

The Regulation of Fiduciaries, Administration Businesses and Company Directors Law of 2012: finally enacted

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Abstract

In December 2012, following a protracted public consultation process, the Cyprus legislature finally enacted the Regulation of Fiduciaries, Administration Businesses and Company Directors Law of 2012 (the ‘Law’). The Law requires all individuals or companies offering trustee, administration or related services to be authorized as ‘fit and proper’ and licensed by the Cyprus Securities and Exchange Commission. The Law sets out accounting and reporting requirements and ensures that the authorities have accurate and up-to-date information on settlors, trustees, and beneficiaries of trusts. Regulated service providers will be required to put in place adequate internal controls, policies, and procedures.

six years Cyprus has put in place a new regulatory regime for professional trustees and providers of company management services under the Regulation of Fiduciaries, Administration Businesses and Company Directors Law of 2012 (the ‘Law’).

The original draft law was published in January 2006 by the Central Bank of Cyprus (‘CBC’), which was the proposed regulator. However, in view of the greatly increased role taken by the Cyprus Securities and Exchange Commission (‘CySEC’) in the Cyprus legal and regulatory environment over recent years, the CBC was replaced by CySEC as the sole regulator under the Law. This is a welcome change, since CySEC is generally regarded as better equipped to perform the role efficiently and effectively in the context of the rapidly changing and highly challenging economic environment.

Introduction

Directive 2005/60/EC of the European Parliament, commonly referred to as the Third Anti-Money Laundering Directive, extends Member States’ obligations to combat money laundering and terrorist financing to cover life insurance intermediaries and trust and company service providers. Following a protracted public consultation process of more than

Principal objectives of the Law

Since the emergence of Cyprus as an international business centre and particularly following its accession to the European Union in 2004, it became increasingly clear that regulation in the fiduciary and administrative services sector needed strengthening. This regulatory shortfall has become more

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apparent of late and has caused serious concern among well-run professional service providers, as it has frequently provided fertile ground for unfounded allegations regarding the quality of professional services in Cyprus.

In particular, registered lawyers and accountants in Cyprus who have provided fiduciary and corporate services via their respective firms and associated companies have been regulated throughout by their respective professional bodies (the Cyprus Bar Association and the Institute of Certified Public Accountants of Cyprus, respectively). However, taking advantage of the lack of general regulation dozens of other service providers have set up business in Cyprus offering services to the public on an unregulated basis, exposing the financial system to potential abuse and exposing Cyprus to serious reputational risk.

Following the enactment of the Law, all individuals or companies offering trustee, administration or related services ('fiduciary services') will now have to be authorized as 'fit and proper' and be licensed by CySEC; otherwise they are required to cease business no later than six months after the date of entry into force of the Law.

Regulated service providers will be required to put in place adequate internal controls, policies, and procedures. The Law sets out accounting and reporting requirements and ensures that the authorities have accurate and up-to-date information on settlors, trustees, and beneficiaries of trusts.

The Law includes a 'four-eyes' rule, requiring service providers to be represented and administered by at least two persons, who must have the appropriate academic and professional qualifications, expertise, and integrity to manage it competently and prudently. It also sets standards for capital adequacy, adequate accounting, and internal control systems, including adequate arrangements to segregate clients' funds from other assets. The offer or provision of fiduciary services without a licence is made a criminal offence.

The Law grants extensive powers to CySEC in the granting, refusal, revocation, and application of

conditions to fiduciary licences. CySEC also has authority to exert control over the names of, and advertising by, fiduciary businesses, the right to obtain information and documents, and powers to conduct investigations and request interviews with applicants.

Registered lawyers and accountants who are regulated by their professional bodies are exempt from the requirement to obtain a licence from CySEC. However, they are subject to the other provisions of the Law.

In summary, the principal objectives of the Law are to regulate the provision of relevant services and to establish and impose licensing procedures for and supervision of such services, offering security to clients, and strengthening confidence in the sector.

Brief analysis of the main provisions of the Law

The following paragraphs give a brief description of the Law's most relevant provisions.

Exempted persons

As noted earlier, registered lawyers and accountants and companies controlled by them are exempt from the requirement to obtain a licence under the Law. In addition, firms authorized to provide investment services under the Investment Services and Activities and Regulated Markets Laws of 2007 to 2012 ('Cyprus Investment Firms') and credit institutions that exercise administrative services in the context of the performance of their business are also exempt from the ambit of the Law.

Like registered lawyers or accountants, Cyprus Investment Firms and credit institutions may opt to submit an application in order to obtain authorization by CySEC but in any case their relevant activities will be subject to supervision by CySEC and they will be required to conform to all the provisions of the Law notwithstanding that they may also be regulated by another body.

The 'fiduciary services' covered by the Law

Article 4 of the Law defines the services subject to its provisions. These may be divided into two main categories, namely trust services and corporate services. Article 4(a) of the Law defines the former as the administration of trusts including, without limitation, the assumption of duties or provision of services such as trustee or protector of any trusts wherever such trusts may have been established or settled and irrespective of the locus of administration or investment or disposition of the property of a trust; Article 4(b) defines relevant corporate services as:

- directorship and secretarial services provided to a legal person, including acting as an alternate director or secretary;
- services such as the holding of shares of legal persons in a nominee or trustee capacity;
- provision of a registered office;
- services related to the opening and operating bank accounts;
- services related to the holding of financial assets on behalf of third parties as defined in the Third Schedule, Part II, Para 1 of the Investment Services and Regulated Markets Law; and
- services ancillary to the services specifically referred to above.

Exempt services

Article 4(4) of the Law provides that certain activities are deemed to fall outside the scope of fiduciary services and therefore do not require a licence, provided that they are not advertised or offered to the public at large. These activities include:

- a. acting as a director of a company which is publicly listed in a regulated market, or a company that is subject to regulation by another regulatory authority and is obliged to have non-executive directors under its regulatory framework or a company in which the Republic of Cyprus or

any other public authority or organization holds the majority of shares;

- b. acting as director or secretary of a company that is beneficially owned to the extent of at least 25% by the person concerned and persons connected with him or her (his or her spouse and close family members), or by a company that is wholly owned by the person concerned and persons connected with him or her or owned by a trust of which he or she or persons connected with him or are the only beneficiaries;
- c. acting as director or secretary of a company that is the sole employer of the person concerned or which belongs to the same group of companies as the sole employer of the person concerned;
- d. acting as director or secretary of a subsidiary of a company referred to in (b) or (c) above;
- e. acting as trustee of a trust of which the person concerned is the settlor where the only beneficiaries of the trust are the person concerned or members of his or her family;
- f. acting as trustee of a trust arising from a will of a natural person; and
- g. acting as a director of fewer than 10 companies excluding companies referred to under (b), (c), and (d) above provided that the person concerned does not control the board of directors of the company in question.

Finally, it should be noted that the incorporation of companies remains within the exclusive competence of lawyers.

Register of licence holders maintained by CySEC

CySEC will maintain a register of licence holders (Article 25 of the Law) and licences may be issued on such terms and conditions as CySEC considers appropriate (Article 12). In order to obtain a licence, applicants must meet specified requirements in terms of professional and academic qualifications

and experience of the people concerned in the business and the internal procedures of the business (Article 7).

Infrastructural requirements for obtaining a licence

In order to obtain a licence a service provider must satisfy the following requirements:

- a. Its head office must be located in Cyprus (Article 6);
- b. It must be represented and administered by at least two persons, who must have the appropriate academic and professional qualifications, expertise, and integrity to manage it competently and prudently (Article 7).
- c. It must employ an in-house lawyer or maintain a regular professional relationship with an external lawyer (Article 9).
- d. It must employ a compliance officer or externally engage these services (Article 9).

CySEC may require the members of the board of directors of an applicant or the natural persons who control the company or the board to complete and submit individual questionnaires.

Obligation to maintain and appropriate records and power of CySEC to confiscate data

Regulated service providers must put in place appropriate internal control procedures in order to ensure that they have accurate, up to date information at all times, in compliance with the Law.

If there are reasonable grounds to suspect that a licensed fiduciary is in breach of the Law CySEC may enter its premises for the purpose of obtaining information and documentation in any form in order to determine whether the licensed fiduciary has complied with its obligations. The obligation of a licensed fiduciary to have adequate internal control systems has also been extended to control systems and procedures to assure compliance with the Prevention and

Suppression of the Legalisation of Income from Illegal Activities Law.

For this reason, Article 3(7) of the Law requires all providers of trustee services to obtain the following information regarding trusts they administer and keep it available at all times for disclosure to CySEC:

- a. identity of all trustees;
- b. identity of the settlor;
- c. identity of the beneficiaries or information on the class of beneficiaries;
- d. identity of any protector;
- e. identity of the investment manager, accountant, and tax consultant (as may be applicable); and
- f. the business of the trust.

Article 30 (6) empowers CySEC to request a licence holder to provide any information or documentation that is reasonably required for conducting its supervisory role and, in the event of non-cooperation on the part of the licence holder, to seize and retain for up to 45 days any registers, accounts, books, documentation, or electronic devices used for the transmission of data.

Administrative fines and sanctions

Articles 26–31 of the Law set out the various sanctions, liability, and penalties for contravention of the Law and provide that this constitutes a criminal offence punishable on conviction by imprisonment of up to five years, a fine of up to €350,000 or both.

If the offence was committed by a legal person, then any of its directors, managers, or responsible auditors may be liable if it is proved that he or she agreed or assisted in the commission of the offence. CySEC may also impose an administrative fine of up to €500,000 (or up to €1 million for repeat offences), depending on the seriousness of the offence.

CySEC is vested with the power to revoke a fiduciary licence if it is established that the service provider is in breach of the provisions of the Prevention and Suppression of the Legalisation of Income from Illegal Activities Law.

Lawyers, accountants, and other regulated individuals and organizations will be regulated by their supervisory body rather than by CySEC.

Amendments to the Cyprus Securities and Exchange Commission Law of 2009

Following the enactment of the Law a draft law has been placed before the House of Representatives to amend the Cyprus Securities and Exchange Commission Law of 2009 (the 'CySEC Law'). The proposed amendments are directly related to and connected with the Law and CySEC's new powers.

The proposed amendments give CySEC the additional statutory powers required to effectively oversee all persons providing fiduciary and trust-related services in Cyprus, including the power to request any information from any legal person in Cyprus including persons acting as trustees in relation to beneficiaries, ultimate beneficial owners of structures, accounts, and copies of various corporate documents.

In particular, the new subsections (3), (5), and (7) being introduced in Section 32 of the CySEC Law as well as the new Section 34(1)(b) have been included so as to empower CySEC to properly discharge and enforce its various duties and responsibilities. In the event of refusal by any undertaking to cooperate and provide information, CySEC may seize and retain any relevant information, archives, books, accounts, and other documents and evidence and of the electronic means of storing and transfer of data, in line with Articles 3(7) and 30(6) of the Law.

Private trustee companies

As noted above, the Law provides an exemption for persons acting as trustee of a trust of which the person concerned is the settlor where the only beneficiaries of the trust are the person concerned or members of his or her family. It is apparent from this that the exemption granted is quite limited and narrow. It should be noted that the original versions

of the bill contained extensive exceptions for Private Trustee Companies ('PTC').

Bearing in mind the very important role that PTCs have in the context of trust administration and succession planning, it would be prudent for CySEC to issue a circular or directive on the matter or to promote an amendment to the Law to the extent necessary so that PTCs would be exempt from the need to be regulated provided that certain conditions are met.

In this respect, we could take certain examples from other countries such as Malta and Singapore. In line with Section 43 of the Malta Trust Act, Cap 331 and Section 4 of the Singapore Trust Companies Act (2005) PTCs are generally not subject to the same form of regulation and are in fact exempted from licensing regulations otherwise applicable to trustees soliciting clients and offering services to the public at large.

Relevantly, a typical family trust structure not involving a professional trustee company would involve a PTC, the shares of which are owned by the settlor and his family or, if off-shore, by a trust or other entity such as a foundation established for the purpose. The PTC is formed for the purpose of acting as trustee of one or more specific trusts. The directors of the PTC will be usually be or include members of the settlor's family who may also be beneficiaries of the trust or advisers to the family. The power to appoint directors is likely to be put under the control of the settlor or the protector.

Commentary

After the protracted six-year public consultation process, the recent enactment of the Law is a very positive and highly welcome development. The Law generally reflects similar or comparable provisions appearing in the laws of reputable international financial centres such as Guernsey (the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law, 2000 as amended) and Malta (Chapter 331 Trusts and Trustees Act of 1989, as amended). It provides an effective regulatory framework and places the fiduciary services sector in

Cyprus on a par with the best trust jurisdictions worldwide, both in terms of transparency and of compliance standards.

There are a number of factors that will determine how effective and successful the Law will prove to be in practice.

First of all, CySEC has been given the significant responsibility for supervising and enforcing the proper application of the Law, together with the necessary powers. A great deal will depend on how diligently and rigorously CySEC undertakes its responsibilities and exercises its powers, both at the stage of granting licences as well as subsequently monitoring undertakings to ensure compliance with the Law.

Secondly, CySEC will need to maintain the correct balance between diligently performing its regulatory role on the one hand and not stifling the development of the fiduciary sector and the attraction of new trust business to Cyprus on the other. These objectives need not be mutually exclusive, and it is important that legitimate and compliant trust and fiduciary service providers are not deterred from offering services by an unduly burdensome and inflexible regulatory regime. CySEC's role and approach will be crucial in ensuring that the correct balance is struck.

Thirdly, the Cyprus Bar Association and the Institute of Certified Public Accountants of Cyprus, in their capacity as the regulatory bodies for registered lawyers and accountants, should take all necessary steps (including legislative initiatives and new disciplinary policies) to ensure that their members adopt higher compliance standards along the lines of those introduced in the Law so as to ensure that competition is on a level playing field without discrimination or market distortions due to double standards. At the same time, the size and resources of law firms and accountancy firms will become a critical factor to determine whether such firms should be licensed (or even continue as going concerns) taking into account the requirement for employing compliance officers and accommodating high compliance standards. An obvious example of a critical factor is the correlation

between the number of clients v employees of a particular service provider firm, given that the higher number of clients, the higher amount of human and capital resources will be required to ensure that proper checks and balances and compliance standards are consistently met and applied at all times. Otherwise, the firm will be *ipso facto* unable to meet the requirements of the Law.

More generally, the rigorous new regulatory and compliance requirements introduced by the Law, if correctly applied and enforced, are likely to change the landscape of trust and fiduciary services in Cyprus as the additional substantially higher human and capital resources required for meeting the new standards will inevitably lead to a consolidation of the fiduciary services market and possibly mergers between existing organizations pooling resources in order to meet the new requirements.

At the same time, it is true that Law does not include all that it ought to have regulated. For example, professional indemnity insurance, while still opted for by a number of service providers, has not been included in the mandatory requirements of the Law, a shortfall that will sooner or later draw the attention of CySEC for resolution through a directive or in the context of a future legislative amendment.

Finally, despite the protracted consultation process there are still a number of areas in the Law requiring clarification. Article 31 of the Law empowers CySEC to issue any directives that it may consider necessary for the enforcement of the Law, and we hope that it will make this a priority so as to minimize any uncertainty or ambiguity.

Conclusion

The enactment of the Law is a long overdue and highly welcome development in the Cyprus financial services sector. Together with the recent modernization of the International Trusts Law it places Cyprus in the 'premier league' of reputable trust jurisdictions worldwide. Cyprus is now in a position to legitimately promote genuine trust business as well as to impose and closely supervise compliance and effectively

enforce applicable anti-money laundering legislation at all levels. For these reasons it is now expected that Cyprus will attract the largest and most reputable trust service providers globally, which in turn will

help Cyprus further consolidate its position as a global participant in the trusts sector. In turn, this should have a positive impact on Cyprus's position as a leading international financial centre.

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