

# THE EMERGENCE OF CYPRUS FUNDS



Cyprus, an EU member country, has set its sights on becoming a fund and asset management centre of excellence, and with the requisite legislation and increasing inflows of foreign investments, the country is well on its way. Developing the fund investment sector and achieving this goal is a long journey for the industry, but the vision is set to become a reality.

Cyprus combines tax efficient features of a modern financial centre with the appropriate infrastructure for the fund's industry. It offers the full spectrum of legislative framework to all fund products (UCITS and non UCITS) and provides fund managers to structure as Alternative Investment Fund Managers (AIFM) in line with the relevant EU Directive or a MiFID compliant Investment Firm, both EU passported. At the end of 2018, the Cyprus funds industry boasted a total of approximately €6.3bn assets under management displaying significant growth over the past few years. Approximately 48 percent of these relate to private equity Alternative Investment Funds (AIFs) and 16 percent to real estate with the remaining 36 percent spread evenly in other AIFs.

## *Why Cyprus*

- EU member country compliant with EU laws and regulations
- Eurozone member
- Cost effective setting up and on-going operational services
- Favourable EU and OECD compliant tax regime
- Extensive network of double tax treaties allowing tax efficient structuring of investments
- Strategic position between Europe, Middle East and Africa
- Business centre with quality professionals and sophisticated infrastructure
- Extensive range of high quality legal and accounting services
- Efficient regulation, fully harmonized with EU Directives
- Collective investments can be listed on the Cyprus Stock Exchange and other recognized EU stock exchanges
- Cyprus based funds and asset managers benefit from low tax rates
- Incentives and tax benefits for high earning managers and high net worth individuals



## Alternative Investment Fund (AIF)

The enactment of the Alternative Investment Funds (AIF) Law in July 2014 aligned the Cyprus legal and regulatory framework with EU Directives on asset management, with the aim to enhance transparency and investor protection. Following continuous efforts to modernize the fund framework, Cyprus introduced a new law offering more investment structuring possibilities and upgraded rules for the authorization, ongoing operations, transparency and supervision of Cyprus AIFs, as well as the regulation on the role and responsibilities of their directors, depositaries and external managers. AIFs that are established under Cyprus fund legislation can be sold on a private placement basis or marketed to professional investors across the EU under the Alternative Investment Fund Managers Directive (AIFMD) passport.

With the enactment of the Alternative Investment Funds Law 124(I)/2018 or the "AIF Law 2018" in July 2018, Cyprus has modernized and significantly enhanced the offering of AIFs, or "non-UCITS", which can be registered and domiciled in Cyprus. The AIF Law 2018, which replaced the AIF Law of 2014, has introduced the possibility to set up Registered AIFs (RAIFs). It also fine tuned the other types of AIFs

(ie AIFs with Unlimited and AIFs with Limited Number of Persons). In brief, the AIF Law 2018 allows for the creation of AIFs with Unlimited Number of Persons (AIF-UNP), AIFs with Limited Number of Persons (AIF-LNP) and Registered AIFs (RAIF).

The main provisions of the AIF Law 2018 can be summarized as follows:

- ability to create AIFs with unlimited investment compartments (ie umbrella funds), each with a separate investment strategy and asset pools
- the units of AIFs can be listed on stock exchanges
- there are various options available in relation to the appointment of an investment manager and depositary, providing maximum flexibility
- investor units are freely transferable
- the AIF-LNP is limited to a maximum of 50 investors
- possibility to create RAIFs, which do not require licensing, consequently, time to market is significantly shortened

## Key Benefits of Cyprus AIF

- Cost efficient and simple to set up, manage and operate
- Modern regulatory framework in line with EU Directives
- Increased flexibility as a number of asset classes can be included in an AIF investment strategy
- Significant tax incentives offered by its attractive tax framework
- Full transparency through annual reports to the Cyprus Securities and Exchange Commission (CySEC) and investors, which include audited financial statements, borrowing information, portfolio information and Net Asset Value calculation
- Supervised by a competent and accessible regulatory authority



## Registered Alternative Investment Fund (RAIF)

RAIFs are a new and innovative fund vehicle launched in July 2018. They are geared to professional and well informed investors only and offer a quick and cost efficient fund launch of only one month from the date of filling a notification pack to the regulator, CySEC, which will include the AIF in the list of Registered AIFs.

The Cyprus Registered AIF is able to market to investors across the EU and will be managed by a full scope Cyprus or EU Alternative Investment Fund Manager (AIFM). Although the RAIF is not “authorized”, it is indirectly subject to regulatory oversight through its AIFM. In addition to the full scope AIFM, a sub-threshold AIFM which is subject to prudential regulation, a MiFID Investment Firm in Cyprus or any EU member country may also manage a RAIF, provided it is a closed ended limited partnership and invests more than 70 percent in illiquid assets.

The new vehicle also provides structuring flexibility as it may be organized in any legal form available under Cyprus law (investment company with fixed or variable capital, limited partnership or common fund), it can be open or closed ended and it can follow any strategy and invest in any type of assets, with the exception that it cannot be established as a money market, loan origination fund and fund of funds.

The RAIF regime, whereby the fund does not require authorization from CySEC or subsequent monitoring, while being stamped as an AIF by virtue of the law,

offers new opportunities for a quick and cost effective fund launch. This new type of fund needs to fulfil the following conditions: the fund manager must qualify as a full scope Cyprus or EU Alternative Investment Fund Manager (AIFM), and the fund must be targeted to professional investors and/or well informed investors. Third country AIFMs will be able to submit a request for registration of an AIF, once the country where these have been established has granted passporting rights pursuant to the AIFMD. CySEC will rely on the regulated status of the AIFM, to ensure compliance and indirect supervision of applicable laws and appropriate standards by the fund. Another key benefit of this fund is the use of the EU marketing passport via its AIFM.

### *Key features of Cyprus RAIF*

- No licensing required
- No minimum capital requirements
- No investment restrictions
- Multiple compartments possible
- Can operate as open or closed ended
- Units of RAIFs may be listed
- Requirement to appoint local depository
- Can be converted into an AIF



	<b>AIF with Limited Number of Persons</b>	<b>AIF with Unlimited Number of Persons</b>	<b>Registered AIF (RAIF)</b>
<b>Regulator</b>	CySEC	CySEC	CySEC - however, no licensing required
<b>Limitation on Number of Investors</b>	50 (with look through provisions)	Not applicable	Not applicable
<b>Available Structures</b>	Variable Capital Investment Company (VCIC), Fixed Capital Investment Company (FCIC), Limited Partnership (LP)	Variable Capital Investment Company (VCIC) Fixed Capital Investment Company (FCIC), Common Fund (CF), Limited Partnership (LP)	Variable Capital Investment Company (VCIC), Fixed Capital Investment Company (FCIC), Common Fund (CF). Limited Partnership (LP)
<b>Eligible Investors</b>	Professional and/or well-informed investors	Professional and/or well-informed investors or Retail investors	Professional and/or well-informed investors
<b>Minimum AuM Within 12 months</b>	€ 250.000	€ 500.000	€ 500.000
<b>Umbrella Funds</b>	Possible for all structures	Possible for all structures	Possible for all structures
<b>Minimum Share Capital</b>	Self managed funds only €50.000	Self managed funds only €125.000	Externally managed RAIF does not require minimum share capital
<b>External Manager Licensing Requirement</b>	No, can be self managed	No, can be self managed	Yes, always externally managed
<b>Director Requirements</b>	Fit and proper	Fit and proper	Fit and proper
<b>Depositary Requirements</b>	Based in Cyprus, EU or third country that has cooperation agreement with Cyprus, exemption in specific circumstances	Based in Cyprus, EU or third country that has cooperation agreement with Cyprus. When managed by AIFM shall be located in Cyprus	Always based in Cyprus, except for Limited Partnerships managed by a MiFID entity
<b>Reporting</b>	Audited annual report and half-yearly unaudited report to be submitted to CySEC and made available to unitholders	Audited annual report and half yearly unaudited report to be submitted to CySEC and made available to unitholders	Audited annual report and half yearly unaudited report to be submitted to CySEC and made available to unitholders



## Alternative Investment Fund Manager (AIFM)

Cyprus can offer specific advantages to non EU fund managers wishing to raise capital in Europe, as well as to develop a presence in the European market to benefit from the right to easily distribute their funds to investors in all EU countries.

One of the key issues monitored and assessed by many non EU fund managers is whether it makes sense to establish a European management company. There are related reasons for such considerations. First, the difficulties associated with utilizing the private placement regimes, and second, the recognition that even if or when the AIFMD marketing passport is extended to non European fund managers, there is likely to be a period of uncertainty of application and approach – and in any case this demands full compliance with AIFMD requirements. As such, establishing a European management company is an attractive solution.

Another solution is the use of management company platforms, which are currently the most popular means of gaining entrance into Europe. This trend is very wide with the number of platform providers growing in Cyprus and across the rest of Europe.

The platform solution provides investment managers with a fully compliant UCITS/AIFM entity and, consequently, a European passport to market their funds within the EU, without the need to establish their own fund and/or management company substance in an EU member country. Managers benefit from the efficiencies provided by the pre-existing structure of the platform in terms of sharing costs, existing middle and back office operating models, tried and tested systems and speed to market. It should be noted that third party platforms are generally umbrella fund structures, which allow investment managers or promoters to join the platform within which they can manage their own separate sub-fund (compartment) in accordance with their own investment strategies.

## *AIFM in Cyprus*

### Cyprus AIFM marketing an EU AIF in the EU

- EU regulator to regulator notification: The cross border marketing by the Cyprus AIFM of an EU AIF is subject only to a notification procedure, under which relevant information is provided to the host member country by the AIFM's regulator (the notification procedure is similar to that for UCITS operators under UCITS IV)

### Cyprus AIFM marketing a non-EU AIF in the EU

- Through Private Placement: a Cyprus AIFM may market a non-EU AIF to professional investors in the EU under the national private placement regimes (and those EU AIFs which are feeders of a non EU AIF master fund) provided that:
  - o It is authorised under, and complies in full with the AIFM Law except for the depositary provisions (however, an entity performing equivalent tasks has to be appointed subject to certain conditions)
  - o The third country where the non EU AIF is established is not listed by the Financial Action Task Force (FATF) as a Non-Cooperative Country and Territory (NCCT)
  - o Appropriate cooperation arrangements are in place between CySEC and the regulator in the country of establishment of the non-EU AIF



## EU Passport for Funds

The “Single EU Passport” has opened up good prospects for Cyprus to be used as a base for setting up funds, or for fund management companies seeking to take advantage of the country’s beneficial framework to manage and/or market funds across Europe from Cyprus.

The UCITS and AIFMD ‘management’ and ‘marketing’ passports allow fund managers to manage and/or sell funds across the EU, without the burden of establishing extensive administrative functions for every jurisdiction. They also allow them to create economies of scale where existing fund management companies are consolidated.

Similarly, the Alternative Investment Funds Directive (AIFMD) has introduced a ‘passport’ for the distribution of units of AIFs to professional investors in the EU. Cyprus AIFMs, once authorized by CySEC, can market their EU AIFs to professional investors in all member countries, using the simplified regulator to regulator notification mechanism as opposed to having to seek permission from each member country and comply with different national laws – the so called National Private Placement Regimes (NPPRs). The AIFMD provides a transposition schedule applicable to non EU AIFMs and non EU AIFs wishing to raise capital in the EU.

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## Popular Funds in Cyprus

### *Private Label Funds*

This is geared for wealthy individuals and family offices as it allows the grouping of assets under an umbrella structure with no cross liability between the sub-funds while the investment objectives and restrictions are being determined by the fund promoter. Additionally, such structure ensures ongoing tax compliance and provides for a dedicated method of valuation of all the family assets at regular intervals whereas money may be withdrawn through flexible redemption procedures.

### *Shipping Funds*

Cyprus being among the largest ship management centres globally and ranking amongst the largest merchant fleet worldwide, is a place for alternative finance for ships using capital markets. The tonnage tax system, currently in force in Cyprus, enhances the already very favourable taxation framework of AIFs. The assets will be registered predominantly under the Cyprus flag, and taxed under the tonnage tax system. Hence, the fund will be totally exempt from taxation on its operating profits and any capital gains realized.

### *EuVECA Funds*

EuVECA Funds aim to make it easier for venture capital managers to raise funds across Europe by creating a pan-European marketing passport for managers registered under the EuVECA designation. The European Commission considers that venture capital has a key part to play in supporting growth within the EU and the EuVECA Regulation sought to improve access to funding for unlisted small and medium sized enterprises (SMEs) and other start-up companies and also to increase non bank finance for the EU economy.

### *Other Funds*

During the last few years there has been an increase in registration in real estate funds, energy funds while there is wide interest for structuring and managing funds in education, ICT sector, start ups and funds investing in the banking sector and financial services.



## Taxation

Fund Taxation Breaks	Investor Taxation Breaks
<ul style="list-style-type: none"> <li>• Gains from trading in securities are tax exempt</li> <li>• Notional Interest Deduction (NID) for new equity may reduce taxable base for interest received by up to 80% (for company type funds) reducing the effective tax on interest to 2,5%</li> <li>• Excluded from tax are dividends received, capital gains arising from sale of property abroad, capital gains from sale of shares of foreign property companies</li> <li>• No subscription tax on the net assets of the fund</li> <li>• Fund management services provided to alternative funds are not subject to VAT</li> <li>• Each compartment of an AIF, although legally is not treated as a separate entity, for tax purposes it is treated as a separate person (ie separate taxpayer)</li> </ul>	<p><b>Foreign investors</b></p> <ul style="list-style-type: none"> <li>• No withholding tax on dividends</li> <li>• No taxation on redemption of units</li> </ul> <p><b>Resident investors - Non Domiciled</b></p> <ul style="list-style-type: none"> <li>• Option of 8% flat rate taxation on performance based variable remuneration for certain employees</li> <li>• Exemption from withholding tax on dividends of 17%</li> <li>• No taxation on redemption of units</li> <li>• No withholding tax if investor is a company</li> </ul>

## Post-Brexit Opportunities

Cyprus is positioning itself to be a strategic partner for Britain in the wake of Brexit. The countries share a long history and excellent bilateral and business relations, with the added benefit of Cyprus' legal system being based on English Common Law. The recently reformed Cyprus fund sector could provide significant support for British based investment funds and managers when Britain leaves the EU, and in the event of the EU revoking Britain's passporting rights. A member of both the EU and the Eurozone, Cyprus can offer British based firms the flexibility to maintain their current operations, without having to relocate staff or operations post-Brexit to a jurisdiction within the EU. By contracting a company in Cyprus, UK investment managers would have a fully-compliant UCITS/AIFM platform with a European passport to market their funds in the EU. The Cypriot company would delegate the portfolio management back to the UK manager, but be responsible for risk management and compliance. The British manager would benefit from the Cyprus platform's pre-existing structure in terms of sharing costs, existing middle and back office operating models, tried and tested systems, and speed to market



# Oneworld Group

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For more information feel free to contact our chairman George Philippides ([gphilippides@oneworldweb.net](mailto:gphilippides@oneworldweb.net)).

Alternatively, you can contact Savvas Shiatis ([sshiatis@oneworldweb.net](mailto:sshiatis@oneworldweb.net)) m +357 99597339 at Oneworld Ltd, Kikis Lagos ([klagos@onepluscapital.net](mailto:klagos@onepluscapital.net)) m +357 99693210 at One Plus Capital Ltd.

**Nicosia**  
(Head Office)  
75 Prodromou Avenue  
Oneworld House  
PO Box 25207  
Nicosia 1307, Cyprus  
T +357 22496000  
F +357 22493000  
[reception@oneworldweb.net](mailto:reception@oneworldweb.net)

**Limassol**  
79 Spyros Kyprianou Avenue  
Protopapas House, 2nd floor  
PO Box 51718  
Limassol 3076, Cyprus  
T +357 25337745  
F +357 25337765  
[limassol@oneworldweb.net](mailto:limassol@oneworldweb.net)

[www.oneworldweb.net](http://www.oneworldweb.net)  
[www.onepluscapital.net](http://www.onepluscapital.net)