

Alternative Investment Funds (AIFs) The Cyprus Perspective

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Foreword

The European investment fund industry has witnessed significant growth in recent years, a trend strongly anticipated to continue. According to the latest data published by the European Fund and Asset Management Association (EFAMA) in April 2015, total AuM in Europe increased by approximately 15% in 2014 to reach an all-time high of EUR 19.0 trillion. The total assets of the European asset management industry have grown 74% for the period 2008 and 2014. Industry research suggests that this figure will grow at a compound annual growth rate of nearly 6% over the next five years. This growing demand is also being fuelled by changes in investor demands for regulated products offering greater investor protection.

Lehman's bankruptcy in September 2008, and the wider effects of the credit crisis have had a lasting impact on the Alternative Investment Fund (AIF) sector, and the industry has undergone many changes in order to win back investor confidence and meet the needs of a growing audience of institutional investors allocating capital to AIFs.

Seven years on, policy makers, institutions and asset managers have worked to introduce new regulations and reform outdated business practices in order to avoid another major economic downturn, and restore stability and growth to the global economy.

The AIF industry continues to grapple with an environment of change and uncertainty. The trend towards increased institutionalization of the sector continues, bringing even greater focus onto the due diligence, risk management and transparency management processes of funds and their managers.

The European Union has responded with enhanced regulatory measures such as upcoming amendments to its UCITS and MiFID regimes, as well as the transposition of the AIFMD in 2013.

Cyprus is primed to meet these demands, with its legal and regulatory framework having aptly responded to the regulatory changes, while concurrently offering investors and fund promoters stability coupled together with cost and tax efficiency. Being a new market entrant, Cyprus has both the advantage of well-established models to emulate and the disadvantage of the industry bias favouring the familiar. Being a well-regulated EU member state, it combines tax efficient features of a modern financial centre with the necessary

infrastructure for the funds industry. Occupying a unique nexus between East and West, Cyprus is in the right place at the right time, to position itself as a preferential jurisdiction for investment funds and investors seeking to target relatively new and increasingly affluent regions including Eastern Europe, Russia and the CIS, Africa, India and Southern Asia.

Cyprus, offers the full spectrum of legislative framework to all fund products, and the enactment of the Alternative Investment Funds Law (AIF Law) in July 2014 provides for a significant modernisation of the related legal framework and offers a comprehensive tool box and new structuring options competitive to those of other established jurisdictions.

The dominance of English as a legal and business language, together with international preference for Common Law based corporate structures, continue to be a very important factor in choosing a fund's jurisdiction, especially in an industry which predominantly operates in English. The abundance of experienced lawyers, accountants, custodians, fund administrators and fund managers, and Cyprus UK based legal and business system make Cyprus an attractive jurisdiction for the setting up of Alternative Investments Funds.



Demetris Papaprodromou
Managing Director



Introduction

An AIF is a collective investment undertaking which:

- raises external capital from a number of investors,
- with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and
- has not been authorised as a UCITS “Undertakings for Collective Investments in Transferrable Securities”.

The Cypriot House of Representatives passed the Alternative Investment Funds law in July 2014. The passing of the law has aligned the Cyprus legal and regulatory framework with the latest EU directives on asset management, transparency and investor protection.

Cyprus now offers the full spectrum of legislative framework to all fund products (UCITS and non UCITS) and AIFs that are established under domestic Cyprus fund legislation can be sold on a private placement basis or marketed to professional investors across the EU under the AIFMD passport.

AIFs Legal Forms

An AIF can take the following legal forms and may be established with limited or unlimited duration:

- Fixed Capital Company (FCC)
- Variable Capital Company (VCC)
- Limited Partnership (LP)
- Common Fund (CF)

Main characteristics of the AIF Law

The AIF Law introduces new structuring options which were not possible under the previous framework, such as:

- Umbrella structures with multiple investment compartments, which allow the management of different pools of assets with different investment policies, the assets and liabilities of each such pool of assets being ring-fenced;
- Common funds, which are contractual fund structures where investors participate as co-owners of the assets of the AIF. This is a commonly used investment vehicle in other established funds jurisdictions such as Luxembourg and Ireland, particularly for structuring investments of pension funds;
- Possibility to make public offerings of shares/units of AIFs (the offering of ICIS shares/units was restricted to private placement only);
- Possibility of listing, which increases the AIF’s potential investor base and enhances marketability and transparency;
- The Depositary function may now be undertaken, in certain cases, by an entity other than a credit/banking institution, subject to certain conditions. This may aid in the structuring and operations of AIFs not directly investing in financial and money market instruments, such as private equity and real estate funds.

Types and forms of AIFs

AIFs are categorised into the following two types:

Alternative Investment fund with unlimited number of persons:

which may be marketed to retail investors and/or professional and/or well-informed investors,

Alternative Investment Fund with Limited number of persons (being 75)

which may be marketed to well-informed and/or professional investors

Professional Investor is any investor that is considered, or may be treated on request, as a professional client as defined in the Markets in Financial Instruments Directive 2004/39/EC (“MiFID”)

Well-informed Investor is an investor not considered to be a Professional Investor who meets the following criteria:

he confirms in writing that he is a well-informed investor and has been notified of the risks associated with investing in the AIF in question, and

either:

- his investment in the AIF is at least EUR 125,000; or
- he has been evaluated as a well-informed investor either by a banking institution, or a MiFID compliant investment firm, or UCITS management company, or AIFM



Tax Benefits

Cyprus has an advantageous and fully EU and OECD-approved tax regime, with AIFs also enjoying significant tax benefits. An AIF is treated identically to any other Cypriot entity, provided an AIF is structured in the form of a private limited liability company, and its management and control is exercised in Cyprus, it can benefit from the 12.5% flat corporation tax on annual net profits earned worldwide. Due to the favourable income exemption regime, in general terms AIFs will not be subject to Cyprus tax. The following are the main tax advantages enjoyed by an AIF:

- No stamp duties on the subscription, redemption, repurchase or transfer of units;
 - Exemption from tax on any income arising from trading in “securities”. The term ‘Securities’ includes but is not limited to: shares and share options as well as other options on titles, debentures, bonds and rights of claims thereon, participations in companies, units in open-end or closedend collective investment schemes such as Mutual Funds, International Collective Investment Schemes (ICIS)/ Alternative Investment Funds (AIFs) and Undertakings for Collective Investments in Transferable Securities (UCITS);
 - No withholding tax on income repatriation or dividends paid to unit holders
 - No withholding tax on interest payments made to non-residents;
 - No capital gains tax on the disposal of shares/units by the holders
- Tax exemption on capital gains from the sale of immovable property located outside Cyprus
 - An extensive network of Double Tax Treaties in place with more than 58 countries worldwide



Key Players

Investment Manager

AIF with limited number of persons

An alternative investment fund with limited number of persons which has taken the form of a Variable Capital Company (VCC) or of a Fixed Capital Company (FCC), may either be self-managed in accordance with paragraph (a) below, or appoint an external manager in accordance with paragraph (b) below, whereas the alternative investment fund with limited number of persons which has taken the form of Limited Partnership (LP) shall always appoint a manager in accordance with paragraph (b), which shall undertake the duties of the general partner:

- a. in the case of a self-managed alternative investment fund with limited number of persons:
 - i. the portfolio management function shall be exercised by its board of directors and it stems out from its instruments of incorporation, namely that its exclusive purpose is the management of its portfolio; and
 - ii. where it is justified by the scope, the nature, the scale and the complexity of its activities, it shall establish and maintain the internal audit, regulatory compliance and risk management functions, which may be exercised by the same person;

b. in the case an external manager is appointed, the duties of the external manager shall be exercised by:

- i. a management company authorised in accordance with the Open-Ended Undertakings for Collective Investments Law, a CIF and/or a company established in a third country as long as it is authorised to provide the portfolio management service and is subject to prudential regulation regarding the provision of that service, where the portfolio of an alternative investment fund with limited number of persons includes one or more financial instruments; or
- ii. any company which, in accordance with its instruments of incorporation, has as its sole purpose the provision of the portfolio management services to the specific alternative investment fund with limited number of persons.

In this case, the appropriateness of the manager of the alternative investment fund with limited number of persons is assessed by the Securities and Exchange Commission, on the basis of the information submitted in the file of the application to grant authorisation to this fund, whereas any change in the information regarding the person to whom the portfolio management will be delegated shall be communicated immediately to the Securities and Exchange Commission.

AIF with unlimited number of persons

An external manager must fulfil the following licensing requirements:

- i. Established in an EU member state:

the manager must be authorised under the AIFM Directive or the UCITS IV Directive.
- ii. Established in Cyprus:

must be authorised under the Alternative Investment Fund Managers Law or the Investment Services and Activities and Regulated Markets Law or be a Management Company of the Open Ended Undertakings in Collective Investments Law.
- iii. Established in a third country:

the manager must be an AIFM of a third country complying with the relevant provisions of the Alternative Investment Fund Managers Law.



Depository

Funds must appoint a single and independent depository whose responsibilities include:

- Safekeeping fund's assets by holding in custody of all financial instruments, which can be registered in the custodian's books and those that can be physically delivered. Also for other assets, the custodian must verify ownership of the fund and maintain an up-to-date record of all assets
- Cash flow monitoring in regard to investors and service providers, ensuring the fund's cash flows are booked at eligible entities and are accurately monitored
- Oversight functions ensuring compliance with the fund's rules and instruments of incorporation, valuation procedures and that they comply with applicable law and regulations. There are also possibilities to subcontract safekeeping duties to a foreign licensed custodian acting as sub-custodian.

Eligible providers:

A credit institution, MiFID investment firm or other entities that are subject to prudential regulation. The latter may be suitable for funds whose investment portfolio consists of non-financial assets or non-money market instruments.

An alternative investment fund with limited number of persons may not appoint a depository

- a. where its total assets shall not exceed the amount of five million euro, or its equivalent in another currency; or
- b. where the instruments of incorporation or the partnership agreement of the alternative investment fund with limited number of persons shall limit the number of its unit holders during the duration of the fund, to up to five persons; in case the alternative investment fund with limited number of persons has more than one investment compartment, the unitholders of all its investment compartments are accounted for in the calculation of the number of unit-holders of the alternative investment fund manager with limited number of persons; or
- c. where the assets of the alternative investment fund with limited number of persons are not subject to custody

Fund Administrator

The administrator's role is very much to monitor the fund, so as to ensure that the actions of the investment manager and the operations of the fund are in line with the objectives of the fund, the regulatory environment applicable to the fund, the tax environment within which the fund operates, and the client relationship management role between the fund and its investors. Even though the law does not impose the supervision of all administrator work under CySEC, most of the fund administrators in Cyprus, our firm being one of them, are already licensed and regulated by CySEC to provide corporate and fiduciary services.

Our Team

Our firm was the second firm in Cyprus that got approval to provide all corporate and fiduciary services from the regulator, CySEC. We have a multi-disciplinary team of specialists who can assist you in all aspects of setting up an AIF, the licensing process and the ongoing maintenance and compliance with the new legal framework of the Fund.

Through the use of cutting edge technology and highly qualified and experienced personnel (most of our staff are UK Chartered Accountants having previously worked in big four firms), with an in-depth knowledge of the local Laws and requirements and, coupled with their international Corporate, Fiduciary, Tax and Financial Services experience, can assist you with any challenges you face in setting up and maintaining an AIF and obtaining the relevant licenses.



Our Services

Our services can be divided into three distinct functional areas and include, among others:

- Fund set-up & operations
- Fund accounting & Valuation
- Transfer agency and secretarial

Fund Set-up

- Choosing the appropriate legal form of the fund
 - We examine the alternative forms that the fund can take, and we provide our advice and guidance on the best choice of legal form so that it meets your requirements.
- Preparation of the Application Package
- Follow-up on the application process
 - Our experienced team will reply to any queries raised by the regulator or provide additional information or clarification as requested.

Fund Operations

- Asset trade capture and booking
 - Our operations team supports the trading and accounting teams by ensuring that all trades are accounted for and settled correctly. It requires extensive trade capture, and booking capabilities incorporating advanced knowledge of a variety of financial products, and a sophisticated information technology infrastructure.
- Our advanced fund administration platform can accommodate the following:

- Portfolio operations
 - Entry and processing of all types of portfolio transactions
- Automatic trade processing which not only allows trades to be downloaded from external systems, but also be reviewed and edited before posting.
- Extended reporting capabilities
- Asset validation checks
 - Ensuring that the portfolio transactions comply with the offering documents and any other internal control procedures.
- Reconciliation with brokers/custodian
 - Ensuring that the portfolio of assets (including cash) is reconciled and agrees with the positions from external sources on a daily/monthly basis.
- Corporate actions monitoring, processing and recording
 - Identify and process all applicable corporate actions (dividends, rights issue etc).
- Reconciliation of the custodian's records with the portfolio position with regards to details of assets and cash.

Fund Accounting & Valuation

- Maintaining proper statutory accounting records
 - Maintaining accounting records in accordance with the fund's governing documents, and the accounting principles and standards applicable to the fund (GAAP or IFRS).
- Pricing and valuations

- Ensuring compliance with the relevant valuation policies, as these have been predefined in the offering documents. Our systems can accommodate all types of portfolio transactions
 - Buy Long/Sell Long and Sell Short/Cover Short
 - All types of equity and debt securities, as well as all derivative products (put and call options, swaps, futures, forwards etc) can be handled.
- Each of these events is processed automatically for a fund, group of funds or across all funds.
- Correctly account for all fees payable to fund
 - For example (investment manager standard and performance fees, custodian etc). Reconciliation with the relevant service agreements.
- Correctly account for all accruals and prepayments, expenses, interest, dividends,
- Calculate the Net Asset Value (NAV) of the fund correctly and in a timely manner.
- Preparation of monthly, quarterly, semi-annually or annual financial statements.



Transfer Agency

Transfer agents fulfil a central role in the funds industry, as everything from the processing of subscriptions and redemptions, to communications with the investors flows through the transfer agency.

Advanced Transfer Agency Solution

We have invested in one of the industry's most advanced solutions for transfer agency and shareholder record-keeping. It is an end-to-end solution which enables us to easily manage all aspects of shareholder interaction, from account activity and shareholder profiles, right up to contact history. Supporting a wide range of sizes and types of domestic and offshore transfer agency operations, our system was designed to respond to the most demanding environments in the industry today, delivering excellent customer service, and building insightful reports.

An Integrated Offering

Our system is also tightly integrated with our fund accounting solution as well as with our Investors' Reporting solution, and in combination with the two can produce investor-ready web reports at the push of a button.

Processing Subscriptions

- Receive applications and process any subscriptions in accordance with the terms of the prospectus or offering documents and carry out suitable KYC and AML checks and ensure compliance with applicable money laundering rules and other regulations such as FACTA, CRS etc.

Processing Redemptions

- Receive applications and process any redemptions in accordance with the terms of the prospectus or offering documents.

Update the Register

Communications & Other Corporate Actions

- Responding to requests concerning an investor's account and providing information to investors about new offers, maturity dates and all other investor-friendly information
- Acting as the fund's paying agent to pay out interest, cash and stock dividends.

Secretarial Services

In most of the cases where we act as transfer agents, we also undertake the complete range of secretarial work. In our capacity as secretary we are responsible for all corporate secretarial functions and general corporate governance of the company. More specifically:

- Maintaining all statutory registers & corporate records.
- Preparing & circulating all necessary papers for meetings of the Directors and taking proper minutes during the meetings.
- Making applications to the relevant authorities for confirmations relating to taxation, consents, bye-laws.
- Preparing notices, agendas & attending Directors/General meetings (if required).
- Submission of notices & filings to the relevant stock exchanges and governmental authorities.
- Drafting Administration Agreements.
- Assisting in the opening of bank accounts

AIFs at a glance

	Alternative Investment Fund with Limited number of persons	Alternative Investment fund with unlimited number of persons
Regulatory Authority	CySEC	CySEC
Limitation on Number of Investors	75	Not applicable
Available Structures	Variable Capital Company (VCC), Fixed Capital Company (FCC), Limited Partnership (LP)	Variable Capital Company (VCC), Fixed Capital Company (FCC), Limited Partnership (LP), Common Fund (CF)
May be Marketed to	Professional investors, and/or well-informed investors	to retail investors, and/or professional investors, and/or well-informed investors
Umbrella Funds	Possible for all structures	Possible for all structures
Minimum Share Capital	Not applicable	€125,000 or €300,000 if self-managed
Investment Manager - Self Managed	No need to be properly licensed – Duties can be performed by the Board of Directors	Needs to be Properly Licensed
Investment Manager - External Manager	Needs to be properly licensed, if dealing with investments in financial instruments.	Needs to be Properly Licensed
Directors Requirements	Fit and Proper	Fit and Proper
Fund Administrator	No need to be properly licensed. Preferable to use licensed ASPs under CySEC	No need to be properly licensed. Preferable to use licensed ASPs under CySEC
Depository Requirements	Depository can be located in Cyprus, EU or third party country (subject to fulfilment of certain conditions) If total assets are less than Eur5mln, or the fund has up to 5 investors, or its assets are not subject to custody, No requirement to appoint a depository	Depository can be located in Cyprus, EU or third party country (subject to fulfilment of certain conditions)

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