

## **Introduction**

The Alternative Investment Fund Managers Directive (AIFMD 2011/61/EU), entered into force on 21st July 2011, with the aim of providing for an internal market for Alternative Investment Fund Managers (AIFMs) and a harmonised regulatory and supervisory framework for the activities within the EU of all AIFMs.

The AIFMD introduces a “passport” for the distribution of units of AIFs to professional investors in the EU. Cyprus AIFMs once authorised by CySEC can market the EU AIFs they manage to professional investors in all other Member States using the simplified regulator-to-regulator notification mechanism as opposed to having to seek permission from each Member State and comply with different national laws.

## **Legal Framework**

On 5th July 2013 Law 56(I)/2013 (AIFM Law) came into effect transposing the AIFMD into Cyprus legislation. The AIFM Law closely follows the context of the AIFMD and sets out the legal framework that will apply to an AIFM with regard to authorisation, capital requirements and operating conditions, governance and risk management, delegation rules, remuneration, reporting, depositary regime and marketing conditions.

The competent authority for regulating and supervising AIFMs under the AIFM Law is the Cyprus Securities and Exchange Commission (CySEC).

## **Application of AIFM Law**

The AIFM Law shall apply in particular to the following activities:

- A Cyprus AIFM managing Cyprus AIFs or AIFs of another Member State or third country;
- An EU or third country AIFM managing Cyprus AIFs;
- A Cyprus AIFM marketing units or shares of AIFs they manage in other Member States or third countries;
- An EU or third country AIFM marketing units or shares of AIFs they manage in Cyprus.

## **The Product Test – identify the AIF**

The AIFM Law defines an AIF as 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 its investors; and
- is not an Undertaking for Collective Investment in Transferable Securities (UCITS).

The following are specifically excluded: holding companies, joint ventures, securitisation special purpose entities, pension funds, employee participation schemes or employee savings schemes, and family office vehicles.

## **The Manager Test – determine the AIFM**

An investment fund manager offering services to AIFs shall be authorised as a Cyprus AIFM if:

- its head and registered offices are located in Cyprus;
- it is a legal person whose regular business is managing one or more AIFs irrespective of their legal form and whether they are established in the EU or not, open-ended or closed-ended, listed or non-listed, etc.; and
- the aggregate of the assets under management (AuM) of all AIFs managed by the investment fund manager exceeds:
  - (i) EUR 100 million (including leverage), or
  - (ii) EUR 500 million (for unleveraged funds but with a lockup period of 5 years).

The AIFM can be the external manager of the AIF, or even the AIF itself where its legal form permits it and its governing body chooses not to appoint an external AIFM (i.e. internally managed AIF).

## **The Regime Test – registration vs the possibility to opt in**

Investment fund managers whose aggregate AuM do not exceed the thresholds are exempt from authorisation, but are however subject to registration and reporting requirements in their home Member State. Meanwhile, such managers established in Cyprus may elect to opt-in to authorisation under the AIFM Law.

Grand-fathering provisions apply under certain circumstances for closed-ended AIFs, being:

- (i) Closed-ended AIFs which are fully invested as of 22nd July 2013;
- (ii) Closed-ended AIFs that are fully subscribed as of 21st July 2011 and whose term expires by 22nd July 2016 are only subject to reporting requirements.

## **AIFM Functions**

A Cyprus AIFM may be authorised to perform the following functions:

### Core Functions

The AIFM shall engage, at least, in the following investment management functions when managing an AIF:

- Portfolio management;

- Risk management

#### Additional Functions

The AIFM may additionally be authorised to perform any of the following functions in the course of the collective management of an AIF:

- Administration:
  - legal and fund management accounting services;
  - customer inquiries;
  - valuation and pricing, including tax returns;
  - regulatory compliance monitoring;
  - maintenance of unit/shareholder register;
  - distribution of income;
  - issues and redemptions of unit/shares in the AIF;
  - contract settlements, including certificate dispatch;
  - record keeping;
  - Marketing services; and/or
  - Activities related to the assets of the AIF, namely services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the AIF and the companies and other assets in which it has invested.

#### Additional Investment Services

Subject to compliance with the relevant MiFID rules without separate MiFID authorisation being required, **an external AIFM** may also be authorised to provide the following MiFID services:

- (individual) management of portfolios of investments including those owned by pension funds and institutions for occupational retirement, in accordance with mandates given by investors on a discretionary, client-by client basis;
- and (once individual portfolio management is provided, then it may further be authorised to provide):
  - investment advice;
  - safe-keeping and administration in relation to shares or units of collective investment undertakings;
  - reception and transmission of orders in relation to financial instruments.

#### Dual License

**An external AIFM** may in addition obtain a license to act as a UCITS management company subject to authorisation under the UCITS IV Directive (2009/65/EC).

## Organisational Structure and Requirements

### Internal Control Structure

The AIFM Law requires that a Cyprus AIFM establish an internal control structure with hierarchically and functionally independent Compliance, Risk Management and Internal Audit functions.

#### Board of Directors

- Ensure compliance with AIFM Law
- Review effectiveness of policies, arrangements, procedures

#### Senior Management

- Ensure compliance with AIFM Law
- Implementation of general investment policy
- Oversee approval of investment strategies
- Establish and review policies, arrangements and procedures
- Establish and apply remuneration policy
- Supervision of delegated functions

#### Compliance

- Monitor adequacy and effectiveness of policies, arrangements and procedures in place
- Ensure compliance with applicable laws
- Provision of reports to Senior Management and BoD

#### Risk Management

- Implementation of Risk Management policies and procedures
- Ensure risk profile is consistent with risk limits and monitor compliance with risk limits
- Provision of reports to Senior Management and BoD

#### Internal Audit

- Establish, implement and maintain audit plan to examine and evaluate internal control
- Issue recommendations and verify implementation based on results of work
- Provision of reports to Senior Management and BoD

### General Principles

The AIFM Law sets out the following general conduct of business principles:

- act honestly, with due skill, care and diligence and fairly in the conduct of its activities; and
- act in the best interests of the AIFs or the investors of the AIFs they manage and the integrity of the market; and

- have and employ effectively the resources and procedures that are necessary for the proper performance of its business activities; and
- take all reasonable steps to avoid, manage and monitor conflicts of interest and, where applicable, disclose those conflicts of interest in order to prevent them from adversely affecting the interests of the AIFs and their investors and to ensure that the AIFs they manage are fairly treated; and
- comply with all regulatory requirements applicable to the conduct of its business activities; and
- treat all AIF investors fairly with no preferential treatment to investors unless disclosed in the AIF's constitutional documentation.

### **Procedures, Arrangements and Mechanisms Applied by the Cyprus AIFM**

The AIFM shall use, at all times, adequate and appropriate human and technical resources that are necessary for the proper management of AIFs proportional to the size, nature, scale and complexity of the business and activities undertaken in the course of that business.

An AIFM is required to establish, implement and maintain the following:

<p>General Requirements</p>	<ul style="list-style-type: none"> <li>• decision-making procedures and an organisational structure which specifies reporting lines and allocates functions and responsibilities in a documented manner;</li> <li>• adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels;</li> <li>• effective internal reporting and communication of information at all relevant levels and effective information flows with any third party involved;</li> <li>• systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information;</li> <li>• an adequate business continuity policy</li> </ul>
<p>Risk Management</p>	<ul style="list-style-type: none"> <li>• adequate risk management systems in order to identify, measure, manage and monitor (including appropriate stress testing procedures) all risks relevant to each AIF investment strategy and to which each AIF is or may be exposed;</li> <li>• appropriate, documented and regularly updated due diligence process in compliance with the objectives, the investment strategy and, where applicable, the risk limits of each AIF</li> </ul>
<p>Liquidity Management</p>	<ul style="list-style-type: none"> <li>• liquidity management systems to monitor the liquidity risk of</li> </ul>

	each AIF
Conflicts of Interest	<ul style="list-style-type: none"> <li>• effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor conflicts of interest (eg. rules for employees personal transactions)</li> </ul>
Remuneration	<ul style="list-style-type: none"> <li>• remuneration policies and practices that are consistent with and promote sound and effective risk management</li> </ul>
Electronic Data Processing	<ul style="list-style-type: none"> <li>• appropriate and sufficient arrangements for suitable electronic systems</li> </ul>
Accounting Procedures	<ul style="list-style-type: none"> <li>• sound accounting policies and procedures and valuation rules</li> </ul>

The AIFM shall monitor and, on a regular basis, evaluate the adequacy and effectiveness of their systems, policies, procedures and arrangements and take appropriate measures to address any deficiencies.

## **Delegation**

The AIFM may be able to delegate the carrying out of some of its functions to third parties subject to certain limitations and requirements which shall vary depending on the type of function being delegated and provided the delegate has an appropriate organisational structure to support the performance of the delegated tasks. Any delegation by an AIFM of any of its functions must be notified to CySEC before the delegation arrangement becomes effective. The entire delegation structure must be justified on objective reasons such as the optimisation of business functions and processes, cost saving, the expertise of the delegate in certain aspects, and access to global trading facilities.

## **Organisational Requirements at Level of the AIF**

### **Depositary**

An AIFM shall, for each AIF it manages, appoint a single depositary who shall be responsible for performing the following services:

- cash flow monitoring ensuring that the AIF's cash flows are booked at eligible entities and are properly monitored;
- safekeeping the AIF's assets comprising:
  - holding in custody all financial instruments, which can be registered in the depositary's books and those that can be physically delivered; and
  - for other assets, verifying the ownership of the AIF and maintaining an up-to-date record of those assets;

- oversight functions, ensuring compliance with the AIF's constitutional documentation, valuation procedures and with applicable law and regulation.

The depositary shall be:

- a credit institution having its registered office in the European Union;
- an investment firm authorised under MiFID for providing the ancillary service of safekeeping and administration of financial instruments for the account of clients; or
- another category of institution subject to prudential regulation and ongoing supervision.

The depositary shall be established:

- for EU AIFs, in the home Member State of the AIF;
- for non-EU AIFs, in the third country where the AIF is established or in the home Member State of the AIFM or in the Member State of Reference of the AIFM managing the AIF.

The AIFM Law provides the flexibility that for an AIF authorised in Cyprus, the depositary may be a credit institution located in any other EU Member State until 22nd July 2017.

### **Independent Valuer**

An AIFM shall ensure that for each AIF it manages it shall have appropriate and consistent procedures in place to ensure that a proper and independent valuation of the assets can be performed in accordance with the AIFM Law, applicable national law, and constitutional documentation of the AIF. Such valuation function shall either be performed by:

- an independent external valuer, being a legal or natural person, subject to mandatory professional registration recognized by law or to legal or regulatory provisions or rules of professional conduct; or
- the AIFM itself, provided that the valuation task is functionally and hierarchically independent from the portfolio management and the remuneration policy and other measures established by the AIFM ensure that conflicts of interest are mitigated and that undue influence upon the employees is prevented.

The appointed external valuer shall not delegate the valuation function to a third party.

## **Authorisation Procedure**

### **Conditions for Granting Authorisation**

A Cyprus AIFM submitting an application for authorisation under the AIFM Law must be a limited liability company with shares, subject to the provisions of the AIFM Law and the provisions of the Companies Law. It shall satisfy, among other, the following conditions:

- (a) sufficient initial capital and own funds (see "Share Capital Requirements" further down);
- (b) the persons who effectively conduct the business of the AIFM are of sufficiently good repute and are sufficiently experienced also in relation to the investment strategies pursued by the AIFs managed, and the conduct of the business of the AIFM being decided by at least two persons meeting such conditions;
- (c) the suitability of the AIFM's qualifying shareholders (i.e. shareholders with direct or indirect holding of 10% or more of the capital or voting rights of the AIFM) towards ensuring sound and prudent management; and
- (d) the head office/central management and the registered office of the AIFM are located in Cyprus.

### **The Application for Authorisation**

The application to CySEC for the granting of an authorisation shall consist of the Application Form provided by CySEC which is to be accompanied, among others, by the following documents/information which relate to the Cyprus AIFM, the AIFs managed and any additional information to be required in order to offer cross-border services:

#### **AIFM related information:**

- Detailed Business Plan;
- Internal Regulations Manual;
- Organisational Structure;
- Memorandum and Articles of Association;
- Information on the remuneration policies and practices;
- Information on delegation and sub-delegation arrangements of functions to third parties;
- Information on:
  - (1) the persons effectively conducting the business of the AIFM, their good repute and experience in the AIF investment strategies, and
  - (2) the details of the direct and indirect shareholders of the AIFM that have qualifying holdings and of the amounts of those holdings.

#### **AIF related information:**

- Investment strategies (including the types of underlying funds if the AIF is a fund of funds), and the risk profiles and other characteristics of the AIFs it manages or intends to manage, and location (including the location of any underlying master fund);

- The AIFM’s policy as regards the use of leverage;
- Constitutional documents;
- Depositary arrangements;
- Prospectus/Investors disclosure document.

### Timeframe

Applicants will be notified within 3 months of the submission of a complete application of whether the authorisation is granted, which period can be extended for a further 3 months if required. CySEC may restrict the scope of authorisation as regards the investment strategies that an AIFM is allowed to manage. The applicant shall make use of the authorisation within 12 months of its granting.

### Share Capital Requirements

	Internally Managed AIF	External AIFM
<b>Initial Capital</b>	€300.000	€125.000
Plus: Additional Own Funds <sup>1&amp;4</sup>	0,02% of the amount by which the value of the AuM <sup>2</sup> of the AIFM exceeds €250 million.  Maximum total of €10 million.  At all times, shall never be less than 25% of the preceding year’s fixed overheads.	
Plus: To Cover Potential Professional Liability Risks <sup>3</sup>	Either:  • Additional Own Funds <sup>4</sup> equal to 0,01% of the AuM, valuing derivative at market value. CySEC may lower to 0,008% on the basis of historical loss data for a 3-year period or may increase if not satisfied that the AIFM has sufficient funds; or  • Professional Indemnity Insurance covering 0,9% of the AuM for claims in aggregate per year, and 0,7% of AuM per individual claim; in such case the AIFM would need to maintain own funds that are equivalent to the value of the excess under the policy.	

1. May provide up to 50% of such additional own funds in the form of a guarantee given by a credit institution or an insurance undertaking with its registered office in a Member State, or in a third country where it is subject to prudential rules equivalent to those of the EU.

2. Only includes those AIFs for which the AIFM is the appointed AIFM and excludes assets managed on a delegated basis. Timeframe Applicants will be notified within 3 months of the submission of a complete application of whether the authorisation is granted, which period can be extended for a further 3 months if required. CySEC may restrict the scope of authorisation as regards the investment strategies that an AIFM is allowed to manage. The applicant shall make use of the authorisation within 12 months of its granting.

3. The adequacy of such funds or insurance should be reviewed at least once a year.

4. Own funds must be invested in liquid assets or assets readily convertible to cash in the short term, and should not include speculative positions.

## **Tax Considerations**

### **Corporate Taxation**

#### **Registration with the Cyprus Income Tax Authorities**

The Cyprus AIFM is liable for registration with the Cyprus Income Tax Authorities for the purposes of obtaining a Tax Identification Number within 60 days from the date of its incorporation as a company and not from the date when the AIFM obtains CySEC authorisation.

#### **Significant Tax Considerations**

If adhering to tax residency requirements and maintaining management and control in Cyprus, the AIFM will be eligible for the enjoyment of:

- 12,5% Corporate Income Tax Rate on income accrued from the carrying out of the AIFM's operations (core and additional functions and additional investment services if applicable) following the deduction of expenses incurred wholly and exclusively in the production of income including but not limited to office costs, payroll and outsourcing costs; and
- no withholding tax on income repatriation by the AIFM to non-resident shareholders.

#### **Other Tax Considerations**

In the event where the Cyprus AIFM derives income from sources other than those outlined above, income may be exempted from or subject to tax accordingly. The benefits of the Cyprus tax framework will still be available to the AIFM, including but not limited to:

- exemption from tax on foreign dividends subject to moderate conditions relating to source and taxation of income distributed as dividends with no minimum participation threshold imposed;
- 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 closed-end 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);
- if related to the AIFM's ordinary course of business and therefore deemed as "active interest income", interest received by a regulated AIFM will be taxed at 12,5% corporate income tax;
- extensive Double Tax Treaty Network (more than 43 treaties concluded); and
- full harmonisation with the EU Directives.

#### **Value Added Tax**

A Cyprus AIFM's revenues are mainly exempt for VAT purposes in Cyprus. The Cyprus VAT Legislation provides specific guidance with respect to the meaning of "funds and management of mutual funds" that would benefit from this VAT exemption. In this respect "fund management services" that are offered to mutual funds include the following main categories of services: investment management, administration, and promotion/marketing.

Nevertheless, the AIFM in Cyprus might become liable to obtain a VAT number in Cyprus not only as a result of its revenue activities but also as a result of acquisition of certain types of services from outside Cyprus (e.g. advertising) or goods over certain threshold from other EU Member States.

Depending on the exact nature of the services provided by a Cyprus AIFM and on whether it acquires taxable services from service providers established outside Cyprus a liability to selfaccount for Cypriot VAT under the reverse charge mechanism might arise, resulting in additional cash outflow. Whether the AIFM can recover input VAT as a credit from the Cypriot VAT Authorities, this would very much depend on where its clients are established and on the partial exemption method used. Where a special partial exemption (apportionment) method is to be used, that method needs to be agreed in advance with the Cypriot VAT Authorities.

## **Why AIFMs in Cyprus?**

Cyprus has the tools to develop as a preferred platform for the cross border placement of Alternative Investment Funds (AIFs) to professional investors in the EU, while concurrently allowing non-EU managers to access the European market by choosing Cyprus as their Member State of Reference and entrance point into the EU. Once authorised in Cyprus, an AIFM is granted rights to the European "passport" allowing them to offer their services and market their AIFs cross border.

### **Cyprus – an attractive solution for the establishment and operation of AIFMs:**

- Member of the EU, Eurozone and OECD;
- Attractive tax environment with one of the lowest corporate income tax rates in the EU and Eurozone at 12,5%;
- Rigorous anti-money laundering regulations;
- Modern and transparent legal system based on common law;
- Significant number of multinational companies and international banking units, further empowering the productive and positive nature of the business environment;
- Multilingual and highly educated workforce possessing international professional qualifications;

- Highly skilled service providers specialised in servicing the fund industry, offering a wide range of customised services in fund and acquisition structuring, fund administration, custody and audit services;
- Highly competitive professional services fees compared to other European jurisdictions, without compromising the level of quality of the service provided;
- Strategically located in the eastern Mediterranean Sea in the middle of three continents – namely Asia, Europe and Africa – and offering a gateway to the Middle East;
- A great place to live and work, offering high calibre business services, efficient tax and cost environment, as well as security and safety for the whole family, culture, history and fabulous weather.

## How can we help?

Totalpro Services Ltd, is a corporate administrator company licensed by CySEC (license no. 015/196). We operate through fully integrated team of associates that include professionals with in depth knowledge of the legislation and past experience with CySEC applications and procedures, able to meet the individual requirements of our clients.

Our Services in connection with the establishment and operation of a Cyprus AIFM include, but are not limited to:

### **Understanding of Impact of Legislation:**

- advice on applicability of the scope of the AIFM Law on your organisation, optimisation of your fund/business structure and advice on the use of exemptions;
- domains impacted (e.g. depositary requirements, remuneration, valuation, and disclosure and reporting requirements).

### **Regulatory and Compliance Services:**

- support in AIFM license authorisation (which includes acting as Promoter of the AIFM throughout the application process with CySEC) or AIFM registrations;
- complete/review necessary application forms/ questionnaires of the shareholders/directors/heads of departments;
- prepare/review documentation, including the following, related to the application prior to submission:
  - Internal Operations Manual
  - Risk Management and Procedures Manual
  - Antimoney Laundering Procedures Manual
  - Business Plan
  - Organisational Structure

### **Operational Compliance**

- review and amendment of constitutional documents such as terms for custody, articles of association, offering memorandum in order to safeguard compliance with the AIFM Law;

- review of delegation agreements and other agreements to be entered into by AIFMs and service providers to safeguard compliance with the requirements of the AIFM Law, performing notifications to the relevant supervisory authority in case of delegation of tasks by the manager.

### **Advisory Services**

We can also assist you in a variety of other services, including, but not limited to:

- locate qualified executive and non-executive directors;
- prepare Internal Audit Manual and conduct annual Internal Audit Reviews;
- act as Compliance Officer with regard to legislative matters;
- provide training in different aspects of the regulation (i.e. Anti-Money Laundering, Risk Management, etc.);
- design a reporting and governance framework;
- develop and implement the following technology related systems:
  - IT architecture and automation of business processes;
  - Information Security Policies and an Information Security Program;
  - Business Continuity and Disaster Recovery Plans.

### **Contact Details:**

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