

# Fund Administration – Opportunities for Offshore and Alternative Investment Funds

Following the implementation of the EU Alternative Investment Fund Managers (*AIFM*) Directive (2011/61/EC) and associated legislation, Cyprus now lays claim to being a growth jurisdiction within the European Union for the establishment and servicing of boutique and low cost alternative investment funds based locally or offshore. The choice of fund administrator is of paramount importance to the set-up of any hedge fund and in Cyprus there are many reasons to use or establish locally-based operations.

Cyprus became a member of the European Union in 2004 and is consequently subject to and benefits from its single market directives as well as its own developing body of jurisprudence, known as the *acquis communautaire*. The European Union offers extensive possibilities for cross-border trade and investment – in particular, the ability to passport financial services to professional investors across EU member states on a relatively unimpeded basis. Indeed, the government has shown increasing awareness of the importance of establishing Cyprus as a thriving jurisdiction for the domicile of collective investment schemes. Most recently President Anastasiades stated that his government "has been working methodically in cooperation with the private sector, to build a modern, well regulated and competitive framework for the collective investment scheme industry". Ancillary to this is the political desire to promote Cyprus as a successful and cost-effective jurisdiction for the establishment and hosting of service providers for the funds industry, including fund administrators.

This commitment has most importantly been demonstrated through the rapid implementation of the AIFM Directive, a key pillar of European legislation in this area. The directive has been implemented in Cyprus through the AIFM Law 2013 and, indirectly, through the AIF Law 2014. Further, the regime for combatting money laundering is ensured through the implementation of the EU Third Money Laundering Directive (2005/60/EC), which has been fully implemented under various statutes, in particular under the Prevention and Suppression of Money Laundering Activities Law 2007.

## EU fund administrator regulation

What falls within the service offering of a typical fund administrator? Annex I of the AIFM Directive specifies that the following activities constitute administration of an AIF:

- 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
- Unit/share issues and redemptions
- Contract settlements, including certificate dispatch
- Record keeping

Under the AIFM Directive framework, these administrative services constitute a complementary service or subset of collective management services provided ultimately by the AIF manager to the AIF. In contrast to the position taken in the United States and many important offshore funds centres, EU law under the AIFM Directive holds the AIF fund manager to be directly responsible for the provision of both investment management and fund administration services to a fund. Aside from the central role of the manager, the logic under the AIFM Directive framework focuses hedge fund regulatory oversight on the ever more important institution of the fund depositary instead of the fund administrator. In

Europe, under the AIFM Directive, fund administrators are effectively sub-delegates of fund managers. Further, one area that has so far avoided comprehensive regulatory harmonisation – ignoring the impact of the pan-EU anti-money laundering regime – is the fund administration industry. Regulation of fund administrators is instead dealt with as a matter of national legislation.

## Fund administrator regulation in Cyprus

Unlike some – but not all – other EU member states, Cyprus has not moved to regulate fund administration as a distinct and separate category of licensable financial services activity. However, regulation is provided for under a number of separate yet interweaving regimes that can potentially be relevant to any player in the market.

### AIFM law

An investment manager authorised under the AIFM law is entitled to perform administration functions in addition to its investment management services of portfolio and risk management for the relevant AIF. On this basis, a fund seeking to set up in Cyprus or to use the services of a Cyprus-based services provider could legitimately refer such activity to the AIF manager itself. However, hedge fund industry practice, especially post-Madoff, may mean that using a service provider that is distinct from the manager can be commercially attractive and a way of further mitigating investor concerns.

### Investment firm law

The Investment Services and Activities and Regulated Markets Law 2007, known as the Investment Firm Services Law, implements the EU Markets in Financial Instruments Directive (2004/39/EC) (MiFID) in Cyprus. Under the Investment Firm Law, an investment firm may be licensed to provide safekeeping and administration services for third parties, including funds, as an ancillary service. However, in line with requirements under the Investment Firm Law, and as is mandatory under the pan-EU MiFID framework, investment firms must undertake or provide one or more of the core financial services and activities (dealing on own account, reception and transmission and execution of orders) to be eligible to undertake safekeeping and administration services on this basis. Therefore, in practice, the MiFID route to regulation of fund administration service providers will typically be relevant only to those institutions that intend to provide such services as an add-on to core MiFID investment services. Further, as administration is framed as an addition to safekeeping services, it would also be necessary for the provider's business offering to include some custodianship services.

However, since the AIFM Law and the Investment Firm Services Law implement the AIFM Directive and MiFID respectively (two key pillars of the EU single market directives), the benefit of undertaking fund administration on this basis is that the service providers would be eligible for passporting rights across the European Economic Area. This would mean that a Cypriot AIF manager or investment firm

could provide its services on a relatively unimpeded basis to funds domiciled within the European Economic Area. It would equally mean that an AIF manager or investment firm based in the European Union, but outside of Cyprus, could offer its services on an unrestricted basis to Cypriot-domiciled AIFs.

## Providers

The Companies Providing Administrative Services and Related Matters Law 2012, known as the Administrative Services Law or ASP Law, was implemented to give full effect to the requirements of the Third Money Laundering Directive and to further the impact of the national Prevention and Suppression of Money Laundering Activities Law 2007 in the context of the trust and fiduciary services provider industry. Certain instances of fund administration may fall within the meaning of 'administrative services' under the ASP Law, which – in relation to the administration of companies – includes the following activities in order of relevance to fund administration:

- Registering details of shareholders on registers
- Providing registered office address, official mailing address and electronic address of companies
- Providing company secretarial services
- Opening or managing bank accounts
- Providing directors for legal persons
- Safekeeping financial instruments on behalf of clients, including acting as a depository (unless regulated by other laws)

Once caught by the ASP Law, an administrative services provider would be subject to licensing regulatory oversight by the Cyprus Securities and Exchange Commission (**CYSEC**). This regulation would entail supervision of management as well as the ultimate beneficial owners of the administrative services provider. Such persons must be of good repute and, in the case of management, sufficiently experienced in terms of academic or professional qualifications to ensure the prudent management of the administrative services provider. Employees must be of good repute and have the necessary skills, knowledge and expertise to perform their assigned responsibilities. A dedicated in-house legal and compliance function must also be established.

Sizeable exemptions to the ASP Law do exist, owing to the fact that the law was intended to complement rather than duplicate regulation in other investment and professional spheres. As such, firms undertaking these services that are already licensed under the AIFM Law or the Investment Firm Services Law would fall outside the scope of the ASP Law, as would providers that are regulated by the following self-regulatory organisations:

- The board of the Cyprus Bar Association (i.e., lawyers) or
- The board of the Institute of Certified Public Accountants of Cyprus Association (i.e., accountants)

Despite this, the volume of providers seeking registration and authorisation by CYSEC under the ASP Law suggests that providers otherwise within the scope of self-regulatory organisation oversight (ie, lawyers and accountants) have nevertheless sought and continue to seek supervision from CYSEC as a way of demonstrating their credentials to potential customers and, indeed, their customers' investor base.

## Fund administration within the European Union

Cypriot service providers have open access to EU financial markets in accordance with the requirements of the single market directives. In the context of AIFs, this is most clearly evidenced in the framework that surrounds the AIFM Directive. Logically, EU-based service providers that benefit from passport rights may also freely offer fund administration services to Cyprus-based investment funds.

Further, the Cyprus anti-money laundering regime benefits from pan-EU recognition of its compliance with the Third Money Laundering Directive. This is a particularly important aspect of any fund administrator's offering, as it will often be a delegate of a fund, or in the context of the AIFM Directive, its manager. As such, the administrator will typically undertake know-your-client checks and due diligence according to the anti-money laundering regime of its EU home state. Banks and other institutions based in the European Union that deal with funds that follow such procedures should not have grounds for complaint on the suitability or robustness of know-your-client policies adopted by the fund or its providers.

## Stature in Cayman Islands and British Virgin Islands

Top offshore hedge fund domiciles the Cayman Islands and the British Virgin Islands both acknowledge Cyprus to be an equivalent or recognised jurisdiction for the purposes of their own anti-money laundering regimes. This is important, given that neither the Cayman Islands nor the British Virgin Islands are part of the European Union or the European Economic Area and can selectively choose which EU member states are fit for purpose in this regard. Being held to be equivalent or recognised means that Cypriot fund administrators to Cayman and BVI funds benefit from a range of nuances under their respective anti-money laundering laws, which can help to raise efficiencies and lower costs when dealing with a fund's investor base. Cypriot fund administrators can:

- Undertake anti-money laundering procedure functions and provide other client-on-boarding services for locally domiciled funds and other institutions without needing to delegate those to group offices or outsource them to

service providers in other jurisdictions which are deemed equivalent

- Apply their own anti-money laundering procedures, rather than needing to comply with Cayman or BVI requirements. The fund can rely on the anti-money laundering procedures of the Cypriot fund administrator to satisfy its own legal and regulatory obligations in the Cayman Islands or the British Virgin Islands
- Qualify as 'eligible introducers' in certain cases, meaning that Cayman and BVI institutions may rely on the know-your-client process carried out by Cypriot service providers instead of carrying out-separate procedures to comply with local law.

## Local tax benefits

Businesses and individuals resident in Cyprus benefit from among the lowest rates of corporate and personal taxation anywhere in the European Union. Companies are subject to corporation tax set at a flat rate of 12.5%. Further, Cyprus fund administrators that form part of multinational groups may receive relief from tax outside of Cyprus, in the event of dividends or other capital repatriation, through its numerous double-tax treaties.

At an individual level, Cyprus's tax regime is equally generous. Expatriates seeking to relocate to Cyprus who generate an annual income in excess of €100,000 are eligible for a tax exemption of 50% of their income for five years for employment starting on or after January 1 2012. This means that the top rate of tax payable by such individuals would amount to no more than 17.5%.

## Comment

The variety of regulatory regimes applicable or potentially applicable to fund administration in Cyprus may seem complex and haphazard at first. However, when taken as a whole the regime can provide in practical terms a significant degree of flexibility to businesses of diverse size and complexity. Larger institutions will no doubt seek licensing under the single market directives where possible, absorbing substantial capital adequacy requirements. Fortunately, smaller participants and start-up operations, such as those run by accounting professionals, need not opt for such extensive regulation and are legally entitled to operate with the streamlined oversight of a self-regulatory organisation. Midway between these two, the CYSEC regulation is provided for in respect of key administration tasks under the administrative services providers regime.

However, regardless of structuring, all fund administrators in Cyprus must adhere to the strict requirements of pan-EU anti-money laundering law, a fact that is recognised and acknowledged by EU institutions and also in key offshore fund domiciles. This flexibility and relative cost-effectiveness, coupled with the recognition of local providers by key offshore fund domiciles, means that Cyprus has all the ingredients to continue its evolution into a thriving jurisdiction for fund administration.



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