

# Investment funds in Cyprus (non-UCITS)

Cyprus is one of the up and coming funds jurisdictions in the European Union. For years popular for foreign direct investment in Central and Eastern Europe and the Middle East, the Cyprus' funds regime now caters fully for pan-EU regulation under the Alternative Investment Fund Managers Directive 2011/61/EU (**AIFMD**) while concurrently providing for lighter-touch alternatives. Importantly, Cyprus continues to be one of the most tax-competitive jurisdictions in the EU.

## Overview

Alternative investment funds (**AIFs**) in Cyprus operate in the shadow of the EU's AIFMD regime, as such Cypriot funds fall into two broad categories:

- 'Full scope' AIFs, whose managers fall within the AIFMD regime, and which consequently benefit from EU/EEA passporting rights; and
- 'Sub-threshold' AIFs, whose management falls outside of the AIFMD regime.

In practice, the test for determining whether the AIFMD is relevant at fund set-up will depend on whether the fund's assets under management (**AUM**) are expected to exceed the following thresholds:

- €100 million; or
- €500 million where the fund is closed-ended (ie no right to redeem within five years) and where it does not employ leverage techniques.

## Types of AIFs in Cyprus

EU regulation aside, Cypriot funds follow the pattern of funds in all other reputable funds jurisdictions: funds may be open-ended or closed ended; funds may be utilised as hedge funds or private equity funds; funds may be single portfolio funds or umbrella funds.

The domestic regime, implementing the AIFMD, is governed by the Alternative Investment Funds Law 2018 (**AIF Law**) and the Alternative Investment Fund Managers Law 2013,

(**AIFM Law**). Under the AIF Law there are four broad categories of AIFs:

- Full scope externally managed AIFs, which are funds whose managers can exercise EU 'passporting' rights.
- Full scope self-managed alternative investment funds (**SMAIFs**), essentially the same as the AIFs above but for the fact they are self-managed.
- Alternative Investment Funds with a limited number of persons, ie investors (**AIFLNPs**), and which are externally managed.
- Self-managed alternative investment fund with a limited number of investors (**SMAIFLNPs**), essentially the same as the AIFLNPs above but for the fact they are self-managed.
- Registered Alternative Investment Funds (**RAIFs**).

AIFs, AIFLNPs, SMAIFs and SMAIFLNPs are considered to be licensed funds, which are licensed by the Cyprus Securities and Exchange Commission (**CySEC**) under either the AIF Law or AIFM Law. RAIFs on the contrary are not licensed by CySEC, only registered, and consequently may be established more quickly.

## Other fund types in Cyprus

In this guide we focus essentially on hedge funds and private equity funds. We consequently do not cover the regimes governing retail funds (UCITS funds) or the more specialised regime relating to EU venture capital funds (EuVECA).

## Fund vehicle options

### Companies

Companies limited by shares are the most common form of entity used for the establishment of open-ended investment funds, with an investor's liability being limited to the amount paid or agreed to be paid in respect of their shares.

Companies are registered under the Companies Law (Cap 113) which is heavily inspired by the UK's Companies Act 1948.

The AIF Law operates to amend certain provisions of the Companies Law regime unsuitable for investment funds. It also clarifies that the capital of investment fund companies may be classed as being with either variable capital (broadly suitable for open-ended vehicles) or fixed capital (broadly suitable for closed-ended vehicles).

### Umbrella funds

AIFs may be structured, under the AIF Law, as umbrella funds, known locally as funds with multiple investment compartments. Companies which are umbrella funds are known in other jurisdictions as segregated portfolio companies or protected cell companies. It is conceivably possible for a limited partnership in Cyprus to be formed as an umbrella fund.

### Limited partnerships

Limited partnerships are the most popular form of fund vehicle for private equity funds as they offer greater flexibility to vary the rights and obligations of limited partners than is possible within a corporate framework. They are also usually tax transparent. Cypriot limited partnerships are formed under the Partnership Law (Cap 116) which is heavily influenced by the English Limited Partnership Act 1907. A variation of limited partnership, known as the 'partnership limited by shares', was introduced in 2015.

### Common funds (unit trusts)

Whilst the AIF Law does not expressly provide for the possibility of licensing or registration of a unit trust as an alternative investment fund, in contrast to other common law jurisdictions, it does provide for a variation of this known as a 'common' or 'mutual' fund. Under a common fund the fund itself is organised in practice as a contract between investors. Common funds have no legal form and are managed by an external manager.

## AIF regulation

The AIF Law provides for two types of *licensable* AIFs namely: full scope AIFs without limitations as to the number of investors and AIFs with limited number of persons (AIFLNP). AIFs and AIFLNPs may be self-managed or externally managed. RAIFs are registered and not considered licensed.

### 'Full scope' AIFs

AIFs can be either externally managed, ie where a third party fund manager is appointed, or self-managed (in the case of SMAIFs). Self-managed funds conduct investment

management as an internal matter through the board of directors or specially convened investment committee.

Most importantly full scope AIFs are able to passport their services freely to professional investors throughout the EEA under the terms of the AIFMD. This type of AIF must appoint an external alternative investment fund manager (**AIFM**) licensed under the AIFM Law (or equivalent in another EEA state) or else apply to become licensed itself as an AIFM where it is a SMAIF, ie self-managed.

AIFs must appoint a depositary usually responsible for custody functionality. The depositary must be based in Cyprus or, in some cases, elsewhere – but must generally be licensed as a credit institution or bank. Under the AIF Law certain restrictions may be imposed depending on the investor type and the requirements under the investment policy of the fund.

Passporting AIFs in Cyprus will typically market solely to "professional investors", a term defined in the AIFMD, or "well-informed investors" a term defined in the AIF Law.

### AIFLNPs

AIFLNPs are subject to the following restrictions:

- The maximum number of investors must not exceed 50 persons.
- The investors must be professional or well-informed investors.

As such, the AIFLNP is Cyprus' equivalent or a 'private' or 'family office' fund found in other jurisdictions.

In addition, the assets under management cannot exceed the thresholds under the AIFMD, ie €100 million or €500 million without leverage and a five-year lock-up period. As sub-threshold funds AIFLNPs are not eligible for EU passporting rights under the AIFMD.

Many of the provisions surrounding the ease of licensing and status of service providers have been relaxed when compared to full-scope AIFs.

For an AIFLNP the manager need not be licensed as an AIFM and may instead be an investment firm (licensed under the MiFID II regime) and in certain cases an unregulated entity.

As far as the depositary / custodian is concerned, if the total assets of the fund do not exceed the amount of €5 million or the number of investors of the fund are up to five then the requirement to appoint a custodian may be waived.

AIFLNPs can take the legal forms as outlined above, ie company, limited partnership or common fund. AIFLNPs can also be self-managed or appoint an external fund manager.

### SMAIFs

An AIF that does not appoint an external fund manager is considered self-managed (SMAIF). Under the AIFMD regime 'full scope' SMAIFs are considered to have the status of an Alternative Investment Fund Manager (AIFM). A Cyprus SMAIF must therefore apply to be licensed as an AIFM by

CySEC, AIFMs, and consequently SMAIFs, are able to exercise pan-EU passporting rights under the AIFMD.

In practice, SMAIFs will exercise management discretion through the board of directors or a specially convened investment sub-committee within the SMAIF.

All provisions set out in respect of AIFs (AIFM issues aside) will also apply to SMAIFs.

### **SMAIFLNP**s

A SMAIFLNP is essentially the self-managed version of an AIFLNP. As such, the provisions relevant to AIFLNPs (manager issues aside) will also apply here.

### **RAIF**s

Unlike other AIFs, RAIFs are not subject to licensing or authorisation processes by CySEC, only a registration process. As such RAIFs may be established more quickly than other AIFs.

RAIFs are specifically relevant to professional and 'well-informed' investors only. A RAIF may be organised through any of the fund vehicles options noted above. They may be structured in the form of an umbrella fund or as single portfolio vehicles.

Unlike AIFLNPs, a RAIF may comprise of an unlimited number of investors. However, all RAIFs must appoint a duly authorised AIFM, which will impose a greater level of practical oversight on the RAIF than may be found with an AIFLNP.

Having appointed an AIFM a RAIF will benefit from the pan-EU passporting regime contained in the AIFMD. In consequence marketing RAIFs across Europe can be significantly streamlined when compared to non-EU jurisdictions as the manager may rely on cross-border passporting arrangements to access all EEA jurisdictions. There is no need to rely on private placement regimes.

### **RAIFs and other AIFs compared**

The following provides a high level comparison of features between RAIFs and other forms of AIFs:

- RAIFs are not subject to CySEC authorisation and licensing procedures, but to mere registration. To this effect RAIFs are not subject to ongoing monitoring by CySEC and as a result it is a prerequisite that they are externally managed by an AIFM established and licensed in Cyprus or in any other EU / EEA member state. It is for the AIFM to ensure the general supervision and compliance in accordance with its own regulatory regime.
- Since RAIFs will need to appoint AIFMs it is expected that AIFMs themselves will engage in detailed vetting processes which are managed independently from the direct oversight of CySEC.
- RAIFs established as limited partnerships may appoint as managers UCITS management companies or Cyprus investment firms (CIFs) authorised under MIFID II, instead of AIFMs. In these situations, the RAIF would

need to be closed-ended and invest a minimum of 70 per cent of its funds in illiquid assets.

- CySEC needs to be notified only about the setup of a RAIF with minimal ongoing reporting requirements. To this effect, CySEC maintains a special register for RAIFs, including all approved RAIFs.
- There are no minimum capital requirements in respect of setting up a RAIF in Cyprus.
- There are no significantly rigid investment restrictions in respect of RAIFs. The only caveat to this is that fund of funds, money market funds or loan origination funds are subject to special requirements.
- The assets under management of a RAIF are subject to no limitation, however, minimum assets under management of at least €500,000, or the currency equivalent, is to be reached within the first 12 months of registration.
- All RAIFs must appoint a depository, which may be a credit institution (ie a bank), a CIF or other EU MIFID firm. The depository must have its registered office in the EEA or in a third country provided that CySEC has signed a Memorandum of Understanding for Cooperation and Exchange of Information with the competent authorities of that third country.

## **Licensing and registration process**

### **Licensing as relevant to full scope AIFs, AIFLNPs, SMAIFs and SMAIFLNPs**

CySEC will assess a number of items when considering an application for a licence under the AIF Law including, but not limited, to the below:

- The operation of a licensed AIF vehicle requires the prior authorisation of CySEC. Authorisation is granted only if CySEC approves the application; the regulation, by-laws or instruments of incorporation; the choice of persons actually managing the AIF and the choice of the depository.
- In the case that CySEC refuses to grant the authorisation, the reasons for such a decision must be justified.
- AIFs are not subject to minimum capital requirements but within 12 months from the date on which the authorisation is granted, the AIF is required to hold assets of at least €250,000 by raising funds from investors and, based on the provisions of the AIF Law, the minimum amount of assets should not include the capital commitments for the acquisition of AIF units.

As relevant to SMAIFs and SMAIFLNPs

- The management body must consist of at least three natural persons, of which at least one performs executive tasks. Portfolio management responsibility falls with the Board of Directors.

- The business activity must be exercised by at least two natural persons who possess the requisite good character and integrity, as well as sufficient knowledge and experience to that end and who constitute senior management.
- The administration of the SMAIFLNP can be delegated to independent third parties.
- Risk Management functions can be outsourced or performed internally. When outsourced, the person responsible for the function should be named, along with the company the function is outsourced to. When run internally, the executive director that does not perform portfolio management can perform this function.
- Where it is justified by the scope, nature, scale and complexity of the fund's activities, the law allows for the same person to exercise this role combined with internal audit and/or regulatory compliance.

### RAIF registration

The relevant forms and documents for registration must be completed by the proposed AIFM of the RAIF and submitted to CySEC using its dedicated upload portal. The required documentation comprises:

- Certificate of incorporation (or equivalent).
- Memorandum and articles of association (or equivalent).
- Arrangements regarding the depository.
- The RAIF's information memorandum.
- AIFM licence.
- External financial consultants' confirmation.
- Investment strategy of the fund.

Following submission of the application form a RAIF is expected to be authorised to be set-up within a period of 30 days.

### Anti-money laundering compliance

Cyprus AIFs are obliged to comply with the Cypriot anti-money laundering and terrorist financing (**AML/TF**) legislation, including assessing and applying a risk-based approach to money laundering and terrorist financing risks and compliance.

The AIF should appoint an anti-money laundering compliance officer from its senior staff who has the ability, knowledge and expertise to perform the functions required. In practice it may be possible for AIFMs to supply such individuals to act on behalf of AIFs though care must be taken with any potential outsourcing. Ultimate responsibility for maintaining and implementing satisfactory AML/TF procedures remains with the fund however.

### Automatic exchange of information obligations

Cypriot AIFs are not directly subject to the US Foreign Account Tax Compliance Act (**FATCA**), however Cyprus has introduced legislation implementing FATCA requirements for 'financial institutions' to identify and report certain US accounts to the Cypriot Tax Department (**TD**) on an annual basis.

Cyprus has also enacted regulations (**CRS Regulations**) to implement the OECD common reporting standard on automatic exchange of information (**CRS**) into Cypriot law. Under the CRS Regulations, Cypriot 'reporting financial institutions' have to report information on the holders of 'reportable accounts' which are tax resident in 'reportable jurisdictions'.

The majority of Cypriot AIFs fall within the definition of an 'investment entity' and are generally classed as a 'financial institution' for FATCA and CRS purposes. As a result, those funds have information gathering and reporting obligations to report the relevant information to the TD on an annual basis and that information will then be sent automatically to the relevant home tax jurisdiction of the relevant account holders.

### Supervision and enforcement

CySEC can require a special audit of all AIFs and their managers. Regulated funds must also provide CySEC with periodic reports and such information and access to records as CySEC requires. CySEC may apply to court to preserve the assets of a regulated mutual fund.

CIMA has the power in relation to an AIF to revoke its authorisation or registration, impose conditions upon it, require the substitution of a promoter or management, appoint advisers or persons to assume control of the affairs of the AIF or require the reorganisation or winding up.

The auditor of an AIF must immediately give written notice to CySEC if it is, or is likely to become, unable to meet its obligations as they fall due; is carrying on or attempting to carry on business in a manner prejudicial to investors or creditors; or is maintaining insufficient accounting records to allow its accounts to be properly audited.

CySEC also has the power to impose administrative fines for breaches of the AIF, AIFM or other relevant regime regulating AIFs in Cyprus.



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