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KPMG Works with Cyprus to Grow Alternatives Sector

The island's popularity with the industry is flourishing

BILL McINTOSH

Industries aren't built in weeks or months or even a few years. The development of the funds sector in Cyprus is no exception. It is a story of persistent effort by KPMG Cyprus and joined up regulatory supervision involving the Central Bank of Cyprus (CBC), the Cyprus Securities and Exchange Commission (CySEC), and the country's Ministry of Finance.

Angelos Gregoriades, a KPMG board member and head of tax, began investigating how Cyprus might develop a sector specialising in investment management services in 1995. Among his first ports of call was Elena Ambrosiadou, co-founder and CEO of hedge fund IKOS. Against the backdrop of an asset management conference Gregoriades and Ambrosiadou began discussing how Cyprus could develop an alternatives industry. "I was trying to promote Cyprus in different financial services areas," says Gregoriades. "The alternatives market took time to develop but those early efforts came to full fruition in 2005 when IKOS, advised by KPMG, gained regulatory approval from CySEC and commenced trading from Limassol, on the country's south coast."

He quotes from Elena Ambrosiadou's recent speech in Paris, explaining the technology behind global operations including trading from Cyprus: "In today's world, communications technology means we can be part of the information/data highway wherever we are. What does this mean? We at IKOS have already positioned ourselves in order to make the most of a global resource pool within a European framework. In today's markets electronic connectivity allows you to trade 24 hours a day from anywhere in the world. Now, being close to the market no longer means physical proximity. It means being close to your regulator, your investor and your service provider, all of which happens via electronic media continuously, and in regular patterns via reporting, face to face meetings and due diligence processes. The evolved manager of today is the electronic manager who can navigate away from crowded markets through trading, resource and location independence. Geographical flexibility is not about offshore, unregulated tax havens - IKOS is regulated by five bodies. Geographical and positioning flexibility is about being able to attract the best from around the globe and at the same time be a global player with global infrastructure. Operate locally but manage globally."

Knowledge gained from experience

"Our knowledge has been built up at KPMG from not only tax professionals but by personnel in legal and auditing who service the investment management firms and their funds" says Gregoriades. "For example some companies or

funds, although registered in Cayman, will be audited in Cyprus. KPMG now has more than 50% share of registering and auditing collective investment schemes registered at the Central Bank. Through this experience we are leaders in that field."

"IKOS was one of the companies which we helped obtain CySEC registration and they have come a long way in their growth and development as an organization and in attracting investors," says Gregoriades.

"Their business has grown significantly, with 60 strong in Limassol, and key affiliations, offices, execution and/or research sites in London, Vienna, Tokyo and New York. During this process, IKOS has facilitated the repatriation of Cypriot nationals and the employment of foreign professionals, and the company currently employs staff from 20 different nationalities. We are also very pleased that in the context of its social responsibility, IKOS has offered MBA scholarships to Cypriot students at Cranfield University in the UK."

Cyprus – an alternative EU destination

"Now that Cyprus (since 2004) is a European Union country it has gained a lot of respect in international markets." Indeed, Cyprus is on the OECD "white list" of jurisdictions that have substantially implemented the internationally agreed tax standard.

If EU membership has changed how the funds business operates in Cyprus, so too has the example of other regulators, notably the UK Financial Services Authority (FSA). "Even before we were part of the EU, the Central Bank – for the fund authorisation process – more or less aligned its directives with the FSA and its procedures."

Furthermore, now that personal tax rates have increased in the UK, and given the UK's comparatively higher corporate tax rate, there exists a further opportunity for Cyprus to attract hedge fund managers. "There is evidence of people looking for alternative jurisdictions," says Gregoriades. "We think there is a place for another jurisdiction and that IKOS is an important example of what can be done. The theme we want to bring forward is for hedge fund managers to consider Cyprus as an alternative jurisdiction."

Whether large or small the financial benefit of becoming established in the lower tax Cyprus regime is substantial. Taking the example of a small hedge fund firm with \$200 million in assets, it is likely that the lower operating costs (personnel, office rent and utilities) of a Cyprus operation would allow the business to be profitable at a holding

company level when the same business would not be profitable elsewhere in more expensive European locations. As an example, investment managers might want to develop dual base solutions, separating the types of services being offered in Cyprus and those provided in another location (for instance, a sub-advisory agreement could see back office or marketing services shift to Cyprus).

Turnkey service to setup

KPMG aims to provide hedge fund firms with a turnkey service to setting up in Cyprus. This could be for an entire relocation or might be limited to the setting up of some middle and back office services in a country that will be cheaper to operate in than the UK. KPMG has experience offering a variety of services across numerous disciplines and jurisdictions.

"I think we could provide a good package to a hedge fund manager that may want to come and use Cyprus," says Ioannis Gaiganis, KPMG's Senior Manager of Investment Fund Services. "That could include a manager's personal affairs and setting up a private family trust arrangement. It could also extend to advice on structuring the operation as well as any other activities that need to be set up in Cyprus."

The first step for a manager wanting to set up in Cyprus is to register with CySEC. A fund can't do anything until it gets this approval, but the process should take less than six months. KPMG and others are pushing the Minister of Finance to streamline processes to have the procedure done in two to three months. To help a hedge fund firm get the quickest turnaround, KPMG offers a full advisory service to navigate the registration process. "We'll fill out the necessary forms and give advice based on our previous experience," says Gaiganis. "We also set up a direct meeting with CySEC and sort out any additional information that may be required. We will advise a firm all the way – we will be the intermediary that assists in the registration process."

While the registration is being reviewed, KPMG offers an array of other services. This is designed to facilitate a smooth transfer to Limassol's sea front boulevard, where many of the island's commercial trading, shipping and investment firms have their offices. "We can offer hedge funds a one stop service," says Gregoriades. "We can support them in looking for office space and we can screen potential employees. We can give them alternative office space solutions. For setting up their systems, we can advise on risk and IT. We also provide ongoing compliance and tax advice as well as audit services."

The cost of CySEC and advisory fees for a hedge fund firm to get up and running varies depending on the share capital of a company that is being set up. KPMG estimates the sum at some €30,000 to €50,000. Owing to the 0.6% stamp duty on share capital, firms are generally advised to register capital as a share premium which doesn't bear stamp duty.

Typically, €1 million of share capital is registered (with the remainder as premium) giving a tax cost of €6,000 plus a further €10,000 to €15,000 to incorporate the company. KPMG can recommend outsource service providers to help new fund management firms get the right service at the right price. It also has a network of experienced professionals from company directors to qualified accountants, which can help the resource requirements of new companies.

CySEC registration is the most important threshold for a new firm to cross. After that there are few other potential pitfalls that a hedge fund firm will face. "We are known to the market," says Gregoriades. "Our legal and tax system is simple to follow. It is not like going to a country that has very complicated laws in play. It is all based on UK standards. We operate basically on the Company Act 1948. There are updates to bring it up to the level of the EC directives, but it is simple legislation. Because of the size of the market we know the local players and the people to whom you may need to talk to get where you want to go."

Presenting the package

"Though we know our product is competitive today, the other part of our effort is to ensure that as things evolve it remains competitive and that changes in regulation don't compromise the competitiveness of the product," says Gaiganis. He notes that the country's Collective Investment Schemes Law is very competitive compared to jurisdictions in Luxembourg, Ireland or the Channel Islands – disproportionately so relative to the number of funds attracted to Cyprus so far. "It is a good package," he says. "It just needs to be presented better."

To that end, KPMG is helping to take the Cyprus proposition to the next level and promote it. Road trips in the Middle East and London are scheduled for later this year and there are plans for the island to pitch directly to hedge fund managers at a future industry conference. The CSE is backing the initiatives and CySEC is expected to become involved at a future date. "We are trying to bring all of the actors of the industry together and secure their participation in a way that is beneficial to all," says Gaiganis. Crucially, the Finance Ministry is keen to use legislation and tax treaties to help the financial services industry expand.

As a global network, KPMG International helps backstop the fund services the firm offers in Cyprus. Hedge funds like IKOS are global in nature and KPMG matches their service needs through its entire network. For example, some IKOS Funds are listed on the Irish Stock Exchange (ISE) and their Administrator is in Ireland, so KPMG Ireland acts as the auditor to the Funds. One day, these services may be provided from Cyprus.

KPMG's Fund Services Group is made up of professionals from all jurisdictions who contribute to the firm's services and provide the relevant information to clients about what is happening in other jurisdictions. At KPMG Ireland, for example, there is a benchmarking function that monitors what is happening in all jurisdictions with fund management practices. It details accounting issues that relate to fund managers as well as tax and the various compliance requirements in each country.

"There is a wealth of knowledge there that we rely on and use whenever it is needed by a client," says Gaiganis. "That network gives us access to regulatory information and market behaviour that we try to interpret for the development plans we have for Cyprus."

KPMG Cyprus employs eight lawyers across tax and legal with half having experience helping funds on the legal requirements to set up. This provides a thorough proposition for advice on the prospectus, promotional materials, agreements that relate to the fund manager and the fund itself as well as the structuring of the share capital and the management shares that are created. "With each and every requirement of the client, we have to adapt to what is needed," says Gregoriades. "This also brings us back to the one stop service we offer. Whatever we can do, we do in house, but we can also get assistance from other service providers."

The firm will also help with marketing and advice on raising assets.

"When we help a fund set up we don't just help by sending the information from the fund to the regulator," says Gaiganis. "We try to understand it and see if there is any value we can add in the structuring of the fund. We've had cases where we have suggested changes to make the fund more competitive. We end up with a fund that is likely to be competitive and if we believe in the product we can suggest which doors an asset manager can knock on to present its product. We can definitely recommend houses where you should go and if they like the product it will certainly help that they know we are assisting in setting up that product." **THFJ**

"For the near future, alternative funds in Cyprus, especially the hybrid fund arrangements that went into Russia, look poised to grow from expanding demand for investment in other east European countries such as Poland and the Ukraine"



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Destination Cyprus

Cyprus targets hedge funds in expanding funds sector

BILL McINTOSH

In the late 1980s and early 1990s, the funds industry in Cyprus enjoyed a mini-boom that showed there was demand for a modern financial services sector. The island's strategic location on the doorstep of three continents and its well-educated, English speaking workforce continue to attract firms and business.

In recent years, there has been renewed focus on building a strong financial sector in Cyprus. Regulation is being continually updated and improved, while institutions like the Central Bank of Cyprus, the Cyprus Securities and Exchange Commission (CySEC) and the Cyprus Stock Exchange (CSE) have engaged in a long-term development effort to grow the funds sector. Also contributing to this is the fact that the Cyprus Company Law derives to a large extent from the UK Company Law and a strong banking sector that avoided the perils which caught up numerous banks in Europe and the United States in recent years.

This is the backdrop to the continued growth in the Cypriot investment management sector. Currently 21 investment management firms¹ have applications for licences before CySEC to join the 70 or so firms already established. Perhaps the most significant of the new applicants is a member of the Gazprom Group, the Russian energy giant and among Europe's biggest companies by market capitalisation, which is planning to set up a Cypriot investment services arm. "After the financial crisis, a lot of big corporations seem more comfortable setting up their own investment services arms to deal with the needs of the group as well as offer services to others," says Liana Ioannidou, a senior officer with CySEC, commenting on the trend in investment firm applications. "That is what we suspect is happening."

CySEC shares regulatory powers with the Central Bank. It authorises and supervises investment managers whereas the Central Bank regulates alternative funds. Founded with the CSE in 1997, CySEC became a public body with more powers in 2001. It regulates the securities market and oversees compliance of investment firms with anti-money laundering measures as well as licensing and supervising investment firms. Proof of the determination in Cyprus to attain best practice is the country's compliance with 28 of the 30 principles laid out by the International Organization of Securities Commissions. Also indicative of ongoing efforts to develop the right framework for fund managers, the CySEC council has commissioned a committee of experts to provide advice on setting up a comprehensive risk based system of supervision to

be implemented in 2010. More recently, the regulator has signalled that ongoing deliberations about the legal framework for other investment schemes will take into account the European Commission's Alternative Investment Fund Managers directive when it is eventually finalised and passed into law.

Private equity funds established

The funds sector regulated by the Central Bank is comprised of around 50 funds, mainly private equity in investment strategy, but with a dozen or so real estate funds. The majority of funds are from Europe, Russia, former CIS countries and the Middle East. Like its counterparts at CySEC, handling a surge in investment firm applications, Central Bank officials have 12 fund applications before them. "There is growing demand for funds," says Spyros Stavrinakis, a Senior Director with the Central Bank. "As far as inquiries are concerned we assume that the level of activity means that there will be more applications. There is increasing interest due to the European membership and Cyprus can easily adapt to the European rules for non-UCITS funds because it has a long standing industry with experience."

The island looks well placed competitively for the non-UCITS fund sector to develop. It could win funds market share from Luxembourg and elsewhere in the coming years as the sector develops further. It is the experienced investor designation that is the main focus of Cyprus's fund development and of most interest to hedge funds. Fund legislation in Cyprus covers all investment schemes including unit trusts, limited partnerships, investment companies with fixed and variable capital with licences restricted to private funds and funds for professional investors.

There are long-term plans for CySEC to assume fund registration and regulation from the Central Bank. But the move isn't imminent and the Central Bank expects to give substantial notice well ahead of the formal shift in responsibilities. CySEC is planning to train personnel to administer the funds regime and it is broadly acknowledged that funds already registered and compliant with the existing framework will be recognised in the new one when it arrives. "There is agreement that the Central Bank's role in licensing and regulation will move to CySEC but it will remain with the Central Bank until CySEC has sufficient resources to discharge its mandate," says Stavrinakis. "It is important for market participants to get sufficient notice. Funds already registered will be grandfathered, that is to say, they won't have to apply for a new licence."

The Central Bank had responsibility for promoting the funds sector until it was replaced by a specially mandated promotions agency in 2002. But Stavrinakis is matter of fact about detailing the advantages to funds of setting up in Cyprus and highlights an

efficient and competitive financial sector with over 40 banks providing custody, administration and other services to funds. He also cites the island's well established legal and accounting sectors as well as the legal and court system being based on English law. "These are factors which help with the establishment of new business in Cyprus," he says.

Analysts note that the Cyprus regime offers some additional specific benefits to hedge funds. As an example the cost of legal fees for setting up a fund in Luxembourg is generally some €70,000 to €100,000, in Cyprus it is a fraction of that at around €15,000 to €20,000. The Cypriot regime also permits accountants with experience of the process to represent a fund to the regulator rather than requiring direct client presence with the regulator as in Luxembourg. Costs are also likely to be lower in Cyprus. In Luxembourg, for example, there is a 0.01% levy on fund assets under management but no such charge in Cyprus. Fund administration and custodial services are also cheaper than in other centres.

The Central Bank has discretionary oversight to respond to how a fund manager wants to set up a fund vehicle. It is interested in developing governance and transparency rules to help the funds sector achieve best practice and attract new business. Though Cypriot banks provide custody and administration services financing is still the reserve of international investment banks. But this looks to be changing as one of the applications before the Central Bank is from a local commercial bank which is looking to develop in this area of the market. More of this type of expansion is expected.

Leading the Cyprus market

Barclays, Banque Nationale de Paris and Société Générale are among the foreign banks active in Cyprus. But it is Cypriot group Hellenic Bank that leads in the custodial services segment of the market with an estimated 70% share overseeing assets of over €2 billion. Charalambos Phokas, manager of trust and custodian services says Russia, Greece and Europe are the key markets Cyprus must target to develop the alternative funds industry. "Demand is increasing," he says. "There is considerable appetite for registering these funds. If the fund industry is promoted in the right way it could lead to huge demand as Cyprus has a very favourable tax regime."

Hellenic Bank covers both local and international markets. It also offers to act as a trustee for a fund if it incorporates as a trust rather than as a private company. Phokas estimates his own business could double in size but allows that that will ultimately depend on how the funds industry as a whole progresses. "Our advantage is that we have an automated solution that uses a minimum of staff and depends instead on technology," he says.

1. These are firms that wish to offer investment services and carry out investment activities pursuant to the national law transposing MiFID

The man behind the plan to build the funds industry is Minister of Finance Charilaos Stavarakis, a senior ex-Bank of Cyprus executive and someone who has been very active in international business. Though Phokas acknowledges the Minister's contribution, he is keen for both the Central Bank and the Ministry of Finance to contribute more to developing the Cypriot funds sector at a time when new business is up for grabs. "The Central Bank of Cyprus and the Minister of Finance need to be actively engaged in developing the funds industry and hedge funds," he says. "But the Finance Ministry can have an active role in promoting the sector. They have the channels to promote this business just as they are promoting the international business of Cyprus as a financial centre." Phokas hopes the authorities will do road shows like they do for CSE but extend this to include promoting the funds sector and work with local banks and administration service providers. In some ways, the financial crisis afflicting most countries offers Cyprus a competitive advantage. Strict rules apply to local banks which mean there was no exposure to any of the structures run by Lehman Bros. On short-term credits, for example, Cypriot banks are restricted to paper rated no lower than A-1. "The banking industry was not affected by the financial crisis," says Phokas. "There were no liquidity problems. On the contrary, there was no issue with stability of Cypriot banks." Hellenic Bank runs business outside of Cyprus and uses Citibank in Moscow where the Cypriot firm has significant operations. In turn, Hellenic Bank serves as sub-custodian for Citi in the Cyprus market. In other markets Hellenic Bank uses different local custodians. "Using different local custodians rather than the same global one gives better knowledge of a particular market," says Phokas. "It is always better to know the local player."

A developer's market

The financial crisis hit activity in local real estate. British and Russian investment stopped expanding but it hasn't contracted either. "Cyprus cannot go against the global economic trends," says Theophanis Theophanous, partner for Investment and Wealth Advisory with Deloitte Cyprus. "We have been affected. But things haven't stopped." He adds that the tax treaty with Russia may not be as beneficial as earlier but argues that it is still the best one around and that this should put a floor under the market until it expires in 2012.

Though secondary residential property prices are gauged to have dipped around 15% over the past year, prime residential and commercial property values have held steady. Part of the reason for this resilience is the limited supply for so-called Grade A commercial space. Local developers are reluctant to build on spec, even though the few projects that do proceed on this basis are usually fully let well before project completion. As a result, many companies

build their own offices. The latest example of this is IKOS, the global leading hedge fund (whose sub-investment manager activities are based in Limassol, Cyprus) which has just begun constructing its own multi-purpose development. "Demand for Grade A space has grown in recent years as companies like IKOS have come here or expanded," says Antonis P. Loizou, senior partner of Nicosia-based property firm Antonis Loizou & Associates. "With more demand for Grade A office space commercial development will be more wide spread as developers become more comfortable with demand being sustained." He adds that despite the financial crisis office rents have held up and there has been growing demand for large facilities with a 1,000 square metre footprint.

In the Cyprus market, Limassol (based on the south coast and the island's second largest city) is the more cosmopolitan centre as it is the home of many shipping and international companies. In comparison, Nicosia is the administrative centre and hosts local companies and international companies, including major government and financial institutions. Loizou says Nicosia is about 30% cheaper than Limassol where Grade A seaside view office space is €20 per square metre per month while Grade B offices with no seaside view go for about €12. In Nicosia, in the central part of the island, the Grade A rate is about €15 and Grade B €10.

The prime residential market around Limassol has seen values remain steady. West of the city there are a variety of golf courses easily accessible from the estates to the north where 600 square metre villas complete with a swimming pool and seaviews can easily cost over €1 million. Foreigners who make a €300,000 investment in property get automatic residency status and a Cypriot passport after six years. For that price, a newcomer can get a three bedroom house with a pool and beach front either east or west of Limassol with prices decreasing as distance from the city increases.

Favourable tax regime

If Cypriot property prices look better value than Mayfair so, too, does the tax regime. Corporate tax is assessed at 10% but it can be reduced through allowances and domiciling companies outside the EU. For employees of asset management firms, a €100,000 income would attract total tax of about €22,000. For partners and others, the marginal tax rate on all income tops out at 30%.

From the development of its financial and banking sector, Cyprus has companies that offer a wide range of the business services most frequently needed by asset managers. Albourne Partners, the London-based alternative investment fund services provider, has developed a major presence in Cyprus since opening an office in 2001. It has 50

of its 180 worldwide staff in Cyprus working on due diligence, IT and operations support. Technology service providers are also well established and have substantial experience in financial services. "IT companies like IBM, Oracle and others offer the full range of products," says Kyriacos Kokkinos, General Manager at IBM Cyprus which has 50 specialist IT staff. "And the ability of people to service this is there. It is a very competitive market."

Kokkinos says the business perspective of a multinational workforce is a valuable advantage for Cyprus. He and others like to actively recruit from overseas Cypriots and foreign nationals who are already involved in servicing financial firms abroad. "We believe this is an area that has the potential for growth – whether from Islamic funds, hedge funds or others," he says. "We are trying to attract foreign direct involvement in other financial services products."

Signet Athena, a fund of funds operator with \$1.8 billion invested in seven portfolios, is a global firm with offices in Lausanne, London and Washington. It opened an office in Nicosia two years ago where it has two employees but expects to add more. "I think it makes sense for hedge funds to come here," says Harris Tsangaris, a risk manager with Signet. "Cyprus is a good environment. There is a good skill set, good infrastructure and a good local workforce. I am hopeful we will be able to expand here."

With Cyprus an EU member since 2004, there are growing hopes of a resolution of the 35 year dispute with Turkey that divides the island. Certainly it is inconceivable that Turkey will ever be admitted to the EU while still basing more than 30,000 troops on the island's northern territory. Though the political differences are deep-seated, reconciliation is closer than at any time since the conflict ignited in 1974. Some observers believe that a solution to the division is likely over the next five to 10 years. "In the meantime," says Deloitte's Theophanous, "we are experiencing gestures of goodwill from both sides."

One final point Cypriots and non-Cypriots both like to make is just how pleasant life can be on an island that is at the intersection of civilisation in the south-eastern Mediterranean. "We always leave the quality of life until last," says Ioannis Gaiganis, senior manager of Investment Fund Services at KPMG Cyprus who abandoned grey, land-locked Luxembourg earlier this year to relocate his wife and four children to a beach-side home near Larnaka, the home of one of the island's two main airports (the other one being Pafos), which is being re-opened in completely new facilities. "We don't dwell on it, but we can't not mention the lifestyle benefits that being here brings. It is a year around holiday location – whether it is the weather, the facilities or the tourism industry." **THFJ**

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Q&A with Charilaos Stavrakis

Minister of Finance for the Republic of Cyprus

INTERVIEW BY BILL McINTOSH



As part of *The Hedge Fund Journal's* exploration of Cyprus as a centre for hedge fund growth, we submitted questions to Minister of Finance Charilaos Stavrakis concerning a number of key issues. Below we print the Minister's response to those questions. The overall message is that the Government of Cyprus is carefully focused on providing the regulatory, legal and technical support to build a dynamic and growing funds sector.

Q: Please discuss some of the important developments in the financial sector.

A: Cyprus enjoys a strategic geographical location and historic relationships with countries where alternative investment funds, including hedge funds, have yet to exploit their full potential. Furthermore, Cyprus enjoys a number of additional comparative advantages as an international and regional business centre deriving mainly from being a member of the EU and the Eurozone, the high educational level of its workforce, the satisfactory and continuous upgrading of its infrastructure in airports, ports and telecommunications, the high quality of consultancy services, such as legal, accounting, auditing etc. the modern and transparent legal, financial and accounting systems, modelled to that of Britain, as well as a fully liberalised foreign investment regime, only to mention a number of them. Thus, Cyprus can act as a stepping stone for investment fund managers, including hedge fund managers to reach markets like the CIS countries and the Middle East / North Africa area.

The entry of Cyprus to the Eurozone was a major achievement. Now the Government is focusing on developing the advantages offered by membership. In the funds sector, the possibility of listing funds, and listing rules on the Cyprus Stock Exchange, are constantly evaluated. The Cyprus Stock Exchange was established under the Cyprus Securities and Stock Exchange Law of April 1993 and commenced trading in 1996. Also, since 2006, the Cyprus Stock Exchange has been developing its infrastructure and its regional collaboration with the Athens stock exchange in a forward looking and dynamic step.

Our non-UCITS funds legislation, in force since 1999, provides the current legislative framework. We believe that it constitutes a good basis for the attraction of non-UCITS in Cyprus. However, it is important that we proceed with a comprehensive and fully transparent legislative framework for UCITS and non-UCITS, in full compliance with the relevant *acquis communautaire*, taking into consideration the latest initiatives at the EU level to regulate alternative investment fund managers. To this end the expertise of successful financial centres will be used.

“A very efficient communications infrastructure is essential for a competitive financial sector”

The Ministry of Finance within the framework of the broader vision of upgrading the role of Cyprus as an international and regional business and financial centre is at the centre of a wider initiative, in close co-operation with the Cyprus Investment Promotion Agency (CIPA), the competent supervisory authorities and the private sector to modernise the institutional and legislative framework that is required so as to offer an appropriate environment that attracts investment funds, including hedge funds to Cyprus.

Furthermore, Cyprus regulation on investment firms focuses on corporate governance including:

a) requirement for an independent risk manager within any trading or investment firm;

- b) a requirement for an internal audit function with the responsibility to monitor and report procedural weaknesses;
- c) a board of directors with clear compliance responsibilities; and
- d) an oversight capability to review and discipline the function of the board with the transparency provided by board meetings.

The focus on corporate governance creates a healthy environment for the financial sector, which not only complements but also strengthens the global regulatory environment that the Cyprus Securities and Exchange Commission (CySEC) registered firms may experience, for example, with the Securities and Exchange Commission in the US.

A fully transparent and comprehensive legislative framework, in conjunction with prudent supervisory authorities and a favourable tax regime, in full compliance with the *acquis* and the EU Code of Conduct on Business Taxation, will provide the best preconditions for the significant upgrading of Cyprus as a reputable international and regional financial centre. Moreover, it should be noted that Cyprus conforms to the OECD standards on transparency and exchange of information.

Q: How are these actions being coordinated?

A: We have set up a monitoring committee, under the chairmanship of the Ministry of Finance and with the participation of the competent supervisory authorities, CIPA, and the private sector (representatives of professional associations and companies serving the alternative investment fund market, including hedge funds), which convenes on a regular basis to monitor the progress made in the achievement of our objective in upgrading the role of Cyprus as an international and regional financial centre and the progress made with regard to the various measures that have been decided within this overall framework, as well as to tackle additional gaps and bottlenecks that arise.

Q: What is the Finance Ministry levy on corporate tax, personnel income tax and other taxes? How does this compare with Europe? Is world-wide income taxed in Cyprus and are there exceptions that are possible or can be enacted?

A: The Cyprus tax laws were designed to support the development of the country, with a transparent tax regime and low tax rates for the taxation of both factors of production capital and labour, thus contributing positively to the attraction of international investment. The corporation tax rate was set at 10%, whereas for physical persons an income up to €19,500 is taxed with a zero rate,

with the highest marginal tax rate set at 30%. Cyprus thus offers one of the lowest rates both for corporations and physical persons in the EU. Note, too, that Cyprus investment firms are not subject to withholding tax on payments of dividends and interest to non-resident investors, while capital gains realised on immovable property held outside Cyprus (or on shares in companies owning property outside Cyprus) are outside the scope of capital gains tax. Moreover, profits from the disposal of securities (shares, bonds, debentures etc.) of companies incorporated in Cyprus or abroad, and options thereon, are exempt from tax. Further, we ensure that investment funds, including hedge funds and their related corporate structures benefit from our wide and beneficial Double-Tax Treaty (DTT) Network. We currently have more than 40 DTTs in force and are negotiating 16 others. We believe that the existence of these treaties combined with the low overall tax regime offer significant possibilities for international tax planning through the island both at corporate and individual levels.

The tax system of Cyprus provides for the taxation of the worldwide income of tax persons being tax resident of the Republic. However, businesses maintaining a permanent establishment abroad and earning income from an active business are exempt from taxation in respect of the profits earned by the permanent establishment. Furthermore dividends received by companies resident in Cyprus from foreign companies, under certain conditions, can be exempt from tax. It should be noted that if tax is paid abroad on income earned abroad, this is allowed as a deduction against tax in Cyprus imposed on the same income either through the application of provisions of DTTs or unilaterally.

Q: Communications infrastructure is key. What part of the Government of Cyprus is overseeing telecoms infrastructure? What is the plan to improve it?

A: The continuous upgrading of the infrastructure constitutes one of the main pillars in our development policy. We fully acknowledge its importance and intend to complement private investment in it. In this regard, Cyprus does have a high quality communication infrastructure, adequately regulated. The sector has been fully liberalised upon accession to the EU, whereas the regulatory authority – the Office of the Commissioner of Telecommunications and Postal Regulation – was established in 2002.

The competition that was achieved via the full liberalisation of the market has contributed, and will continue doing so, to widening the services offered, upgrading their quality and lower prices for the consumer. In this competitive environment,

there is a continuous pressure on service providers to upgrade and enrich their services at low cost and offer low prices to the consumer.

Q: What will the Government of Cyprus do to commit the country to developing a hedge fund manager sector? Has it gathered intelligence on what other regimes are doing, such as Ireland, some Swiss cantons, the Channel Islands, etc?

A: We are convinced that the role of the Government should concentrate on the provision of a modern and transparent regulatory framework, a prudent supervisory framework to create an environment conducive to investment funds, including a favourable tax regime. The above in addition to the other comparative advantages of Cyprus as an international and regional business and financial centre will facilitate the embedding of Cyprus as a hedge fund centre. We are working on these areas, building on our strengths and looking to eliminate gaps and bottlenecks, by bringing our hedge fund industry actors together and encouraging the development of the expertise required by our alternative fund industry.

We are aspiring to grow Cyprus' credibility as a reliable specialist centre for alternative funds. The arrivals of hedge fund management activities of major businesses like the IKOS Group (which operates its sub investment management activities from Cyprus including trading, portfolio management as well as risk management) and hedge fund specialists Albourne Partners, are a testimony to the growing expertise of the sector. With our support, the private sector is responding particularly well to alternative fund requirements and is positioning Cyprus as a fund management services domicile and back office services centre. Several high-profile complex alternative funds are now targeted by our country's main financial service providers. The Government fully supports these efforts.

Q: Who has the government engaged to advise them on how to develop country as a hedge fund host?

A: The participation of the private sector, including experts from global accounting and auditing companies and experts in the alternative investment fund industry, in the Monitoring Committee set up for the promotion of investment funds constitutes a forum that helps the government to identify the gaps and the bottlenecks in the development of the country as a hedge fund host. Moreover, in the elaboration of a transparent and comprehensive regulatory framework for UCITS and non-UCITS funds, the government will make use of foreign experts as well. **THFJ**

“We are convinced that the role of the Government should concentrate on the provision of a modern and transparent regulatory framework, a prudent supervisory framework to create an environment conducive to investment funds, including a favourable tax regime”

Best of All Worlds

The advantages of Cyprus as an EU base for hedge and private equity funds

IOANNIS GAIGANIS, SENIOR MANAGER, INVESTMENT FUND SERVICES, KPMG CYPRUS

Good reasons to choose Cyprus as a hedge fund and private equity fund location

Cyprus is an attractive financial centre combining the advantages of a traditional offshore centre with those of a full member of the European Union. Almost 25,000 new companies were registered in 2008 and the Cyprus Registry has nearly 214,000 companies listed in total.

Despite the global economic slowdown, by May 2009 more than 6,000 new companies had been registered. Far from being a place where the “bronze plated presence” rules, Cyprus has an excellent infrastructure allowing clients to add real substance to their tax planning in the form of fully-fledged operations in the island.

With a population of approximately one million, Cyprus is much larger than the other financial centres of Bermuda, the Caribbean, the Channel Islands, the Isle of Man, Malta or Luxembourg and has a large number of talented professionals available to work in the financial services industry. Yet it is still possible to contact directly the government and legislators in the jurisdiction, without having to deal with the layers of bureaucracy that tend to exist in more mature and more complex financial centres.

A great combination of effective regulations, flexibility and incentives

The regulators have shown that they are determined to ensure that any participant in the market complies with its effective regulations but demonstrates a pragmatic business-friendly attitude with a flexibility that is unfamiliar in an EU jurisdiction. Cyprus is closer to Ireland or Luxembourg in the strength and depth of its regulation than it is to Bermuda or the Caribbean jurisdictions. The creation of a robust regulatory framework was a structured part of the long term strategy to build a mainstream finance centre in the country. In this role, the Central Bank of Cyprus is a fully autonomous public institution that regulates the International Collective Investment Scheme (ICIS) legislation, whereas the Cyprus Securities and Exchange Commission regulates the establishment of financial services companies and particularly fund management companies set up by hedge fund managers.

Over the past 10 years, Cyprus has moved from being an offshore to an onshore jurisdiction. It has completed a programme of reforming all its finance sector legislation in line with international best practice and has put a simplified, effective and transparent tax system in place that is fully compliant with the EU, the Financial Action Task Force on Money

Laundering (FATF), the Organisation for Economic Co-operation and Development (OECD) and the Financial Stability Forum. As a result of these reforms Cyprus is no longer considered as a tax haven. It is actively involved with the OECD and part of its “white list”. It closely works with the EU and the Commonwealth in modelling global regulatory policy. Cyprus’ finance industry has benefited significantly from the country’s national policy and the financial services sector is one of the fastest growing of the Cypriot economy and one of the most important employers of trained professional staff. Finance companies have benefited from a reduction in bureaucracy, streamlined procedures, lower fees and compliance costs and a more consistent implementation of standards.

Hedge fund location

Cyprus is becoming a destination of choice for hedge fund managers from the UK seeking new locations to conduct their hedge fund business for obvious reasons:

- It offers a 30% cap on personal income tax.
- The domiciliation in Cyprus of hedge fund management companies has a 10% capped corporate tax that can often be reduced or eliminated entirely if certain aspects of management and control of the company are not carried out of Cyprus.

Table 1. Comparison of expanding financial centres

CYPRUS	DUBAI	MALTA	LUXEMBOURG	IRELAND
<ul style="list-style-type: none"> • Investment of ICIS of \$800 million to \$1 billion (est.) • New legislation from January 2003 for UCITS and ICIS • EU & OECD compliant • Uniform corporate rate tax of 10%, no discrimination • Low tax rates due to: <ul style="list-style-type: none"> - No tax on disposal of securities - Exemption system on dividends/profits from abroad - No thin capitalisation rules - Thin spread of income - No exit costs - Extensive treaty network • Centre for a large number of collective investment schemes • Highly skilled relatively cost competitive workforce • Highly competitive office rental market (approx €800 /month) • Cyprus is an English speaking member of the EU and the Eurozone • In the crossroads of three continents (Africa, Europe, Asia) • Use of the International Financial Reporting Standards promoting a more transparent reporting of firms, financials 	<ul style="list-style-type: none"> • Regulatory environment built to support the development and facilitation of investment funds, under the specifications of best practices from leading jurisdictions • Introduction and formulation of the Dubai International Financial Centre to promote an effective framework for the development of fund management • Enactment of the Collective Investment Law sets out the framework for regulating funds and permits the operation of various types and categories of collective investment funds • Presence of a large number of international banks and other financial institutions providing fund administration services • Substantial presence of hedge funds • Islamic funds operate in addition the treaty with the Malaysian Securities Commission 	<ul style="list-style-type: none"> • Locally domiciled mutual funds assets in 2006 \$6.4 billion • The legal system provides a variety of structures for funds • Malta is an English speaking member of the EU that has recently adopted the euro • Low office rentals and a cost competitive workforce • Large accounting firms have their offices on the island providing a wide variety of services to the local market • Excellent Infrastructure and communications network • The entire financial sector has recently been reformed and the Malta Financial Services Authority was formed which has centralised all financial services of Malta providing a more efficient environment with less effective procedures for the firms and the clients 	<ul style="list-style-type: none"> • Locally domiciled mutual funds assets in 2006 \$3.024 billion • Luxembourg is the 2nd largest fund administration centre in Europe in terms of NAV • The financial environment has long term experience with offshore financial services and it is an established offshore private banking centre • Luxembourg was the first in the EU to introduce a tax transparent investment vehicle to support pooling of multi-national corporations • Total NAV of funds services in Luxembourg: €1.967 billion • 2,238 funds domiciled in Luxembourg • Advanced industrial model established • Active collaboration of investment firms with the government and the regulator 	<ul style="list-style-type: none"> • Locally domiciled mutual funds assets in 2006 \$767 billion • A catalyst to attract business with a legal and regulatory environment to facilitate development investment funds promoting an efficient environment for the development of fund administration • Abundance of services available • Ireland is an English speaking member of the EU part of the Eurozone • Establishment of the Dublin International Financial Services Centre promoting a range of internationally traded financial services • UCITS directive promoting a single market for mutual funds in the EU • Availability of skilled people • 7,000 funds with combined NAV \$1.7 billion

- Hedge fund administration and back office functions benefit from a flexible regulatory approach and low operating costs compared to other mature hedge fund centres.

Cyprus' credibility as a reliable specialist centre for hedge funds is growing steadily. IKOS, one of the pioneers of the modern era of the hedge fund industry, whose association with Cyprus dates back to the mid-1990s and which was originally regulated by the Central Bank, developed its Cyprus presence to become a Cyprus Investment Firm (CIF). The company is regulated by the Cyprus Securities and Exchange Commission, CySEC (as well as by the US SEC and CFTC/NFA), and acts as the sub-investment manager to the IKOS asset management group. This development, along with the strong local presence of hedge fund specialists like Albourne Partners, is a testimony to the expertise of the sector professionals in the country who have responded particularly well to more complex fund strategies and structures which have used Cyprus as a fund management services domicile or back office services centre. Several high-profile complex hedge funds are now targeted by the country's main financial service providers to achieve their goals. These efforts are facilitated by Cyprus' legal and regulatory framework. Characteristically, an important advantage of Cyprus' fund management service is that it is relatively flexible and quick to set up a fund once you have all the necessary information and documentation in place. It may be possible for a complex private equity or hedge fund to be set up within four to six weeks. It is also easy for an existing fund management firm or financial services entity to obtain the authorisation to operate in Cyprus on the basis of "passporting" an existing license from another EU jurisdiction.

While Cyprus has an array of experienced and sophisticated professionals, it is also less expensive than other mature fund locations. Operational costs in Cyprus are similar to the ones in the Cayman Isles or British Virgin Islands, but less expensive than Bermuda and certainly less than in the Channel Islands, Dublin or Luxembourg. In the current economic climate, many governments are targeting what they perceive as "tax havens", which could be a major disadvantage for investors who merely want to find a tax-efficient way of managing their investments.

One advantage of Cyprus is that although it has low taxation (zero tax on gains from securities trading), as a member of the Eurozone it is less likely to be accused of being a "tax haven" of any sort and this makes it an attractive place to invest in the future, especially considering the country's excellent international relations with the Middle East and the Commonwealth of Independent States.

Setting up a fund in Cyprus

Since 1999 and the passage of ICIS legislation, investment funds started forming a distinct sector within the Cyprus financial services industry. Alternative funds and specialised private equity funds are particularly well catered for, but all types of funds, including equivalent vehicles to the Luxembourg SICAVs, SICAFs and Undertakings for Collective Investments in Transferable Securities, or UCITS, are available.

Cyprus funds are regulated by the Central Bank of Cyprus. There are several different types of funds that can be registered in Cyprus, each suited to different needs.

International Collective Investment Schemes can be set up under a number of legal structures:

- A variable capital investment company (SICAV equivalent).
- A fixed capital investment company (SICAF equivalent).
- A unit trust.
- A limited partnership.

The non-UCITS funds of Cyprus usually take one of three forms:

- Experienced investor fund.
- Private scheme with a focus on risk capital investment.
- Retail fund.

These funds offer unique advantages:

- Unrivalled investment flexibility.
- Clarity to investors.
- Low set-up and operating costs.
- Unique tax advantages (no income tax, no capital gains tax and no withholding tax on investment income).

Amongst the advantages of choosing Cyprus as an alternative jurisdiction for registering and licensing a fund is the "can-do" culture of the practitioners and the accessibility to the regulator. Appointments are accommodated as early as possible to smooth out any difficult matters enabling the process to be shortened considerably. Professional support is available from a number of established fund administrators, law firms, auditors and banks.

The Cyprus Investment Firms Act

The Cyprus Investment Firms Act of 2002 the application of which is overseen by the Cyprus Securities and Exchange Commission (CySEC), provides the legal framework for the provision of investment services as well as for the registration, regulation of operations and supervision of Cyprus investment firms (CIFs). Under the provisions of the Act, the following professionals may provide investment services:

- CIFs – investment firms operating within Cyprus, excluding credit institutions, provided that they have been approved by the CySEC.
- Credit institutions established in Cyprus, provided that they have received an authorisation by the Central Bank of Cyprus.
- Investment firms with their registered offices outside Cyprus – whether providing investment or non-core services through a branch or operating on a cross-border basis without a branch, provided they have been granted a license from another EU member state. The "passporting" of authorisations granted by non-EU countries is also possible.

The Act governs the provision of any of the following investment services:

- Reception and transmission, on behalf of investors, of financial instruments orders.
- Dealing in financial instruments for own account.
- Managing of investment portfolios in accordance with mandates given by investors where such portfolios include financial instruments.
- Underwriting in respect of issues of financial instruments as these are defined in the Act.
- Safekeeping and administration in relation to financial instruments.
- Safe custody services.
- Granting of credits or loans to clients to enable them to carry out transactions in financial instruments, where the firm granting the credit or loan is involved in the transaction.
- Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and acquisitions.
- Services connected to underwriting.
- Investment advice concerning financial instruments.
- Foreign exchange services where these are connected with investment services.

The procedure to obtain a CIF authorisation follows a written application to the CySEC that includes, among other legal documents, a business plan detailing the purpose and organisational components of the company along with the various measures for the prevention of the legalisation of the proceeds of criminal activities. It is however relatively easy for an existing fund management firm or financial services entity to "passport" an existing license from another EU or non-EU jurisdiction.

Legal and regulatory framework

Over the past 10 years, Cyprus' legal system has constantly evolved to present a sophisticated and comprehensive legal framework based on UK law and designed to attract foreign funds and other companies to register and operate from Cyprus on the following principles:

- It features a focused system of financial services regulation and provides a comprehensive framework for the setting up, licensing and marketing of

all types of collective investment schemes and institutional funds and for providers of investment services.

- It has incorporated modern banking laws which conform to the best practices of EU banking regulations and supervision requirements and provides for an adequate level of regulation of non-banking financial activities.
- It allows the setting up and recognition of trusts and has brought Cyprus company law in line with EU company laws, particularly by providing clear rules for mergers, divisions and the disclosure of financial statements, the regulation of branches and other matters.
- It adopts EU and OECD standards in respect of supervision and the prevention of money laundering and insider dealing with its Financial Intelligence Unit (FIU) acting as the Unit for Combating Money Laundering (MOKAS).
- It consolidates the various provisions in Cyprus law on professional secrecy which provide the necessary reassurance to foreign investors without hindering the supervision of fiscal and regulatory compliance and without obstructing investigations into financial crimes as money laundering and insider dealing.

The prevention of money laundering

The laws for the prevention of money laundering define the crime of money laundering along the lines adopted in the EU and make it a criminal offence in Cyprus to utilise or to employ money derived from crime. The offence may also be committed by those who aid or abet money laundering. The supervisory authorities and operators within the financial sector are obliged to report any evidence of money laundering which comes to their knowledge to the police. Detailed regulations govern the duty of financial operators to know and identify clients, to keep proper records and to report suspicious transactions to the authorities. The competent authorities have issued guidelines elaborating and explaining the legal requirements in this regard for the benefit of their respective licensees.

Adherence to these guidelines is ensured by MOKAS. Cyprus' anti-money laundering system was extensively assessed by the FATF arm Moneyval in 1998, 2001, 2005 and 2009, concluding that Cyprus adopted measures in line with international standards and should be commended for the very comprehensive legal framework put in place. The International Monetary Fund (IMF) also assessed Cyprus' international financial sector and concluded that banking supervisory and regulatory systems applied to the international banking and financial services sector, including anti-money laundering systems, are of high standard and in line with internationally accepted principles.

Cyprus' tax framework and taxation of collective schemes

The Cyprus tax laws are designed to support the development of the country as an international financial and business centre in order to:

- Promote international investment.
- Support actively the development of financial services.
- Provide certainty and clarity on international tax issues.

CIFs are subject to a unified corporate tax of 10% and are exempt of profits from the disposal of securities or dividend income. There is no withholding tax on payments of dividend, interest and royalties to non-residents while capital gains realised on immovable property held outside Cyprus (or on shares in companies owning property) are outside the scope of capital gains tax. Cyprus has a wide and beneficial Double-Tax Treaty (DTT) Network. There are currently more than 40 DTTs in force and 39 others being negotiated and the existence of these treaties, combined with the low overall tax regime, offer significant possibilities for international tax planning through the island both on corporate and individual levels.

Cyprus Investment Funds Association

The Cyprus Investment Funds Association or CIFA is coming to life as the industry witnesses an increased interest by international fund promoters in domiciling their alternative funds in Cyprus. This is without doubt driven by a number of success factors which amongst others includes the presence of a comprehensive legal and regulatory framework, cost competitiveness and a professional business environment. As a result of these developments, the Cyprus Investment Promotion Agency is broadening its remit to represent the interests of the fund industry and this complements the initiative taken previously by core market players to set up specialist fund administration operations with a clear distinction from fund management business. The strong growth anticipated by the industry in the next few months and years necessitates that the CIFA starts to encompass a wider spectrum of practitioners actively involved in the funds industry. The CIFA's primary objective is to act as a channel of communication and to make representations to the Cyprus government and the regulator on legislative, regulatory and fiscal matters which amongst others have an effect on the business and/or professional interests of its members.

People and quality of life

Although Cyprus is continuously evolving as a financial centre, it already has everything in place to make it an excellent alternative base for hedge fund businesses and people. There are a

variety of structures on offer, with a large talent pool of experienced professionals to deal with setting up and administering funds with service quality and low cost. The island also boasts the highest number of accountants in the world on a per capita basis with many international companies in addition to the big four providing accounting, auditing and consulting services. An indication of the profession's high standards is that Cyprus was the first country in the world to be approved by The Institute of Chartered Accountants of England & Wales to qualify chartered accountants locally. The strategic geographical location of the island, at the crossroads of three continents and at the borders of Europe, facilitates partnerships and serves as the springboard for investments among Europe, Africa, and Asia. The country's location is further enhanced by its connectivity to the busy trade routes to all major cities of Europe, Asia, the Middle East and the Far East. The country's two international airports offer over 1,100 scheduled flights per week served by 32 international airlines as well as by a selection of private and corporate jet operators.

For the fund management firms and people seeking quality service for their business, the lowest EU personal and corporate tax combined with a great lifestyle, Cyprus also offers more than 300 days of sunshine per year, excellent telecommunications infrastructure and breathtaking natural beauty, making it in one of the most liveable financial centres in the EU. **THFJ**

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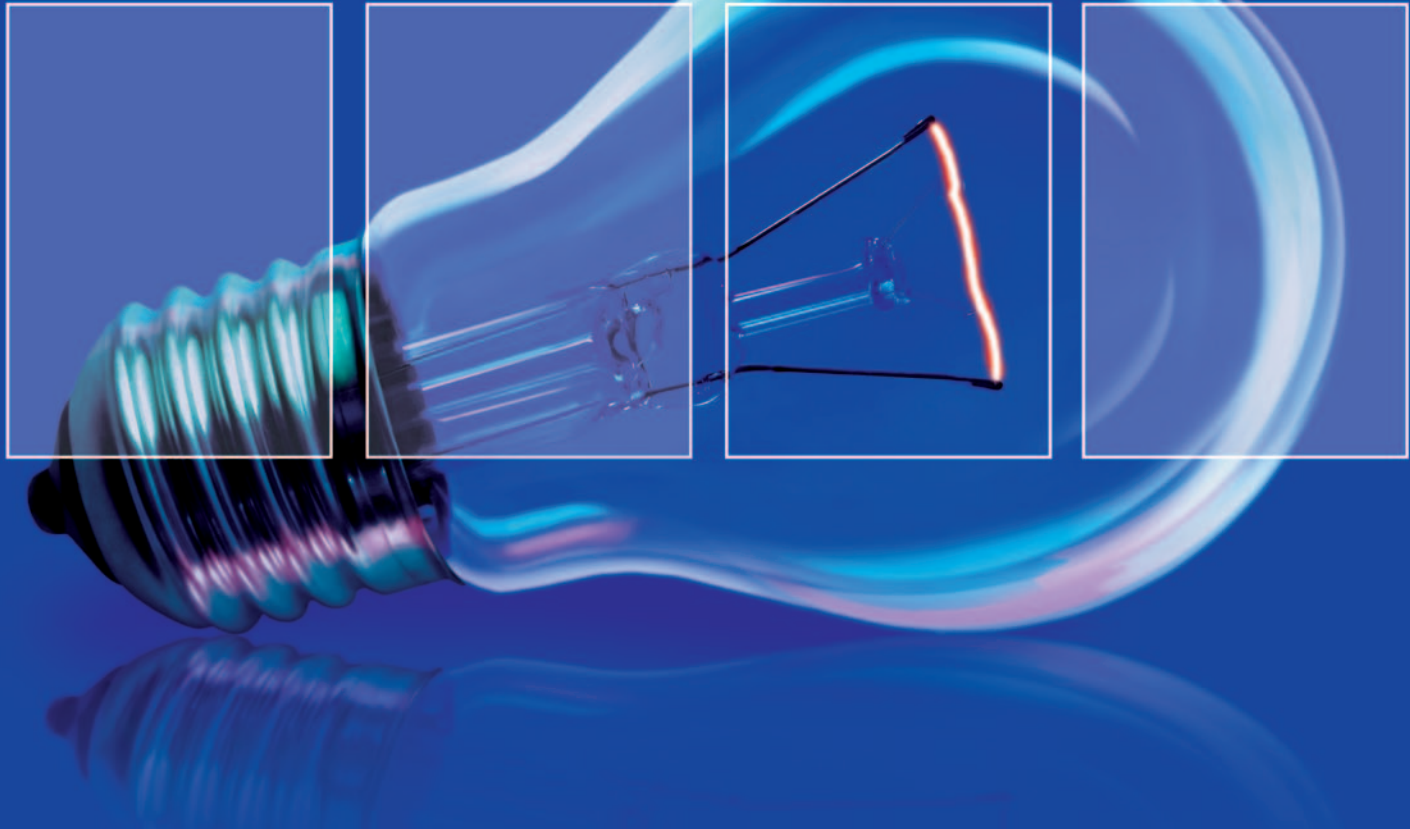
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IKOS

IKOS is one of the first independent hedge funds in Europe. It was founded in 1993 by Dr. Martin Coward and Elena Ambrosiadou. With 70 employees and an asset base of approximately \$1.4bn, IKOS is listed among Europe's 30 largest single manager hedge funds (Financial News September 2009). IKOS operates from six main locations and/or trade execution and research sites in New York, Tokyo, Vienna, London, Cyprus and Monaco. IKOS creates state of the art technology to capture Alpha from trading in global financial markets, including equities, currencies, commodities, interest rates, indices and bonds. Many of its Fund Classes are listed on the Irish Stock Exchange and offer monthly liquidity and report performance daily, since fund inception.

IKOS CIF Ltd is registered as an Investment Adviser with the US SEC, is a NFA member registered with the CFTC as a CPO and CTA, is authorised and regulated by the Cyprus Securities and Exchange Commission and operates within the European MiFID framework.

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IKOS



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KPMG in Cyprus traces its origins back in 1948 and today is one of the largest audit and advisory organizations in the Cyprus market. Our Cyprus Company comprises more than 750 people, including 30 board members, working from 6 offices throughout the island. KPMG is the global network of professional services firms, providing audit, tax, and advisory services with an industry focus including a one stop shop for investment fund services. For each of these core services, KPMG has specialized departments which are headed by partners with long experience in that field and are staffed by highly skilled personnel. At KPMG, our guiding philosophy is to provide our clients with the highest quality service. Through our peoples' high academic and professional qualifications and experience, our Firm can deliver value-adding results in demanding and complex projects. Quality service is a total and continuing commitment. Our highest priority is to work closely with our clients, listen carefully and help them in anticipating and defining future needs and opportunities. The foundation of our integrated service approach, with superior quality service as the cornerstone, is based on:

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