked for the Treasury Department of the Bank of Cyprus Group, London Forfaiting Cyprus and SG Warburg & Co in London. He has a degree in Engineering from the University of Cambridge and qualified as a Chartered Accountant with KPMG in London. He is a member of the ICAEW and ICPAC.