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Reducing barriers to cross-border fund distribution



By Mr. Kevin Mudd

KMG Capital Markets Ltd

European Commission’s effort to create a Capital Markets Union (CMU) within the EU must be backed and supported by all parties involved in the financial services sector. However, whilst many barriers have been removed by recent or forthcoming Regulation and Directives, (for instance, EMIR, CSDR and MiFID II), significant steps must still be taken for the creation of a truly unified capital markets industry.

National barriers

“We believe that following Brexit, the need and necessity to modernise and clarify this overly regulated and, in some instances, unnecessarily complicated sector is greater than ever,” KMG Capital Market’s CEO Kevin Mudd stated. “Cross-border competition and efficiency must be introduced and the only way to achieve that is by deregulating national barriers and introducing harmonised rules across all Member States”.

“We strongly believe and assert that the underlying purpose of the CMU initiative must specifically be to abolish national barriers, which have proven to prohibit and limit the cross-border distribution of funds for instance,” he explained.

We made our views known on these shortcomings to the EU’s Inception Impact Assessment Initiative in relation to “Reducing barriers to cross-border distribution of investment funds”.

Definition consistency

“The uncertainty of different legislative obstacles, mainly at the national level of the Member States, restricts to a large extent the marketing of funds”, Mudd explained. “Removing barriers mainly at national level and clarifying definitions to have the same interpretation across all Member States are the key elements for the facilitation of the cross-border distribution of funds outside of their domicile Member States”.

Mudd went on: “For instance, the Alternative Investment Fund Marketing Directive (AIFMD) was introduced (and/or proposed for implementation) in the 31 EU / EEA Member States and those which have transposed it into national law and national rules have ended up with significantly different rules and regulations between them. This was the obvious result of the flexibility and elasticity of rules and definitions which were allowed within the wording of the AIFMD”.

Future developments must be directed towards the creation of a CMU where all parties involved are clearly defined, with roles and responsibilities adequately, evenly and realistically allocated and barriers that prevent and/or have a material impact on the cross-border distribution of funds, or financial services in general, are reduced or abolished.

Legal certainty

A pivotal element for the efficient and continuous distribution of funds across a CMU is legal certainty. What should have been a simple and cost efficient process – the cross-border distribution of AIFs - has unfortunately proved to be a very expensive and burdensome process. The creation of a CMU presupposes common definitions in relation to marketing and pre-marketing activities. Regrettably, the interpretations across the EU actually vary widely, which is the primary source of much uncertainty and confusion.

The main question to be asked here is: Why there is no common definition between all Member States? Why do market players need to adhere to different rules and procedures? Does this lack of legal certainty translate to lack of trust between the regulatory authorities of those States?”

Our specific recommendations are:

1. The creation of a common/uniform interpretation of terms – a standardised glossary is a necessity.
2. The removal of the necessity to inform individual countries of marketing activity. Meeting regulatory promotional requirements in one EU country should automatically mean meeting them in any other.
3. The abolition of the need for manufacturers to take responsibility for distribution when dealing through regulated intermediaries.
4. The elimination of legal requirements in some countries that require the involvement of local agents.
5. The establishment of a uniform agreement across the EU on what constitutes a “well informed, certified, experienced or sophisticated investor” to fit between retail and professional categories. This should include uniform offering document requirements and investor safeguards and abolish local restrictions on the distribution to such a class.

Kevin Mudd, CEO of KMG Capital Markets – the first Super ManCo (AIFM and UCITS Management Company) to be regulated in Cyprus - has over 30 years' experience in fund management, portfolio management, managing clients' assets, product design, fund structuring, marketing and distribution. KMG Capital Markets is currently the external AIFM to 17 Luxembourg funds, managing a wide variety of alternative investments, circa € 500 million.

Kevin takes a strong interest in the shaping of the financial services industry to ensure high standards and realistic regulation through active participation in and directorships of professional bodies such as CIFA, CIFSA and FECIF.

The Evolving Role of Fund Risk Managers



By Dr. Marios Kyriacou

Senior Consultant of MNK Risk Consulting Ltd

Central banks unwinding quantitative easing, elevated debt levels, multi-century all-time lows in interest rates, economic

problems in 'developed' economies, stretched asset prices, and Brexit are just some of the potential sources of the next financial crisis, according to the latest research from Deutsche Bank in September 2017. These indicators coupled by the 2008 financial crisis, provide risk managers with an invaluable learning experience. The role of Risk Managers and Chief Risk Officers is evolving and the fund industry is no exception. There are currently two major drivers of the evolution of fund risk management – regulatory requirements and investor pressure; and it is in the interaction of these two forces that one can observe both the current state and likely path of risk in fund management.

Regulatory requirements appear to be the most important driver in the evolution of risk in fund management. The Alternative Investment Fund Managers Directive (AIFMD 2011/61/EU) and subsequent level 2 Regulation (EU 231/2013) have profound implications for the role of the risk manager in an investment fund. In regards to governance, risk management is expected to be an independent control function. In regards to operations, risk management along with fund management are considered to be the core functions in a fund. More importantly, in regards to job specification, a substantial amount of energy is required to produce the risk information required. The regulatory reporting templates are demanding; not only the volume of the raw data that must be captured have increased significantly, but analytics should now be calculated monitored and reported on market and liquidity risk as well as credit and counterparty risk. This means interfacing of systems,

collecting specified raw data in large volumes, creating a risk database with historical-drilling capability, conducting extensive data consistency checks and reconciliations, replacing spreadsheets with more automated tools or risk engines, and using such tools for producing all the risk sections of the sixty regulatory templates that must be filled in in XML format over 250 separate line items on a quarterly basis. What is remarkable about this legislative overhaul is that it is most likely current best practice anyway for large asset managers. The profound difference of AIFMD is the intention to apply such obligations to managers with smaller funds in the few hundreds of millions rather than the tens of billions. Even sub-threshold AIFs, with total assets below 100 mio euro, or 500 mio if unleveraged and with a 5 year lock up, have increasing regulatory reporting requirements related to risk analysis, risk disclosures, solvency, transactions reporting under EMIR, MiFID 2 and other EU Directives.

The second major driver of the evolution of fund risk management is investor pressure. Firstly there has been a demand for enhanced transparency with increased frequency of reporting on the risks that funds are taking. Whilst one solution to this demand is to set up managed accounts, in the event that this is neither possible nor desirable, the risk management function may need to be expanded to cater for these extra demands. These demands relate not only to market risk but also to counterparty risk and the investors' aggregate exposure over all their investments. In addition, and in line with the specific requirements of the AIFMD, investors are starting to tailor their investment size with the liquidity profile of the invested fund. Investor pressure is also observable in the decreasing tolerance for breaches in the fund's investment objective and strategy as prescribed in the prospectus document. Whilst previously, it was possible for breaches to be resolved over a significant period of time, that tolerance has significantly diminished. At any point in time the fund manager needs to observe the fund's exposure against all sorts of criteria that have been identified in its investment prospectus. Quite often, additional internal limits may be put in place, which is a best practice. Such limits might apply to a vast universe of

parameters including asset allocation based on region, currency, instrument type, issuer, position sensitivities. Although the ultimate responsibility for adhering to such limits lays with fund managers, the risk manager is typically in charge for monitoring such investment compliance. Therefore, the capacity of a risk manager's systems to monitor a limit structure in a timely and accurate manner is of utmost importance. In the case of limit breaches a strict requirement to be compliant by close of business is not an uncommon feature in funds launched today. Regulators may be taking a more long-term view in maintaining risk exposures within set limits, but at the same time investors are requiring assurances that their funds are being managed in a manner consistent with the prospectus on an ongoing basis.

Regulatory and investor pressure have therefore greatly expanded the role of fund risk managers, both in terms of scope and responsibilities. However, it is the interaction of these two that has the greatest impact on the role of risk management. And this lies with the need to be able to handle and process large data volumes efficiently and effectively. Excessive amounts of time were previously spent attempting to get the indicative data necessary to carry out an analysis or attempting to reconcile trader blotters with back office reports. This generally left little time for the more relevant tasks of a risk manager – the monitoring of actual risk exposures and ensuring these are in line with the fund's stated risk appetite as reflected in the regulatory and internal limits, and the identification of risk mitigation measures and remedial actions. Nowadays, remote, secure and fast functionality, workflow automation, systems, and data processing capability allow risk managers to dispense with a significant part of the drudgery of their role: that which can be done by computers should be done by computers, whilst at the same time giving them the tools to better understand the risks of the funds for which they are responsible. Risk managers are, or should be, well equipped for analysing market risk (e.g. monitoring position size versus risk limits, stressing the risk factors that are likely to impact portfolio value and quantifying the P&L of movements in the underlying positions), monitoring counterparty risk (analyzing the credit

risk of issuers and counterparties, their credit risk migration probability, the loss given default) as well as managing other risks such as the risk of unplanned redemptions and other liquidity issues that may be expected or unexpected as well as operational risks (e.g. system downtime or software failures, investor inter-personation/fraud risks, model validation issues).

To conclude, the role of fund risk managers has evolved far and fast in the past five years. From a partially ineffective bystander, the risk manager now has the regulatory imposed powers and (should have) the tools to effectively monitor and if necessary limit the various risks to which a fund is exposed. It seems likely that such powers and tools are likely to be enhanced further in the next few years. This prospect may be viewed with some trepidation by other stakeholders in the fund management business, particularly investors. Increased power to limit downside risk may be perceived as a threat for limiting upside potential and positive returns. That said if you avoid a severe drawdown i.e. a permanent loss of capital, your long-term returns may actually be better – experience a severe drawdown today and you may be out of business by tomorrow. In addition, it is axiomatic that fund management and risk management are intimately related. Care must be taken to ensure that whilst the risk function is independent, risk management remains an essential element of the investment process.

Marios Kyriacou is a Senior Consultant with MNK Risk Consulting Ltd, a financial services advisory firm assisting Banks, FX Brokers, Fund Managers and other regulated financial institutions with regards to their optimal structure and set-up, licensing, and regulatory compliance. He has 18 years' of experience in the banking and financial services sector. Previous roles include Head of Risk Management of Piraeus Bank Cyprus for eight years and Risk Manager with BNP Paribas UK for another 8 years. He holds a Ph.D. and M.Phil. (Distinction) from Cambridge University and a B.Sc. (First Class, Honours) from Warwick University. Chartered Statistician by the UK Royal Statistical Society. Dr. Kyriacou is appointed as a Board member in several investment companies and teaches risk management at the University of Cyprus.

Cyprus: an emerging European Fund Management hub?



By Dr. Mike F. Balm,

Chief Executive Officer of Emergo Wealth.



By Dr. Constantinos Neophytou

Managing Director of Emergo Wealth.

Introduction

According to a recent report from Cyprus Investment Funds Association (CIFA), Cyprus is fast becoming a location of choice for many promoters and fund managers, with the regulatory and government bodies actively promoting Cyprus as a center of excellence for the international fund and asset management industry.

In principle, the European passport offers the fund management industry exceptional possibilities for cross-border and global fund distribution and could attract both EU and non-EU firms keen to establish themselves as EU-compliant managers and to access European Union investors from Cyprus. As a private investment Group operating out of Cyprus since 1990, Emergo knows a thing or two about the benefits of doing business in Cyprus.

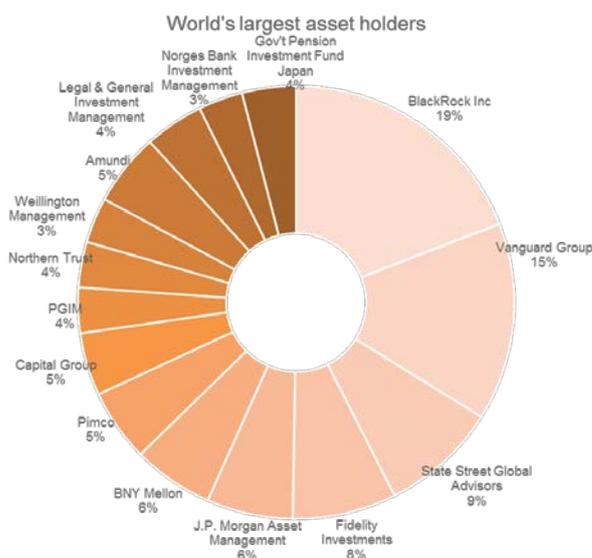
Operating out of Nicosia for close to three decades, we built a significant portfolio of venture capital and private equity investments, in Russia, North America, Europe and Asia. In 2014, we established the first umbrella of Alternative Investment Funds (AIF) for retail investors, aimed at providing cost-effective investment options for institutional and private investors alike.

We remain convinced that Cyprus will serve as an excellent location for establishing and promoting funds internationally.

Can Cyprus based Fund Managers succeed?

As of July 2017, the European fund management sector boasted €15.1 trillion in assets under management (AUM), with an impressive 6.5% growth in the first 7 months of the year. The growth is even more impressive when set against a backdrop of low market returns, and increasing pressures on fees and a substantial increase in regulatory and reporting costs. US Fund managers totally dominate the global fund industry (managing 82.9% of AUM), but fund managers, with only 3 European managers managing over \$1 trillion.

The \$1 trillion club



<http://www.visualcapitalist.com/chart-trillion-dollar-club/>

There are early signs suggesting that the Cyprus investment fund sector can capture its fair market share and develop into a significant fund management jurisdiction. This is largely based on the country's key advantages that include lower costs and a strong community of professional service providers. The regulatory framework is largely based on that of sector leaders, Luxembourg and Ireland and already AUM have tripled since 2013.

Our own experience is a case in point. Built on the principles of diligent risk-based portfolio management and unparalleled investor transparency, Emergo's Luctor AIFs have been met with unmitigated success, reaching their initial target set well into the 7-digit range within months of their launch. State of the art online technology tools and marketing to investors across the EU under the AIF Managers Directive, mean that fund managers based in Cyprus can compete and be successful in attracting investors from the European market and beyond. Importantly, a combination of a web-based investor platform, robust process and data security, low investment and administration costs make these Cyprus based funds accessible to a very large number of institutional and private investors from Europe and beyond.

Investments in Private Equity, Real Estate and Infrastructure, to name a few, are excellent targets for the industry and are set for accelerating growth in the next decade. There are a large number of investment vehicles and expertly managed funds available where foreign investors can benefit from the many advantages Cypriot funds and fund managers have to offer. Conversely, Cypriot funds and fund managers can look to Europe and leverage their infrastructure and technology to capture a share of the larger investor base, while at the same time gaining access to new technologies and services not available in their home market. Local institutional investors, like pension funds, should be the first to benefit from the increasing availability of appropriate Cyprus domiciled funds for the reasons outlined above.

The role of the Fund Industry Stakeholders

The Cypriot regulatory framework favors the use of local service providers such as fund depositaries, and while protectionist measurements should be used with care in the European theatre, the trust and confidence placed in local service providers should be mirrored by local institutional investors. After all, if Cypriot fund managers are unable to gain the trust of the institutional investors in their own

marketplace, what chance do they have in the broader market?

To maintain, or even accelerate the growth in the Cypriot Fund Management Industry's AUM, consideration should be given to the following steps that could, or should, be taken to support and facilitate the growth of AUM in Cyprus:

1. Accelerate the much-anticipated update of the legislative and regulatory framework; authorities must ensure that costly delays are avoided.
2. Ensure that the regulator has the resources it needs to provide effective and timely regulatory oversight.
3. Provide support and uniformity through the provision and use of a standardized template library to expedite and improve both the fund authorisation process and the ongoing monitoring.
4. Provide legislative support or lobbying to ensure that protectionist measures do not form an impediment to European access for Cyprus-based fund managers.

CIFA can be instrumental in the design and implementation of these measures, promotion is an important step in the process, but it is implementation that creates a sustainable success story.

Dr. Balm is the Chief Executive Officer of Emergo Wealth. He has been with the Emergo Group for over 25 years and he has held several positions, including Group treasurer and CEO. In addition to his executive duties, Dr. Balm currently serves as a director of various US, Canadian and European holding and operating companies.

Dr. Balm is a Chartered Management Accountant and Chartered Global Management Accountant (UK), a Certified Management Accountant and Chartered Professional Accountant (Alberta, Canada) and a Certified Public Accountant (Delaware, US). He holds a

Master in Business Administration (University of Manchester), and a Doctorate of Business Administration (European University of Switzerland).

Dr. Neophytou is the Managing Director of Emergo Wealth and has been with the Emergo Group for over 15 years, where he has held various roles, including that of Managing Director of Emergo Cyprus. He previously served as the Vice President for Yasoo Health Inc., a nutraceuticals Company and as the Managing Director of Bionature, a drug discovery Company. Previously, he worked as the General Manager of an equity brokerage business in Nicosia. He serves as a Special Finance Advisor to the European Commission.

He held the Welcome Prize post-doctoral research fellowship at Harvard Medical School in Boston. He is a Certified Investment Management Analyst (CIMA®), and holds a Diploma in Company Direction (IoD, UK) and the CySEC Advanced certification. He studied on full merit-based scholarships at Cambridge University (BA, MA) and at University College London (PhD).

The case for institutionalization of real estate investment in Cyprus



By Mr. Jad Wakil

Executive Director, Mouflon Real Estate Fund Ltd

Around 2011, and while attending a conference about real estate in Beirut, I heard a comment that struck my attention and

that I still refer to today; when asked about how to forecast future demand, one of the large developers, speaking on a panel of experts, replied using two simple words: “gut feeling”.

It comes as no surprise that, in small and non-mature markets, where the bulk of investments in real estate is performed by local investors, who are at best organized as family offices or small investment companies with few wealthy individuals, the level of professionalism is below par. The rule of thumb in

most countries is that real estate value always appreciates and is resilient to economic fluctuations, that downturns are always offset by subsequent growth cycles, and that investment in real estate is reserved for a country’s elite, thus making it somewhat monopolistic, and giving these investors the impression that they will always be able to control market prices.

All this, obviously, is not true. Numerous examples from all over the developing world show otherwise. After seven years of fast paced growth in Lebanon, during which some residential prices increased fivefold, the market ran out of steam. And while the gut feeling of developers kept telling them to build bigger, more expensive and more luxurious apartments, market demand crumbled as prices became much higher than what the local buyers could afford, and speculators were looking to exit. Fortunately for these developers, Lebanon did not witness a bubble burst, but, despite asking prices stagnating for the past four years, actual prices have dropped by around 20%.

Cyprus witnessed a similar situation pre-2009, which was further worsened by uncontrolled bank lending, adding more fuel to the fire. Needless to say that all parties involved got burnt when the economic winds shifted, and the market collapsed to 50% or less of its former value.

Yet these lessons are not learnt, shared, or even taken into consideration when times are good. As soon as a hint of positivity is felt in the market, investors throw caution to the wind, plan according to their feelings and impressions, and build dreams based on wishful thinking. In Cyprus, this is called the citizenship-by-investment program, or the casino license, or oil and gas reserves. None of the above can be dismissed as a potential growth factor for the real estate sector, but surely none can be considered as a long term winning ticket for sustained growth.

What we lack in developing countries is thorough consideration of market and economic factors, and the research and analysis that is required to build forecasts and prepare more accurate plans. No one is lucky enough to have a crystal ball to be able to know the future, but those who take the time to gather information and make analysis-based decision do

have an undeniable advantage. In most cases, the only investors that need to consider each step they make very carefully are institutional investors, since they bear a higher level of responsibility both towards their investors and towards their regulators.

Being an institutional investor, Mouflon Real Estate Fund was able to achieve better than average gross yields on acquisition of commercial real estate, through investment in fully rented prime assets, while securing leverage from local banks with favorable conditions. These conditions would have been impossible to achieve had the Fund not developed an in-depth understanding of the market in order to define its strategy, used specific and stringent criteria to identify and select assets, and performed thorough due diligence on the assets and tenants.

On the flip side, players on the other side of the fence, being individual developers, are still behaving in their good (or should I say bad) old ways. We have been proposed investments one year ago, when we started prospecting for assets, which were offered at reasonable prices pre-negotiations, due to the perception in the market that prices were still falling. One year later, these same opportunities are being offered at 10% more expensive, non-negotiable. I am not saying that prices haven't improved, because they have, and that the situation in the market is not better, because it actually is, but I find such propositions unreasonable. Nothing can justify a 10% increase in one year. There are no indicators that show that prices have increased by that much; the Cypriot economy as whole grew by an encouraging 2.8% in 2016, and the latest RICS price index showed around 3.3% overall increase since the bottoming out of prices. The only reasonable explanation is that this is just the wishful thinking and greedy behavior which the usual suspects are falling right back into all over again. Fortunately these cases are still the exception and not a rule, except perhaps in the Limassol high-end residential bubble, but that is a topic on its own.

Thankfully for the sector, banks in Cyprus are also getting on the bandwagon and using more scrutiny when lending for real estate projects, albeit being overly cautious at times, due to the huge blow they were dealt in 2013, the consequences of which they are and will still be suffering from in the near future.

Hopefully, banks will be playing a more constructive role this time around by sanity checking investments into real estate, and not getting overly excited by positive developments, both macro and micro.

That being said, one of the best ways to achieve sustainable growth in the industry, and attract more and more foreign investment into real estate, is the institutionalization of the sector. Institutional investors bring more structure into the game, along with an increased level of professionalism. They also limit the effects of speculation, while enabling a broader base of investors to enter the market, thus fueling new investments, and injecting a much needed flow of fresh capital into the economy in general and the sector in particular. The AIF law in Cyprus can be used as a medium for these types of investments, particularly when they bring along foreign investors, and many stakeholders - including the CIFA - can assist in the successful penetration of these investors into the market. However, these elements are not sufficient without a better understanding of the needs and requirements of institutional investors by local players, who will need to be educated about the modus operandi of these investors, as well as recalibrate their expectations in terms of dealing with such investors.

Mr. Jad Wakil is the co-founder and Executive Director of Mouflon Real Estate Fund Ltd, an Alternative Investment Fund licensed and regulated by the Cyprus Securities and Exchange Commission. Mr. Wakil is also the co-founder and Managing Director of Tangent, a strategic and financial advisory company operating in both Cyprus and Lebanon.

Mr. Wakil has a wide ranging experience, having worked in in the insurance, banking and financial advisory sectors. He was involved in numerous M&A and private placement transactions, as well as strategic development projects, in diverse sectors including retail, hospitality, logistics, technology, infrastructure, and real estate. He was also involved in the structuring of private investment funds.

AIF Governance Requirements: Money Well Spent?



By Mr. Kypros Georgakis

*Manager Funds Unit, Amicorp
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The views expressed in this article are those of the author and do not necessarily reflect those of Amicorp Group.

In response to the 2008 credit crisis, the EU pursued a successful initiative to regulate alternative investment funds (AIFs) registered, managed, or marketed within its borders. The aim of supervisory measures adopted was twofold: avert a repetition of the destabilising effect the sector had on the global financial system, and strengthen the level of investor protection. The body of documentation supporting this new supervisory framework is extensive, as is also the breadth and depth to which it goes, often breaking new ground (e.g. on remuneration practices of AIF Managers (AIFMs), or the duties of Depositaries).

In this brief article we focus solely on a particular aspect of investor protection, namely, AIFM governance requirements¹. We begin with an overview of regulatory provisions and then proceed to express a view on their sufficiency. We conclude with practical steps AIF sponsors might adopt to maximise the value added by participants in the AIF's governance.

AIFM Governance Requirements

EU Regulation 213/2013 specifies in detail the obligations of AIFMs to apply high standards of diligence in the selection and monitoring of investments, act honestly, fairly, and with due skill, employ sufficient and competent personnel, manage and disclose conflicts of interest, etc. In terms of governance provisions, worth highlighting are:

1. Definition of Risks to be Managed

¹ Subthreshold AIFs not managed by AIFMs are not covered here. While they are subject to lighter

The AIFM is required to operate a risk management framework covering each separate AIF it manages. A key component of this framework is the setting of limits covering the following risk types: market, credit, liquidity, counterparty, and operational. At first sight this may not sound as much, until one realises that it took the financial industry the best part of 30 years (starting with Basel I in 1988) to arrive at common definitions and boundaries between risk types and produce a taxonomy of sub-types within each category.

2. Duties of the Depositary

Without doubt a key pillar of the new supervisory framework is the spelling out of the duties of the Depositary which extend beyond traditional custody and safekeeping of AIF assets to cover also regular monitoring of its cash flows, as well as oversight of the transfer agency, fund administration, and accounting functions, including NAV calculation. Furthermore, the Depositary needs to be independent from both the AIFM and prime brokers acting as counterparties to the AIF.

3. The Three Lines of Defence

In line with regulatory best practice, the primary responsibility for designing and implementing risk management and internal control procedures rests with line management and staff. Permanent risk and compliance functions, independent from line staff need to be in place to act as a second line of defence, with internal audit serving as a third one. The AIFM's Board of Directors is also required to review reports prepared by these three control functions.

How Robust is the New Framework?

The definition of an AIF under the new rules was deliberately drafted in such a way as to capture virtually all non-UCITS funds. Merely bringing the sector under the purview of regulators can act as a deterrent against excessive risk taking, being entangled in conflict of interest situations, or plain fraud. The same can be said of the scrutiny imposed by regulations through the work of control functions, the obligations imposed on the governing body, as

regulation the same governance principles apply as for bigger AIFs.

well as onsite examinations by supervisors. Of course deterrence does not equate complete eradication of all such incidents though one could argue that their frequency, duration, and magnitude will on average over a full economic cycle be reduced compared to the past.

Extracting Value from Governance Participants

At the risk of stating the obvious a governance framework is only as good as the people operating it. For this reason, AIF sponsors are well-advised not to neglect to carry out so-called operational due diligence on shortlisted AIFMs and Depositaries. Besides requesting sight of credentials they should make a point of meeting in person the heads of AIFM control functions (risk, compliance, and internal audit), fund administration, as well as Board members. Things to look out for include:

- fielding of the necessary skillset to effectively carry out the job at hand
- an independent spirit not shying away from challenging management
- a genuinely risk-based method of work rather than a box-ticking one.

Prior to its introduction, AIF regulation was greeted with scepticism by the industry on account of associated compliance costs. Four years on, while no consensus has emerged amongst industry participants it seems that investors have voted with their feet, as testified by the steady annual growth in both the number of EU AIFs and the value of assets under management which reached 28,327 and €5,7 trillion at the end of June 2017. The perceived increased level of investor protection has certainly played a part in this success.

Mr. Kypros Georgakis is a Manager at Amicorp (Cyprus) Ltd assisting clients with licensing and operation of regulated funds. He has over 25 years financial industry experience including investment management of a €0,5 billion multi-asset portfolio, financial control, risk management, and internal audit. He holds an MSc in Theoretical Physics from Imperial College, and is a Chartered Accountant and CFA Charter holder.

Tourism in Cyprus: Setting a long term strategy, not just riding the wave



By Mrs. Damiani Papatheodotou

Research Analyst, AXIA Ventures Group Ltd

By Mr. Nikolas Kourtis

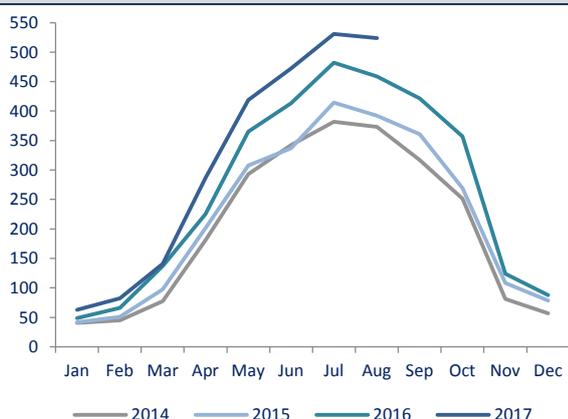
Research Division, AXIA Ventures Group Ltd

While the economy in Cyprus is showing signs of recovery and the GDP is growing at a higher than expected rate, one of the most important contributing factors of this growth is the record levels of tourist arrivals in the last couple of years. The importance of tourism in the Cypriot economy is unquestionable, which raises the question of how to best manage it, in order not only to ensure its long-term sustainability, but, more importantly, to safeguard its contribution to the country's economy in line with its full potential.

Indeed, the tourism industry in Cyprus may be viewed as booming, while the numbers speak for themselves. During the past few years, tourist arrivals and revenues are experiencing significant growth, with 2016 being a record year for both indicators. In particular, total arrivals for 2016 reached 3.2mn with respective revenues of EUR 2.4bn. Political tensions in the region enhanced Cyprus' tourism product as an attractive and safe destination. In addition, the shutting down of the Cypriot flag carrier airline, along with the promotion of an "open skies" policy, boosted the country's flight connectivity, and further assisted the growth of the tourism sector. The aforementioned growth is expected to continue this year with the latest figures clearly indicating that 2017 will be another record year. During the first eight months of 2017, total arrivals reached 2.5mn compared to 2.2mn in January-August 2016, whereas until July 2017, total revenues reached EUR 1.4bn compared to EUR 1.2bn the same period last year. This unprecedented growth in the tourism industry has contributed to corresponding growth in the GDP with spillover effects in many sectors of the economy, such as

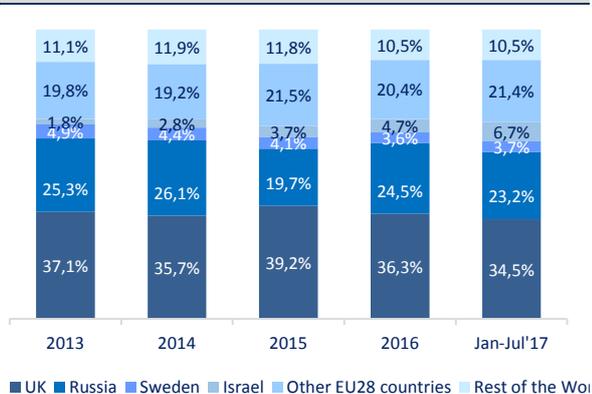
construction and retail. The fact that a substantial portion of this growth may be generally attributed to exogenous factors, like tensions in the region that are out of the control of the government, mandates the development and implementation of a strategy that will secure the country's current status as an attractive and competitive destination and strengthen the tourism industry contribution towards its GDP.

Figure 1: Tourist Arrivals Monthly Distribution (000s)



Source: Cyprus Statistical Service

Figure 2: Tourists' Composition



Source: Cyprus Statistical Service

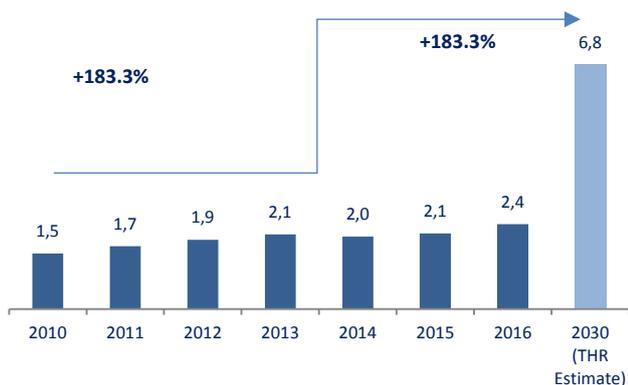
The Cypriot government decided to proceed with an amended National Tourism Strategy, which will be based on a study conducted by an independent consulting firm that specializes in the tourism industry (THR Innovative Tourism Advisors). Although similar attempts were made by previous

administrations, none of them was actually implemented. All the actions taken by the government this time indicate that this is a more serious effort, and the implementation of a strategy may be closer than ever. At the core of the new strategy is the anticipated "natural" growth in the tourism numbers while focusing towards higher quality tourists, and a longer tourist period. This type of tourists will spend more and stay longer, thus increasing the revenues in comparison to the current tourist mix.

It is evident that the government recognizes that this period of unprecedented growth in the tourism industry offers a unique opportunity for Cyprus to establish itself as one of the leading tourist destinations of the region, and this strategy reinforces this effort. The study was presented in an event earlier this month, and for the first time the government initiated a public consultation that will ultimately lead to the formation of the final National Tourism Strategy. The overall target of the study is for Cyprus to become, before 2030, an all year-round sustainable destination receiving 4.8mn tourists, out of which 40% will arrive during shoulder months (November to April; see Fig. 1). Achieving this target will generate c.EUR 7bn in 2030 while reaching a contribution percentage towards GDP of 28%. Amongst other things, the proposed strategy will generate 47,000 jobs and would require an investment of c.EUR 20bn between 2015 and 2030. On first glance, it is evident that the focus of the study is not to increase the total arrivals of tourists, which is already set to surpass the 3.2mn reached in 2016. Instead, THR recommends the "premium and wise" growth model, under which the focus is to attract fewer tourists but with higher spending. As the consulting firm pointed out, the latter suggests an intelligent effort towards selective growth with greater economic, social and environmental profitability. The proposed premium demand strategy focuses on three characteristics: (i) higher per day expenditure; (ii) longer stay; and (iii) more discerning and lower impacts on the society and the environment. As the consulting firm stated, Cyprus' main competitive advantage is that it possesses "the best climate in Europe", all year round. This competitive advantage is envisaged to be reinforced by a menu of tourism experiences, special

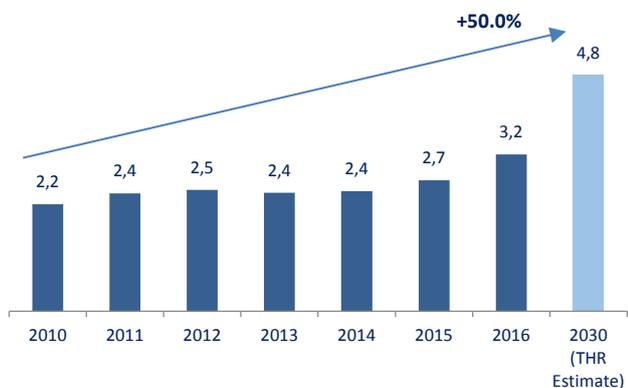
destination attributes and a competitive advantage per business model. The benefits of adopting the strategy will far exceed the benefits of the organic growth that Cyprus will inevitably experience. Specifically, THR suggests that implementing the new strategy will generate additional EUR 27.2bn during 2015 and 2030, versus the alternative – no strategy at all – option.

Figure 3: Tourism Revenues (EUR/bn)



Source: Cyprus Statistical Service

Figure 4: Tourist Arrivals (mn)



Source: Cyprus Statistical Service

The implementation of the strategy requires, first and foremost, the creation of an under-secretariat of tourism (still pending parliamentary approval) which will be responsible for the strategy's full implementation. This will provide the necessary separation of tasks between ministries, along with a clear focus to promote all necessary reforms

required for the timely implementation of the strategy.

Tourism has the potential to be established as one of the major contributors to the country's economy for many years to come, and the relevant figures from the past few years are just a glimpse of what this industry can offer. That being said, the full potential of tourism can only be achieved with the correct and proactive actions that safeguard and enhance all competitive advantages of Cyprus. Thankfully, the latest government initiative of proposing an amended National Tourism Strategy, along with the consensus that tourism is vital to the rebounding of the Cypriot economy and future sustainable growth, provides a strong basis that the country's economy can build upon and continue the phenomenal growth of the past two years.

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Ms. Damiani Papatheodotou joined AXIA in January 2016 as an Analyst in the Research Division, after successfully completing a three month-internship during the period July to September 2015. Damiani primarily focuses on macroeconomic and political research vis-à-vis Cyprus and is the author of AXIA's Cyprus weekly research note. At the same time, she actively monitors a number of European banks in Cyprus, Greece and Portugal with the help of AXIA's Financial Institutions research team. Damiani holds a BSc in International, European and Economic Studies from the University of Cyprus and is due to complete her MSc in Finance.

Cyprus: Transfer pricing is here to Stay



By Mrs. Anastasia Sagianni

*Head of Transfer Pricing Division,
Eurofast*

Transfer pricing has never been as important as it is today. Changes have now also been brought about in the Cypriot tax legislation and as of 1st July 2017, all companies which have intra-group financing will need to have transfer pricing in place. Briefly, intra-group transactions need to be priced (the 'transfer price') in accordance with the provisions of the transfer pricing legislation to determine how much of the profit is allocated, recognized and therefore taxed within the related entities of the group.

The common practice to date was to often use subjective market rates on intra-group loans and/or apply minimal margins on back-to-back loan arrangements which will now no longer be accepted by the tax authorities. Comparability studies will have to be prepared by transfer pricing specialists to substantiate the interest rates used. The Cyprus tax authorities, as well as tax authorities in other jurisdictions, will challenge the transfer pricing adopted in intra-group financing if they feel the interest rates are being manipulated to artificially divert profits away from the functions and risks of the group.

As a result, this will have a significant impact on all Cyprus companies which have such intra-group financing (i.e. loans with related parties) and it is imperative that tax professionals examine your structures to ensure that their tax treatment is correct and their tax risk exposure is mitigated. We strongly advise clients and other interested parties to start reviewing their current group structures and to contact us for more information to assist you in determining the impact of these changes and discuss possible solutions.

At Eurofast we provide a tailored service to meet our clients' transfer pricing needs and requirements.

These include helping you understand how the new transfer pricing legislation impacts your business, identifying the most appropriate transfer pricing methodology, conducting benchmarking analysis to define the arm's length principle interest rate, providing training to your staff, and helping you design an effective and efficient business model.

Over the recent years our tax team has accumulated a wealth of transfer pricing experience and assisted numerous clients in South Eastern Europe to address their transfer pricing needs. We also work with our international association members from Taxand which enables us to provide you with a comprehensive approach to your transfer pricing obligations and opportunities worldwide. Our Transfer Pricing experts are also part of the writing team of "Transfer Pricing Global Guide by Thompson Reuters", a global insight from leading professionals in comparative guides to transfer pricing worldwide.

Contact us to find out all you need to know about Transfer Pricing in Cyprus.

Mrs. Anastasia Segianni is the Head of Transfer Pricing Division at Eurofast, responsible for clients in South East Europe and Middle East. Anastasia obtained her BSc in Economics from the National and Kapodistrian University of Athens with major in Economics and Business Finance, where she also pursued her MSc degree in Applied Economics and Finance, with academic direction in Applied Accounting and Audit. In 2010, Anastasia obtained her professional qualification in Audit by the Institute of Certified Public Accountants of Greece (IESOEL) and since January 2014, she is regarded a Certified Public Accountant according to the Greek legislation. During her professional career, Anastasia has been involved in financial audits and preparation of financial statements in accordance with International Financial Reporting Standards (IFRS). Anastasia specialises in transfer pricing and has substantial experience in various industries. With her interdisciplinary know-how on tax, business and markets, she advises on designing the transfer pricing model that suits to each business. Anastasia was involved in the reviewing of educational material in economics for the Vocational Training Centre of the National and Kapodistrian University of Athens and is a distance learning lecturer in accounting programs at the Vocational Training Centre of the National and Kapodistrian University of Athens.

Disrupting Trends in the Investment



Management (IM) industry

By Mr. Panikos Teklos

Managing Director, Head of Wealth Advisory Services, Deloitte Investment Services Limited

The financial industry has always been full of “buzz-words”, but one seems to dominate the space during the course of the last two years, and that is “Disruption”. The industry has undergone some major structural changes over the past two decades, from super growth cycles to super recession cycles, shady dealings, pyramid schemes, the burst of asset bubbles and the collapse of the housing prices in subprime mortgages market in the USA, all leading to the global financial crisis and recession created in most developed countries. The aftermath of the global financial crisis in 2008 resulted in a New World Order, whilst the unprecedented emphasis on investor protection through ever-increasing regulation and consequently, significantly increased compliance costs, mean that asset managers are looking to find intelligent ways of achieving efficiencies in every aspect they can,

It is always though within such periods of adapting and adjusting to new norms that innovation and entrepreneurship thrive. Financial innovation brought by new technologies is already transforming the industry in unprecedented ways, providing opportunities for more effective and more efficient business models. Digital innovations play a greater role than even before and is expected that several major trends and emerging technologies will impact the investment management industry in the coming years.

We outline below the three broad categories and their potential disruption on the IM industry.

Shifts in investor buying behavior

Fee Sensitivity, transparency and Growth of Passive

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Investing

Retail and Institutional clients are voicing concerns about fee sensitivity and transparency. Firms should develop efficient data structures to facilitate accounting and reporting, making client engagement a key priority. Growth in index funds and other passive investments has been favored during the last years as a reaction to market volatility, slow growth and reduced fiscal spending. The continued growth of low-cost strategies can directly challenge active strategies.

Future Investor Needs

Future investors are more diverse and mobile and often approach investing differently due to their open use of social media and interactions with people and institutions. This market segment faces different challenges since Asset Managers must understand their customers’ specific needs and requirements and reach them through a variety of channels enabling them to carry transactions in every moment and from any place.

Regulatory Developments

MiFID II / MiFIR

MiFID entails significant implications on a massive scale towards the strategy, operations and governance of investment firms, investment banks and participants within the IM space. Through a regulatory text of over 5,000 pages published by the EU, MiFID II aims to increase investor protection and enhance transparency further. While the implementation deadline is fast approaching investment managers need to modernize their business models with upcoming MiFID II changes.

- i. Strengthen governance and organizational requirements
- ii. Strengthen investor protection rules with respect to investment advice, inducements, research, suitability and appropriateness and best execution
- iii. Extend the Pre- and post- trade transparency regime to non-equities

- iv. Increase transaction reporting requirements significantly
- v. Increased disclosure requirements
- vi. Increased product governance arrangements

PRIIPS

Packaged Retail and Insurance-based Investment Products (“PRIIPS”) introduce new reporting challenges whereby insurance, banking and investment firm product manufacturers are required to produce the PRIIPS Key Investor Information Document (KID) starting from January 2018 that will provide details for a transparent look through of performance, risk and cost. The aim is to provide investors with sufficient information prior to making their investment decision.

Key Technologies

Blockchain and Smart Contracts

Blockchain is a new technology attracting lots of attention in the IM industry particularly for its ability to transform and extend IM business value chains. It aims to achieve a decentralized consensus suitable for controlling information through secure, auditable, and immutable records of not only transactions but digital representations of physical assets. Users can issue new assets and transfer ownership in real time without banks, stock exchanges, or payment processors and therefore eliminating the need for a centralized trusted authority to validate transactions. Encryption and verification are fundamental to blockchain because the data is, by design, in motion at the initial stages of processing, as consensus across the network is established. Consensus is the required condition in a blockchain for a transaction to be captured in an immutable block. A block’s content typically contains a validated list of digital assets and instruction statements, such as transactions made, their amounts and the addresses of the parties to those transactions. It uses cryptographic functions to ensure the security of its data.

Through a distributed ledger this technology provides a way for information to be recorded and shared by a community. Each member maintains his own copy of the information, and all members must validate any updates collectively. Community members will be able to view transaction histories and each update creates a new block which is added in the end of the chain. Privacy can also be selectively enforced allowing anonymity. With blockchain, cryptology replaces third-party intermediaries as the keeper of trust with all blockchain participants running complex algorithms to certify the integrity of the whole.

Smart contracts are becoming a cornerstone of blockchain applications, whereby a computer program is capable of enabling two parties to conclude an agreement which is enforceable using blockchain technology. Since the terms of the agreement are stored on the blockchain, the whole process of conducting business is streamlined as the need for intermediaries and of different platforms is removed. Smart contracts represent next step in the progression of blockchain from a financial transaction protocol to an all-purpose utility.

Cognitive technology, Machine Learning & Artificial Intelligence

Cognitive technology comprises several areas, including natural language processing, computer vision speech recognition and robotics. More advanced than bots, cognitive technology mimics human judgement in its ability to recognize handwriting, identify images and use natural language processing to interpret information. Machine learning capability allows these tools to improve over time and has been the foundation of the rapid advance of robo-advisors in the investment management sector.

Cognitive technology has huge transformational potential. An important emerging trend is where enterprises are starting to employ such technologies (i.e. speech recognition, natural language processing and machine learning) to automate perpetual and judgement based tasks which were traditionally performed by humans.

The uses of Artificial Intelligence are potentially limitless but the tools are also expensive to deploy and therefore may have a longer implementation timeline. Cognitive tools can drive value by improving complex, non-routine tasks requiring an element of judgement and learning.

Robo Advisors

The emergence of robo advisors has shaken the market. The firms which employ this technology leverage on client information and algorithms to develop automated portfolio allocations and investment recommendation tailored to individual clients that access robo-advice through digital user interfaces for very low fees. Robo-advisors have disrupted the industry due to their lower fees, innovative interface, the familiarity of the digital savvy generation to this type of services and the broad range of advice that may be offered. Although, this technology is still emerging, Asset Managers with enormous client base may be exposed to this disruption and consider offering a channel for digital strategies and automated advice in order to maintain a competitive advantage.

Investment management firms that execute plans which help them anticipate demographic shifts, improve efficiency and decision making with technology, and keep pace with regulatory changes will likely find themselves ahead of the competition. Real time, flexible access to data will advantage firms, through deeper client insights, to deliver a more tailored client experience, identify new alpha sources and deliver sophisticated investment know-how at lower costs. Many deals will center on targets with access to unique data sources and technologies that can drive differentiated investment capabilities and client experiences. The digitization of the IM industry is no longer a “point of view” or a look through the “crystal ball” – it is a fact and the Investment Managers flexible, versatile and able to

adapt to this constantly evolving landscape are those who stand the reap the benefits in this new era.

Panikos is a Managing Director and the Investment Management and Wealth Advisory Services Leader of Deloitte in Cyprus. Panikos's mandate spans a wide range of areas, namely, Regulatory Advisory (MiFID, EMIR, PRIIPs, AIFMD, UCITSD, CRR/CRD), Strategic Risk Advisory, Asset Liability and Capital Management, Treasury and Credit Risk modelling solutions, setup and ongoing advisory services for Investment Funds, Investment Firms, Asset Managers, ASPs and Banks. Prior to joining Deloitte, Panikos had a long international tenure in Investment Banking, Consulting and Fund Management.

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