The Cyprus Investment Funds Sector and its Significance in the Cyprus Economy

By Christos Vasiliou, Board Member KPMG

Investment funds constitute an attractive investment tool as an alternative to borrowing. The legislative framework for investment, non-UCITS funds in Cyprus is the Law of International Collective Investment Schemes of 1999 (ICIS Law).

In recent years there was a collective effort to promote Cyprus as a competitive funds jurisdiction, both for funds and fund managers, resulting in an upsurge in the authorisation of ICIS involved in various industries such as renewable energy, shipping and private equity. In particular, licenced ICIS increased from 61 in 2011 to 97 by January 2014 (9 of which were registered after the events of March 2013), thus demonstrating the substantial success achieved in promoting this sector.

In an organized effort to modernize and bring the framework up to par with other popular funds jurisdictions such as Ireland and Malta, in February 2013 the Cyprus Securities and Exchange Commission (CySEC) circulated the proposed draft law on Alternative Investment Funds (AIF) which will, once enacted, repeal the ICIS Law in its entirety. The draft law introduces a number of options, such as retail funds which can further be listed and traded on a recognized stock exchange (as the current regulator, the Central Bank of Cyprus, has been only authorizing private ICIS as a matter of policy). There are also provisions for complete legal and accounting segregation of assets and liabilities within the same AIF with the establishment of different investment compartments (umbrella funds). Further a new legal form is introduced, namely the “common fund”, which is a popular contractual structure, widely used in other Member States.

Once the new AIF law is enacted, the supervision of investment funds will be transferred from the Central Bank to CySEC, bringing that way all investment products (UCITS and AIF) as well as their managers (AIFMs, UCITS Management Companies and Cyprus Investment Firms) under a single regulatory authority, as is the case in other Member States. This will ensure that the regulation and supervision of all investment funds and fund managers will be smoother and more efficient.

It is important to note that during the public consultation of the draft law, the funds sector (in particular professionals of the private sector including accountants, lawyers, administrators and custodians) contributed significantly with valuable recommendations and comments, which proved that the funds sector in Cyprus is well advanced and dedicated to the promotion and enhancement of the industry. It should further be mentioned that in an organized effort to promote the funds industry both within Cyprus and abroad, the Cyprus Investment Funds Association (CIFA) was established in 2013 at the initiative of CIPA to promote cooperation and communication among the industry participants, and has been further actively involved in acquiring memberships and representing Cyprus in reputable international associations.

On a European Union level, developments in the funds industry are steadily on the rise; following the global financial crisis and the Madoff scandal the need to closely regulate the funds sector with a set of universal rules led to the application of the AIFMD on a pan-European level, with Cyprus being
one of the first Member States to transpose the same into national law in July 2013. Further, the first draft of the UCITS V Directive, which will strengthen the current UCITS regime will be negotiated at the level of the EU Council, the European Commission and the European Parliament within the first quarter of 2014. In addition, a proposal to establish the legal framework for European Long Term Investment Funds, to complement the regulations of European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) is currently being examined.

Cyprus needs to remain at the forefront of all developments and continue its efforts to enhance the funds sector. At this stage the exact timing of implementation of the new AIF Law is uncertain, as the draft law is still being processed. Cyprus has been in a transitional period for more than a year now, which in turn results in the loss of momentum for the registration of funds, as potential clients are forced to examine, and in the end choose other jurisdictions with more complete regulatory frameworks for the purpose of setting up their fund vehicle promptly.

It is therefore evident that the prompt adoption of the new AIF Law is imperative so as to clear the uncertainty and enhance the effort in promoting the funds sector of Cyprus in the same, successful way as was the case before the transition period. The industry participants should continue to demonstrate the same dedication and support to the sector as they did up to now, so as to ensure that Cyprus continues to evolve into a sophisticated funds jurisdiction and attract fund managers, fund promoters and investors alike into the country.

Mr. Christos Vasiliou is a partner and the Service Line Leader of the Fund Services Practice of KPMG Cyprus. He is a Fellow member of the Institute of Chartered Accountants in England and Wales and of the Institute of Certified Public Accountants of Cyprus. He is also a member of the UCITS & AIFs Technical Committee of CIFA.

“Veni, Vidi, Investivi”¹: Alternative Financing Sources and Investing Vehicles Through Fund Structures

By Panikos G. Teklos, Executive Director and Head of Asset Management of Beneficentia Ltd

If Julius Caesar made a quantum leap into the future, he would have said to the Roman Senate “Veni, Vidi, Investivi” (“I came, I saw, I invested”) instead of his legendary phrase “Veni, Vidi, Vici” (“I came, I saw, I conquered”). It seems that much like the constant hunger of Romans back in the days to build a great Empire, modern investors will always be hungry for returns and hunt for yield. The global economic crisis that started in the middle of 2007, when the subprime mortgages jenga collapsed, has shaken – through contagion – the foundations of every financial institution, household and sovereign, yet it has only made investors change their attitude towards risk and return temporarily. Investors’ short-term selective memory and appetite for higher yields has certainly shown clear signs of return in the course of the last two years. At the same time, while capital markets in the traditional sense of raising Equity or Debt through either public or private offerings are indicating a comeback in interest, they are still pricing-in considerable premia and can be appealing as means of financing only to a select group of borrowers, which are generally larger institutions. On the other hand, prior to providing any loans, Banks are still maintaining rather tight lending criteria and policies scrutinizing potential borrowers much more. In fact, overcollateralization of a loan is no longer perceived a sufficient security and the ability of the borrower to repay the loan has taken front stage.

An alternative solution to this financing issue can be provided by utilizing a Fund structure. As per the European Fund and Asset Management Association (EFAMA), “Net Fund Assets represented 68 percent of Europe’s GDP at end 2013, up from 63 percent at end 2012. This indicator highlights the significant role played by investment funds as financial vehicles raising capital from retail and institutional

¹The latin part of the title was originally created by Citigroup’s Credit Strategy team in London in which the Author was one of the managing members.
investors, and providing funding to many European corporations and government agencies.” Of course, demand for financing alone cannot be satisfied without supply, but in this case the supply condition also exists as seen through the rise in Net Sales of European Fund Assets² by EUR 103 bn in 2013 (versus 2012) thus reaching a total volume of EUR 410 bn. It is clear then, that this demand-supply equilibrium is achieved by matching the need of borrowers – encapsulating any corporation, government or organization – for alternative financing sources with the need of investors to satisfy their more tailored profiles through alternative investments and, for some investor types, offering greater protection.

Characteristics such as (a) structuring flexibility (Share classes with characteristics available to different types of investors), (b) transparency, (c) tax efficiency (choice of jurisdiction), (d) access and exposure of investors to asset classes with very high barriers to entry on a stand-alone basis, and (e) diversification of portfolios through the ability to mix different asset classes together and using a variety of strategies (algorithmic, systematic, fundamental, hybrid), all contribute towards the increased demand and supply of such vehicles. Through these attributes, both fund managers and investors can match the profiles of their target audience and find the fund type that caters for their own needs. For example, retail investors can seek comfort into the UCITS (Undertakings for Collective Investments in Transferable Securities) product, whose regulatory requirements on transparency, diversification, disclosure, types of eligible assets and minimum subscription amounts cater for that level of investor protection. At the same time, an Investment Manager that wishes to set up a UCITS must understand that the level of scrutiny, monitoring and regulation involved is commensurate to the fact that its Fund can be marketed to the full audience of investors, from retail to institutional. Alternatively, there are other types of Alternative Investment Funds (AIFs) that can accommodate more sophisticated and professional investors, where the level of investor protection is lower, but the flexibility in other parameters, such as the type of asset classes, the sophistication of the underlying strategies and the use of leverage, is higher.

While the Fund industry was traditionally much more US-based, Europe has made tremendous progress over the course of the last 20 years in advancing the Fund industry, particularly with the introduction of certain Fund-linked directives both for the actual Funds as well as their respective Managers. The most popular references nowadays relate to the UCITS Directive and the newly introduced AIFM Directive. The former evolved through a number of versions, the most current of which is the so-called UCITS IV, although the base for UCITS V has already been drafted. The UCITS Directive comprises of all the rules and guidelines pertaining to what a UCITS Fund and a UCITS Manager need to follow. Once a Fund is registered as a UCITS, it can benefit from being passported to all EU28 countries without having to apply for authorization in each of these countries³. As to the AIFMD, it is a Directive that governs the requirements and obligations for licensing as an AIFM for managing a Fund classified as an AIF and fulfills a certain set of criteria. Many managers outside of Europe – especially from the US, but also from the UAE and Asia – that already have their Funds set up and run with Assets Under Management, and may wish to market their Funds in Europe in an effort to raise more capital, would need to investigate whether they need to have their Funds hosted under a structure that provides for an AIFM or opt for a license themselves.

European Fund Regulations and Directives are required for the credibility and the right foundations of the European Fund industry, but also need to be pragmatic. It is then the responsibility of every National Regulator, every official body involved in suggesting how these Directives will be transposed into national laws, and of course every National Parliament that votes those proposals into Laws, to consider very carefully and with utmost detail how the Laws will be drafted. In so doing, their primary objective should be to safeguard the investors and the broader economy whilst not make matters so restrictive or impractical and unrealistic for the Fund industry to be able to operate efficiently.

I do believe, that with the right balance of regulation and Fund Industry initiatives, the European and International Fund Statistics already indicate that the contribution of the Fund Industry towards the revival of the European but also the Global Economy is of major significance at present,

² European Fund and Asset Management Association (“EFAMA”): EFAMA publishes results for 2013, 03/03/2014

³ Yet, each member state may have additional regulatory requirements that need to be followed
and would be even more so for the coming years. In fact, the growth of the Fund industry can help in the restoration of confidence in the Banking Sector, as Banks can play the role of a Depositary in such structures. This could even hint towards an opportunity for Banks to consider expanding into the provision of Custodian Services with potentially considerable side revenues generated from the increase in Funds’ registrations and successful operations. It could even (re-)invigorate the Banks’ interest in setting up their own Funds and offer it as an additional product.

As long as this growth is controlled and properly regulated in order to avoid creating another bubble with the relevant repercussions, we are confident that Funds can be the investment vehicle of choice both for existing and upcoming Fund Managers as well as for investors in search of their desired structure and yield. Under the current and projected market conditions, I would argue that managing risk through multi-asset products, combining market-neutral and relative value strategies may prove to be not just good practice, but the necessary shield against market movements stemming out of unpredictable market drivers. Particularly this is the case when such lack of prediction is a result of Politics driving Economics with political agendas difficult to de-mystify.

Mr. Panikos Teklos is an Executive Director on the Board of Beneficentia Ltd and serves also as the Head of Asset Management. Mr. Teklos is an experienced Investment Banker and Financial Consultant with a lengthy international career at senior management positions with Citigroup, Barclays Capital and BNP Paribas. He has extensive and in-depth expertise in Portfolio and Risk Management, Structuring, Distribution and Origination across asset classes using a wide variety of investment vehicles.

UCITS V Remuneration Policies

By Moisis Aristidou, Manager, Baker Tilly Klitou and Partners Ltd

On 3 July 2012 the European Commission published a proposal for a draft UCITS V Directive. The aim of the European Commission was to impose new rules, in an effort to restore the confidence of the investor community, which suffered a significant blow due to the aftermath of the global economic crisis. The effort was concentrated mainly on trying to restrain certain aspects of fund management, which would eventually minimize investor’s risk. After a number of discussions and almost 18 months later, on February 2014, the European Union reached a compromise agreement on UCITS V.

The official statement released by the European Commission on 25 February 2014 claims that the new rules as discussed in the directive will significantly increase the level of protection enjoyed by UCITS investors. To serve as a quick reminder, the UCITS V draft directive, basically covered four main issues:

1. The eligibility to act as a depositary and the criteria for delegating custody.
2. The liability for the loss of financial instruments held in custody.
3. Sanctions for breaches of the UCITS directive.
4. The remuneration of UCITS managers.

Reading through the statement of the Commission, changes in remuneration policies and depositary provisions, together with the introduction of more harsh sanctions for non-compliance, certainly shows the path that the European Commission would like the sector to follow. Key elements of the agreement and more details can be found in the europa.eu website. These include new rules on eligible entities, protection in the event of insolvency, the depositary’s liability and administrative sanctions.

I would like to focus on the provisions with regards to the remuneration policies, which in my opinion will significantly impact the way fund management of UCITS is to be tackled when the directive is voted law.

The European Commission has introduced rules to enhance transparency of the remuneration practices. As noted, the remuneration policies are in line with those in the Alternative Investment Fund Managers Directive (2011/61/EC). In more details the directive covers:

1. The prospectus of the fund must include a description on what remuneration policy is to be followed. Moreover a description on how the remuneration along with the benefits attached, are to be calculated.
2. The oversight of the remuneration policy to be followed is with the Board of directors which is required to review it at least on an annual basis.

3. Performance related remuneration should be assessed taking into account both financial and non-financial criteria. Moreover, at least 50% of any variable remuneration of managers should be taken in the form of shares or units of the UCITS concerned. At least 40% of this remuneration must be deferred for at least three years. In the case where such variable remuneration is significant, the deferred amount must be at least 60%.

4. Categories of staff in scope are defined as employees in senior management, risk takers, control functions and any employee that is compensated within levels of the previously mentioned parties.

5. Annual disclosure in the UCITS report is required with information on remuneration policies followed and an explanation of the way remuneration was calculated (including benefits). The total amount of the remuneration is to be presented as fixed and variable remuneration, including performance fee. Any material changes in the policies should be disclosed.

What the Commission clearly suggests, is that much of the risk of the investor is in the fact that remuneration policies followed so far, encourage risk taking. It is easily understood that high levels of risks, leading to increased levels of profitability if they are successful, means better remuneration for the fund manager. The Commission through the directive discourages excessive risk-taking and instead aims for the promotion of sound and effective risk management.

Concentrating on the general target aimed by the directive with regards to remuneration, it is again clear that an effort to bring together the interests of fund managers and their investors is being made. The risk characteristics and behavior profile of the fund manager who tries to exceed its expected targets, thus increase its reward, should be controlled. Sure, risk profiles of UCITS are clearly defined in written contracts, but are these really controlled and followed, says the Commission?

This is now to be changed. What a better way to discourage risk taking, than suggesting that the fund manager is also an investor. The fund manager’s wealth is essentially tied up in the funds they manage. Introducing personal interest in such an elevated way would presumably make the manager avoid high risks. Is this an effective solution in the problem of investor risk? Should not the Commission focus on setting maximum remuneration by the application of salary caps, instead of essentially defying the manager as an investor as well? Even further practical issues are raised. There are certain jurisdictions outside the EU that could have problems implementing such remuneration policies, as they would conflict with local law.

The European Securities and Markets Authority (ESMA) is to issue guidelines on remuneration policies under UCITS V. As such, clarifications will be made on the rules of the directive. What is next? The agreement reached by the European Parliament and Council on the draft directive is not yet voted law. Final voting is expected to take place in the next months. If voted law the draft directive can be expected to be implemented into national law by the member – states by mid 2016 (unless the agreed timeline changes). What remains to be seen is whether such rules as suggested by the directive, not only on remuneration policies, but in all issues covered, are indeed beneficial for the investor.

Mr. Moisis Aristidou is a Manager in the Audit and Assurance Services of Baker Tilly Kilitou and Partners Ltd. He was previously employed at PwC (Cyprus) and completed the ACA qualification in 2010. He is a member of the UCITS & AIFs Technical Committee of CIFA and a member of the Financial Services Committee of ICPAC.

What Are the Talent Planning Challenges that Lie Ahead in Cyprus’s Efforts to Become a Renowned Centre for All Asset Classes of Funds and Fund Managers?

By Donna Stephenson, Founder and Director of GRS Global Recruitment Solutions

In the last couple of years the number of funds registered in Cyprus has doubled to around 100 with a further 30-40 funds
awaiting registration and licensing. Key industry experts from the fund management sector in Cyprus forecast that this number will further increase and anticipate the numbers reaching around 200 this year. In comparison, looking at a similar jurisdiction – Malta, where currently over 400 investment service licenses have been issued – it is clear that Cyprus has some way to go to increase the number of funds registered in comparison to mature jurisdictions such as Luxembourg. The outlook however is positive, new legislation and favourable conditions for the attraction of funds to Cyprus is a step in the right direction to position Cyprus as an attractive option and a player within the global investment funds industry.

Although the sector is in its infancy, the challenge for Cyprus as the sector develops is to supply local, qualified employees to a growing fund management sector. As with the Forex sector and most recently the Binary Options sector in Cyprus, the favourable conditions and licensing through CySEC has attracted an influx of Retail FX trading firms with many big industry names finding it useful to position themselves in Cyprus. This sector’s local demand for talent has been huge. According to Global Recruitment Solutions, the Cyprus based leading recruitment and payroll consultancy’s survey of Cyprus, 50% of the placements made during 2013 were in the Forex, Binary Options and Cyprus Investment Firms (CIF) sectors, an increase on the survey data of 2012 where this figure was at 37%. The graph illustrates the growth of job placements since 2010. These employees were recruited locally from Cyprus and other EU countries.

Interestingly, this hiring growth could well be mirrored within the Cyprus funds sector, creating new jobs and new career opportunities for local residents of Cyprus in areas such as fund administration, valuation, accounting, portfolio management, and fund incorporation.

In recent years the growth of the fund management sector has been steady, as a result, there has not been an overwhelming demand for recruiting this expertise to the sector. Yet the demand for talent to the sector will increase exponentially as Cyprus succeeds at attracting and increasing the number of funds operating from Cyprus. The talent available in Cyprus will be key to the overall positioning of Cyprus for attracting companies and furthermore supporting the talent needs of these companies with local, qualified and experienced individuals.

Currently the supply of local talent that has experience or exposure to the fund management sector is limited in Cyprus. Yet, the raw material exists. Cyprus boasts a highly skilled workforce, fluent in English with most Cypriots holding degrees and masters from overseas Universities. This local talent has for many years entered the professions on their return to Cyprus with a high percentage commencing their careers within the local accounting and legal sectors. As a result, there exists a surplus of qualified accounting, legal and corporate servicing staff, albeit with no substantial investment fund expertise due to the infancy of the local funds sector but ready for training and development to meet the recruitment needs of the sector in the first instance.

As the sector grows, demand for talent will naturally increase and we may see the mobility of talent coming into the Cyprus fund industry from other fund jurisdictions such as the relatively new Malta fund jurisdiction or the more mature Luxembourg jurisdiction, where individuals have gained substantial experience working for international firms active in the funds sector and have gained experience in dealing with international funds and managers. Cyprus is an attractive location for the migration of talent with its sunny Mediterranean climate, low taxation and general good quality of life. On the other hand, the Cyprus funds industry at its current state of immaturity may not require such experienced talent from other mature jurisdictions and the provision of home grown talent may at this stage be satisfactory.

*The above statistics are compiled using data based on the number of permanent job placements made by GRS in Cyprus during 2010 - 2013 and do not necessarily reflect a complete overview of the Cyprus recruitment and labor market.
International firms operating in the funds sector and present in Cyprus may increase the knowledge of locally recruited employees by seconding them to their overseas offices in more mature jurisdictions to gain knowledge and an insight as well as exposure to the fund sector in a more mature jurisdiction. This experience, if available, would be valuable for any employee but it may not be an option for all firms.

In preparation for a steady growth of the Cyprus funds sector, associations such as CIFA, CIPA and educational establishments are already placing talent planning on the agenda. It is important to promote careers within the fund sector at a local level as well as raise the awareness locally that despite the events of March 2013 in the banking sector, the financial services sector, and specifically the funds industry, provides opportunity and great prospects of economic growth for Cyprus. For example, it is not widely known that the funds sector in Cyprus is one of the fastest growing investment fund centres in Europe. Unfortunately due to the banking crisis there is negative sentiment in the finance sector and through various seminars and promotion of Cyprus as a fund centre, interest from individuals such as the graduates will be aroused and attracted to entering the funds sector. As the sector evolves more will be done through Universities and other academic and private institutions to raise the awareness and promote careers within the fund sector to support the recruiting needs of the Cyprus funds sector.

Training and development for local talent for example in Malta, the Malta Finance Organisation states that skilled staff is provided by the Universities and other Academic and private institutions train students at all levels according to what is required to satisfy the demand of the funds sector. Various courses are offered to students in Malta to train students and employees equipping locals with the required knowledge to service the funds sector.

Steps are already being taken to address the talent needs of the fund industry. Fund management professionals in Cyprus agree that Cyprus needs to identify and establish, as well as partner with overseas educational bodies to create professional qualifications and training programs at a local level to create courses specific to the fund industry. According to fund management experts in Cyprus, the needs of the fund management sector will for example require accountants with fund expertise. There will be additional demands for skills in client relations, valuation verification, risk and liquidity reporting, business analysts and so on.

In summary, the talent pool currently available may not be enough to satisfy the demand for talent from a high influx of fund management firms, yet with accredited training and professional qualifications available for the up-skilling of local professionals and with the right steps promoting careers within the fund sector, Cyprus will have the necessary infrastructure to support the talent needs of a fund industry as it surpass its infancy and develops into a fund centre.

Ms. Donna Stephenson is Founder and Director of GRS Global Recruitment Solutions. Ms. Stephenson graduated with a BSc degree in Business and Telecommunications and commenced her recruiting career with a global specialist recruitment plc in the UK. She relocated to Cyprus in 2003 where she managed a team of recruiters for an international consultancy. Donna along with her co-founder Steve Slocombe established GRS in Cyprus in January 2005. With additional offices in Malta and the UK, GRS has become the largest Recruitment Agency in Cyprus with the most Consultants and the largest recruitment database.