

Cyprus Alternative Investment Funds (AIFs)

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INTRODUCTION

The purpose of this report is to provide an overview of the legal, regulatory and operational framework relevant for Cyprus Alternative Investment Funds (AIFs).

AIFs are defined as collective investment undertakings (and any investment compartments thereof), which collectively:

1. Raise capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of investors; and
2. Do not require authorisation as a UCITS.

LEGAL FRAMEWORK

AIFs are governed by the Alternative Investment Funds Law of 2014 (the "**AIF Law**") and are authorised and regulated by the Cyprus Securities and Exchange Commission ("**CySEC**").

The Cyprus House of Representatives voted on the enactment of the AIF Law in July 2014, in an effort to modernise the local legislative framework on investment fund products in line with EU legislative developments and increase Cyprus competitiveness in the investment funds industry. The AIF Law came into force a few days later following its publication in the Official Gazette, replacing and repealing the International Collective Investment Schemes Law of 1999 (the "**ICIS Law**").

The AIF Law applies to AIFs established in Cyprus and regulates the role and responsibilities of persons engaged in the activity of AIFs such as custodians, directors and asset managers.

It is noted that UCITS, holding companies, social security schemes falling within the scope of the Social Insurance Law of 2010, entities falling within the scope of the Insurance Business Law of 2002, employee participation schemes, entities for occupational retirement, securitisation special purpose entities and investment companies approved by CySEC, are excluded from the application of the AIF Law.

STRUCTURING OPTIONS

The following new structuring options are now possible under the provisions of the AIF Law:

- **Umbrella structures:** AIFs with multiple segregated investment compartments with their own investment policy and assets. Each compartment is subject to the provisions of the AIF Law as a separate AIF. Investors' rights derive from the assets of the relevant investment compartment in which they are invested in, thus ensuring the ring fencing / segregation of the assets and liabilities of each such pool. Subject to the fulfilment of certain collective conditions, it is possible for an investment compartment to invest in another investment compartment of the same AIF.
- **Common fund structures:** AIFs structured as pools of assets in which investors participate on the basis of a single contractual document known as the "Common Fund Rules" (which they deem to accept by virtue of their subscription into the units of the fund). Investors are co-owners of each of the assets comprising the portfolio of the AIF and are liable only to the amount of their contribution.
- **Funds with various investment policies:** The establishment and operation of Cyprus AIFs with a number of different investment policies (investing for example in assets other than financial instruments such as real estate or works of art), is now further aided and/or facilitated by the introduction of provisions permitting the function of the depositary to be undertaken by legal entities other than just credit/banking institutions, under certain conditions. The depositary's role is to safe keep the AIF's assets. By way of derogation, an AIF may not appoint a depositary at all, in certain circumstances.
- **Public offerings and listings:** The AIF's shares/units may now be the subject of a public offering and may be admitted for listing in a stock market, options that allow the establishment and structuring of AIFs looking to enhance their marketability, transparency and investor base through such means.

AIF CATEGORIES

AIFs are categorised as follows:

- (A) AIF with unlimited number of investors (which may be marketed to either (i) retail or (ii) well-informed and/or professional investors) (hereafter referred to as "**AIF-UNP**");
- (B) AIF with limited number of investors (being 75) (which may be marketed to well-informed and/or professional investors) (hereafter referred to as "**AIF-LNP**").

Any investor that is considered and/or may be treated on request as a "professional client" within the meaning of the Markets in Financial Instruments Directive 2004/30/EC (MiFID) is considered to be a **professional investor**. In general, "professional clients" are defined as clients who possess the experience, knowledge and expertise to make their own investment decisions and who are able to properly assess the risks that they incur in their investment decisions regarding the services products and transactions for which they are suited.

A **well-informed investor** on the other hand is an investor who is not a professional investor and fulfils the following conditions:

- (a) Confirms in writing he is well-informed and aware of the risks associated with investing in the said AIF; and
- (b) Either (i) invests at least EUR 125,000 in the AIF or (ii) he is assessed as a well-informed investor with the necessary experience and knowledge to evaluate the appropriateness of his/her investment in the AIF in question by a credit institution falling within the scope of the Banking Laws of 1997, OR by a UCITS management company OR by an Investment Firm.

A **retail investor** is any other investor who is neither a professional nor a well-informed investor.

The most common category is the AIF-LNP, which represents the most lightly regulated investment product currently available in Cyprus. It is noted that with the exception of Parts VI, VII and VIII, as well as of certain other sections of the AIF Law applicable to this category *mutatis mutandis*, the AIF Law *does not* apply to AIF-LNP. As a result, an AIF-LNP is more lightly regulated in the sense that it is:

- Not subject to investment restrictions
- Not subject to minimum capital requirements
- Not subject to the marketing rules as applicable to an AIF-UNP (but subject to different rules as specified by CySEC Directive(s))
- Not subject to certain investor disclosure, marketing communication rules and other reporting obligations as applicable to an AIF-UNP (but subject to different rules as specified by CySEC Directive(s))
- Subject to less stringent requirements as to the contents of their prospectus

AIF-UNP

Legal form

In accordance with the AIF Law, an AIF-UNP may be set up in one of the following legal forms:

- (a) as a Common Fund (“**CF**”);
- (b) as an Investment Company in the legal form of a limited liability company with shares (with fixed or variable capital) (“**ICFC**” or “**ICVC**”);
- (c) as a Limited

It is prohibited to an AIF that falls within the scope of the AIF Law, to convert in any way, to an entity that does not fall within the scope of the AIF Law.

It is possible however, for an AIF established with a certain legal form, for example an investment company, to convert either into a common fund or into a limited liability partnership, provided the conditions specified in the AIF Law are fulfilled.

Open-ended vs Closed-ended

An AIF can be established either as an:

- (A) Open-ended fund, where investors have the right to redeem/repurchase their units upon request at (i) any time or, (ii) at regular intervals not exceeding one year;

Or, as a:

- (B) Closed-ended fund, where investors have the right to redeem/ repurchase their units upon request at (i) regular intervals exceeding one year but less than five years (with the exception of venture capital funds constituted in accordance with EU Regulation 345/2013 in which the initial period of redemptions may be extended up to 10 years from their incorporation date) or, (ii) at a specific point of time which is defined in the fund rules or the instruments of incorporation of the AIF.

Management of AIF-UNP

The AIF-UNP may be either self-managed (but only if established as an Investment Company and one of the conditions specified in section 6(2)(1) of the AIF Law applies) or externally managed by a portfolio manager who:

- (a) Is an Alternative Investment Fund Manager (“**AIFM**”) authorised in accordance with the Alternative Investment Fund Managers Law of 2013 (“**AIFM Law**”); or
- (b) Where (a) does not apply, may operate as either an AIFM authorised in accordance with the AIFM Law or as a UCITS management company authorised in accordance with the UCITS Law or as an Investment Firm authorised in accordance with the Investment Services and Activities and Regulated Markets Law of 2007, as amended.

Each self-managed AIF and each external manager of an AIF where they are not authorised AIFMs, are subject to registration in accordance with the provisions of section 4(3) of the AIFM Law, in the special register of sub-threshold AIFMs maintained by CySEC.

Minimum capital

An AIF-UNP is subject to a minimum capital requirement/minimum initial assets (for common fund) of at least EUR 125,000 (or EUR 300,000 where it is formed as a self-managed investment company).

AIF-LNP

Legal form

In accordance with the AIF Law, an AIF-LNP may be set up in one of the following legal forms:

- (a) as an Investment Company in the legal form of a limited liability company with shares (with fixed or variable capital) ("**ICFC**" or "**ICVC**"); or
- (b) as a Limited Liability Partnership ("**LLP**").

The establishment of an AIF-LNP is allowed provided that it shall not fall within the scope of the AIFM Law (as defined above), nor shall it be managed by an AIFM, and additionally if its incorporation documents (or partnership agreement, as the case may be):

- (a) Expressly state that the fund is only addressed to professional and/or well-informed investors;
- (b) Limit the number of investors (including co-holders) to 75 (for the calculation of which investors in all investment compartments are taken into consideration);
- (c) Do not allow the issuance of bearer shares.

Management of AIF-LNP

An AIF-LNP may be either self-managed or externally managed.

An AIF-LNP set up as an LLP must always appoint an external manager which must undertake the duties of the General Partner.

The duties of the external manager of an AIF-LNP may be exercised by:

- (i) a UCITS Management Company; or
- (ii) a Cyprus Investment Firm ("**CIF**"); or
- (iii) a company established in a third country, authorised to provide portfolio

management services and be subject to prudential regulation regarding the provision of that service (where the portfolio of the AIF-LNP includes financial instruments); or

- (iv) any company, whose incorporation documents state that it has the sole purpose of the provision of the portfolio management service to the specific AIF-LNP (only where the portfolio of the AIF-LNP does not include any financial instruments. The appropriateness of the external manager in such cases is assessed by CySEC on the basis of information submitted with the application for establishing the AIF-LNP).

Further information and costs for the establishment of a CIF and/or a UCITS Management Company in Cyprus can be provided upon request.

DEPOSITARY FUNCTION

The assets of AIFs shall be entrusted for safe-keeping to a depositary, unless an exemption applies. The depositary must:

- a) have its registered office in Cyprus, or in any other Member State of the European Union or in a third country, provided CySEC has signed a Memorandum of Understanding and Exchange of Information with the competent authorities of such third country; and
- b) be either a credit institution, or investment firm or other institution which is subject to prudential regulation and ongoing supervision and which falls within the categories of institutions which have been defined by their home state as eligible to perform depositary functions.

It is noted that for the safe keeping of assets which are **not** financial instruments within the meaning of the Investment Services and Activities and Regulated Markets Law of 2007 *as amended*, the depositary's role may be undertaken by **any entity** which performs depositary functions within the context of its professional or business activities for the performance of which is subject to professional registration recognised by legal, regulatory or administrative provisions or by rules of professional conduct and which can provide sufficient financial and professional guarantees that it will perform its depositary duties sufficiently and meet the commitments associated with such duties.

By way of derogation of the provisions of the AIF Law requiring the appointment of a depositary, a depositary may not be appointed under certain circumstances (e.g. where the AIF's total assets are not eligible for custody).

Further advice on the provisions related to the depositary function of AIFs can be provided upon request.

AUTHORISATION PROCEDURE, TIMING AND OTHER REQUIREMENTS

The authorisation procedure, the content of the application and other requirements vary, depending on whether the application relates to an AIF-UNP or an AIF-LNP.

Specific directives have been issued by CySEC and are in force on the authorisation procedure and requirements for AIFs as well as the terms and conditions of their operation.

Further details on the application process and content, forms, supplementary documents and other requirements are provided upon instruction.

CySEC is required to inform the external manager of the AIF/self-managed AIF itself as the applicant (as applicable) within 3 months of the submission of a complete application file whether or not authorisation has been granted.

TAX

AIFs formed as investment companies are subject to tax like any other Cyprus resident company. A company is considered to be tax resident in Cyprus if its management and control is exercised in Cyprus. Cyprus resident companies are subject to a flat corporate income tax rate of 12,5% on their taxable profit. When combined with the various favourable tax provisions and related factors, Cyprus becomes one of the most attractive and competitive tax jurisdictions worldwide.

The main favourable provisions and factors are:

- No tax on gain from disposal of shares and other qualifying titles
- Dividend income is tax exempt subject to very easy to meet conditions
- No CFC rules
- No thin capitalisation rules
- Unilateral tax credit relief mechanism
- No withholding taxes on any payments made from Cyprus to non-Cyprus resident persons (such payments include dividends, interest and royalties)
- Access to benefits of the Cyprus double tax treaty network and relevant EU Directives (helping to eliminate or significantly reduce foreign withholding tax on payments made to a Cyprus resident company)

WHY CYPRUS?

Cyprus is an ideal location for fund domicile and in fact various factors constitute Cyprus to be a strong contender amongst other traditional fund jurisdictions.

- EU Member State and member of the Eurozone
- Adheres to the relevant wide EU regulation
- On the white list of the OECD
- FAFT approved country, which is relevant for investors and managers alike
- Favourable tax regime which is very efficient for funds and fund investors
- EU and OECD compliant tax system
- Attractive double tax treaty network
- Well-regulated jurisdiction
- Speedy time frame for set up and implementation of AIFs
- Common law legal system allowing AIFs to operate in a similar legal environment to that of other common law legal systems
- Lower cost propositions, without compromising quality and timeliness of service
- Highly skilled professional services
- Strategic geographical position not far from the heart of Europe where investors and key service providers reside and close to Middle East and Asia where significant investor pools are located

AIFs enjoy the reputation and status of regulated funds but with sufficient flexibility and reasonable regulatory supervision. Their key benefits can therefore be summarised as follows:

- Flexibility
- Transparency
- Investor protection
- Reasonable regulatory requirements
- Tax efficiency
- Low set-up and operational costs

NOTES

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve Management Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.