Brexit: Challenges and Opportunities for the Financial Services and Investment Funds Industry

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After the UK referendum and the yes vote for Brexit, it has become a serious topic of discussion, as well as an interesting subject for organizing events and functions across the globe with many debates and working groups. The matter is unfolding every day in the newspapers and other media all over Europe but also internationally.

Some of the main questions that are being asked are:

1. Will companies that operate from the UK and have UK as their Hub for Europe be affected?

2. Will there be persons that will be relocating to other EU Countries?

3. What will happen to EU Institutions that are headquartered in the UK such as the European Bank for Reconstruction and Development (‘EBRD’) and the European Banking Authority (‘EBA’)?

4. Will there be a soft Brexit or a hard Brexit?

5. Will the UK strive for an agreement that will be similar to Norway or Switzerland?

6. Will the UK stay in the EEA and benefit from the passporting of services, products and persons provisions (if this is accepted by the EU)?

7. If the UK leaves the EEA will UCITS, MIFID, AIFM passporting rights be withdrawn?

8. What will be the impact on the EU Budget?

9. Will the UK cease to have a Commissioner and EU Parliamentarians?

10. Will the UK change its tax rates after Brexit?

The fact of the matter is that this is a political process and deal (if there will be a deal) to be driven by the UK leadership and negotiated with the EU leadership. The UK will have 2 years from the time the papers are presented to be negotiated and conclude a deal with the EU.

Since the UK papers/positions are not presented yet and the positions of the EU are not yet known, surely not a lot can be said about what does Brexit mean and what will really happen. What can be said is that there are different scenarios that can possibly be formulated and analysed when looking at the Banking, Financial Services and Investment Firms & Funds. One can only start preparing and seeing possible implications of Brexit (if in the end there will be one) taking all scenarios into
consideration at this time.

Definitely Banks and Financial Services companies that have a base in the UK and make use of the passporting provision to operate in EU member states might be faced with a situation that they will need to relocate to or incorporate in an EU member state and then use the passporting provisions to operate in other EU member states from that specific jurisdiction.

Asset Management Companies that are based in the UK will possibly need to set up and establish substance (offices, human and systems resources on the ground) in EU member states so that they can manage the UCITS or Alternative Funds. They can of course outsource the portfolio management back to the UK.

Although admittedly there are many uncertainties and unknowns in the Brexit equation and parameters can vary, one can only prepare and plan in the best possible way.

Can Cyprus possibly play a role and offer solutions?

If we look at the below chart, we see that EU capital markets activity is mostly handled in the UK. So the matter of Brexit is a serious one and preparation and planning is needed at all levels.

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\text{U.K.-EU Ties} \\
\text{EU capital markets activity is mostly handled in the UK.}
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- 87% of U.S. investment banks EU staff work in the UK.
- 78% of EU capital markets activity conducted in the UK.
- 76% of all MiFID* passporting done by UK-based firms.
- 74% of all EU trading in OTC derivatives.

Source: Bloomberg.com

Apparently over 5,000 financial firms use the UK as a base to access the EU single market. It is estimated that up to 600,000 people might move post Brexit.

What can Cyprus professional services firms with the support of the Government and other stakeholders do?

Cyprus and the UK enjoy excellent business and investment relations. The UK familiarity of Cyprus’ legal and tax systems, the friendly encounter, the fact that Cyprus is an active member of the British Commonwealth and the overall familiarity of the environment of doing business in Cyprus to British Banking and Financial Services firms surely positions Cyprus as an EU member state and a Country that can work with the UK and the businesses that might be possibly affected. Cyprus can offer solutions to these UK firms and organizations that might possibly be affected. Cyprus and the UK can work together and analyse the different scenarios with a scope to find effective solutions.

It is indeed too early to know or foresee what might happen but preparation and planning need to start from now as in all cases, success comes when preparedness meets opportunity. From the above chart it is clear that Brexit is an important matter on which Cyprus and the UK can work together for mutual benefit.

The UK Government can be approached from the Cyprus Government while working groups can perhaps be composed from both the private and public sector with a focus on assessing the impact and the needs of Banking and Financial Services Firms & Investment Funds and start making preparations, analyse the implications as the matter is unfolding and try to find and examine probable solutions to the companies, persons and financial products.

It is evident that Cyprus can play an important role for the UK as a common law, rather than a civil law, jurisdiction within the EU, with fully harmonized EU regulations and directives on Banking, Financial Services & Investment Funds, geographically well placed to function as a “bridge” between Europe, the Middle East, Asia and Africa.

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Cyprus Fund Administration

Legal Framework

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Cyprus Fund’s industry has been growing rapidly in the last couple of years. Cyprus Investment Fund Association ("CIFA") in collaboration and co-operation with Cyprus Securities and Exchange Commission ("CySEC"), in an attempt to enhance the regulatory framework for Funds, Fund Managers and Service providers dealing with services attributable to Funds’ stakeholders, are working towards the launch of a legal framework which will regulate, monitor and supervise the Fund Administration Services provided from Cyprus to local and international Funds and Fund Managers.

The proposed Legal Framework for Fund Administrators here in Cyprus will oblige the existing service providers and new service providers that are willing to be involved in the Fund Administration Services to apply to CySEC for authorisation and be accredited with the License of the Fund Administrator.

The main requirements for a Firm to be accredited with the License include the independence of the firm, meaning that the Fund Administrator will be wholly and exclusively incorporated to provide only the services included in the proposed Legal Framework. Applying this approach, Cyprus, CIFA and CySEC will be able to promote to Global Managers that are interested in establishing Funds here in Cyprus that the Fund Service Providers are independent entities dedicated only to one category of service. This will also enhance and lead to internal developments of these entities including the development of their personnel towards the establishment of the highest possible quality of services to be provided to Funds and Fund Managers.

Furthermore, the Legal Framework will require the entities to employ, by having an employment contract in place, at least two qualified people as Fund Administration involves high level of accounting and valuation techniques. The aim of this requirement is to promote a regulated service that is run by experienced people with previous experience in Funds or in the main fundamental foundation which is needed for someone to be able to solve, deal and deliver solutions to Funds.

Going further, one of the main discussions held during the drafting of the Fund Administration Law was the capital requirements of a firm that wishes to establish a Fund Administration Business. It was concluded that the requirement of a minimum capital, payable only in cash, should exist in order to ensure and promote a service that would provide an extra guarantee and comfort to the Clients. Going further to this, considering the risks and exposures involved, it was also concluded that having an initial cash contribution was not sufficient and the legal framework should bind the Fund Administrators to maintain a capital adequacy at all times.

In addition to the extra safety of the Clients of the Fund Administrator, it was also proposed and included in the Fund Administration Law that all Fund Administrators are obliged to have a minimum 5-year renewable professional indemnity insurance covering all Member States or some other comparable guarantee against liability arising from professional negligence.

Further to the above requirements, the licensed Fund Administrator should have in place a business continuity plan and other manuals that will enable the firm to perform its operations on a smooth way for the benefit of the stakeholders of the funds.

Last but not least, the Fund Administration Law will entail several reporting obligations towards CySEC, being the regulatory authority of the Fund Administrator. The Fund Administrator will be required to submit its annual audited financial statements to the CySEC and such other information, returns and reports as the CySEC may from time to time request. The auditor’s report, including any qualifications thereto, shall be
reproduced in full in the Annual Report. The annual Audited Financial Statements shall be published and submitted to the CySEC by the 30th of April each year.

By touching some of the aspects of the proposed Legal Framework, the future prospects and potential effects that are expected from this framework can be easily identified. The said legal framework in combination with the regulatory environment, combined with Cyprus’ geographical location at the crossroad of three continents and its workforce being educated and trained in the EU with a long tradition of multicultural and multilingual expertise, can establish Cyprus as domicile of choice, for the provision of a full scope of Fund related services to Funds and Fund Managers.

CIFA and CySEC along with all professionals involved in the market of Funds are trying to offer and promote a trustworthy, regulated and monitored environment to investors that wish to invest either in Cyprus Funds or through Cyprus Fund Managers around the Globe and establish the best possible practice of fund investor protection.

Mr. Andreas Yiasemides is a Partner of K. Treppides & Co Ltd since 2013 and Managing Director of Treppides Fund Services. He has extensive experience in the advisory services of banking institutions, financial services companies and funds. He holds a BA (Hons) in Economics with specialization in Accounting, Finance and Econometrics and an MBA in Finance and is also a Fellow Chartered Accountant of FCA. Mr. Yiasemides is a founding member and a member of the Board of Directors of CIFA, as well as a Non-Executive Director in the Board of Directors of the Central Bank of Cyprus.

Supervision: Advising on AIFMD Passorting Equivalence

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The European Securities and Markets Authority (‘ESMA’) published “ESMA’s advice to the European Parliament ("EP"), the Council and the European Commission (“EC”) on the application of the AIFMD passport to non-EU AIFMs and AIFs” on 19 July 2016. The purpose of this publication was to address whether to extend equivalence of passporting to twelve major asset management jurisdictions. This would enable asset managers from those jurisdictions to market their funds across the EU without having to conduct private placements on a country-by-country basis.

Following the publication of a first set of advice on the application of the passport to six non-EU countries (Guernsey, Hong Kong, Jersey, Switzerland, Singapore and the United States) in July 2015, this new paper published in July, sets out ESMA’s advice on the application of the passport to the following twelve non-EU countries: Australia, Bermuda, Canada, Cayman Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Switzerland, Singapore and the United States.

As noted in the ESMA paper: “In accordance with Articles 36 and 42 of the Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD), non-EU alternative investment fund managers (AIFMs) and non-EU alternative investment funds (AIFs) managed by EU AIFMs are subject to the national private placement regime (NPPR) of each of the Member States where the AIFs are marketed or managed. However, the AIFMD makes provision for the passport, which is currently reserved to EU AIFMs and AIFs, to be potentially extended in the future. Article 67(1) of the AIFMD establishes that, by 22 July 2015, ESMA shall issue to the European Parliament, the Council and the Commission advice on the application of the passport to non-EU AIFMs.
and AIFs in accordance with the rules set out in Article 35 and 37 to 41 of the AIFMD.

In addition to the above, ESMA noted that it will continue to work on its assessment of other non-EU countries with a view to delivering further submissions to the European Parliament, the Council and the Commission.

Methodology

ESMA’s advice sets out the criteria, methodology and data that will be used to assess the potential extension of the passport to non-EU countries. These criteria will be used when assessing each non-EU jurisdiction.

In summary the criteria include:

- the effectiveness of cooperation arrangements with the non-EU jurisdictions;
- investor protection;
- market disruption;
- obstacles to competition; and
- monitoring of systemic risk.

Results of ESMA Advice

ESMA concludes that five jurisdictions – namely Guernsey, Jersey, Switzerland, Canada and Japan – have equivalent regimes on an unqualified basis. But for other major jurisdictions such as the US and Hong Kong, ESMA considers them equivalent for some types of fund activity but not for others.

ESMA, however, declined to provide definitive advice in relation to the Cayman Islands, Bermuda and Isle of Man due to either impending regulatory changes in these jurisdictions or lack of AIFMD-like regimes.

Notably, ESMA seems more concerned about ensuring reciprocity of access than whether there is a match between AIFMD and third country regimes regarding investor protection provisions. The decision to grant equivalence via a delegated act lies with the EC.

The EC could either adopt ESMA’s proposals around narrower and tailored equivalence determinations for those regimes or it could wait for unqualified equivalence. Similarly, the EC may determine that there haven’t been enough positive determinations to justify extending the passport to any of the jurisdictions, because to do so might create imbalanced access.

Potential Impact for Cyprus

- Markets are becoming more and more competitive thus it is of paramount importance to enhance the expertise / knowledge of Cyprus-based providers. The favourably assessed by ESMA non-EU jurisdictions have years and years of expertise in the industry and thus can very easily attract new structures.

- The access to capital markets is becoming a “fair game” for all participants. The necessity for non-EU AIFM and non-EU AIFs to adopt the provisions of AIFMD ensures a fair competition in the EU market. Therefore, Cyprus-based AIFs and AIFM are not in a disadvantageous position because of the regulatory regime.

- The changes in regulation and compliance are constant which highlights the importance of flexible structures able to comply quickly with new requirements / developments. Hence, it is very important that any regulatory changes or enhancements are enacted quickly to avoid losing potential new structures to other jurisdictions.

Mr. Marios Charalambides holds a BSc in Finance from the University of Cyprus and is an ACA, member of the ICAEW. He began his career at PwC Cyprus in 2003 and now he holds the position of Director, Assurance and Advisory. Mr. Charalambides has extensive experience in assurance services with a number of high profile local and international clients operating primarily in the financial services sector. He recently completed a 2-year secondment in PwC CI. His main clients include banking institutions, brokerage and investment firms and funds. He also provides technical support to the Cyprus Accountancy Consultancy Services of PwC Cyprus.