

DOI: <https://doi.org/10.53486/cike2022.53>

CZU: 336.714:347.73(478)

## ANALYSIS OF AIF REGULATION IMPLEMENTATION IN THE REPUBLIC OF MOLDOVA AND THE REPUBLIC OF CYPRUS

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**Abstract.** Modern financial relationships between investors and beneficiaries evolved, seeking efficient management of financial resources. Alternative Investment Funds (AIFs) gain a greater role in international financial intermediation bringing plenty of benefits for market participants and the market as a whole: flexible investment tool, lesser administrative burden, wide diversity of asset classes, favourable taxation, market diversification and others. Legal regimes are important to promote investments and the employment of AIF as investment tools. The stable operation of AIFs in many EU countries is attributed to clear and efficient regulation. The Republic of Moldova adopted the EU AIF regulatory regime in 2020 but does not register the same success as many EU financial centres. The supposition is that the law is not being implemented as expected and that there are other structural factors requiring regulators' attention.

The aim of the paper is to compare the national AIF regime with one of the successful cases in the EU and determine which factors within the compared jurisdictions may hinder the appropriate application of AIF law in Moldova. The data used for the paper are official sources, legislation and market data. The methodology is mostly qualitative based on analysis and synthesis.

Findings suggest that the adoption of EU AIF-related legislation had a beneficial effect on modernising Cyprus AIF regulation. In order to develop the national AIF market, it is necessary for intersectoral cooperation of regulators to eliminate structural weaknesses and create incentives for AIF application.

**Keywords:** Alternative Investment Funds; Undertakings for Collective Investments; Non-UCITS; Collective Investment Vehicles; AIFs' Regulation; AIFMD; Asset Management; Structured Finance; Investment Funds; Risk-spreading Investments.

**JEL Classification:** K2, K23, K29

### 1. Introduction

In the regulated financial markets, alternative investment funds are subject to a lighter regulatory burden compared to other types of investment vehicles or investment institutions. This fact, explains the popularity of these vehicles among different types of investors, especially in the financial centres known as developed ones. There are various advantages to choosing to invest via alternative investment funds.

First of all, as named – lesser regulations give them the freedom to capitalize on a wide range of investment opportunities that are usually not available for other regulated entities, or not available until certain prudential requirements are met. Secondly, alternative funds contribute to the overall market liquidity and increase market diversity, creating a certain category of assets for

investment. Not less important, the investment activity of AIFs plays an important role in pricing, which serves further purposes of financial, economic and monetary analyses.

The reality of a growing interest in employing AIFs is explained by their practicality and potential for substantial financial returns under low-risk settings. The assets of funds are typically not associated to traditional portfolio investments, which can increase portfolio diversity, reduce total portfolio risk, and open the door to higher returns.

The purpose of analysis lies in determining whether there are any prospects to establish or enhance the national AIFs regulation or other factors hindering the employment of AIFs. The need for this study to identify best practices in AIF regulation stems from the fact that Moldova's capital market has reached a stage of development that calls for more flexible and creative investment products to encourage investments and enable the funding of the economy.

## **2. AIFS OPERATING FRAMEWORK**

### **2.1. Analysis of the national state of the art in AIFs regulation**

In the Republic of Moldova, a comprehensive AIF legal framework was adopted relatively of late, by the adoption on February 6, 2020, of the so-called *Law no. 2 regarding alternative collective investment organisms*<sup>40</sup> (hereinafter: *Law no. 2/2020*).

According to the *Law*, the so-called Alternative Organisms for Collective Placements (Abbreviation in original: *OPCA*) are investment companies organised as joint-stock or limited partnerships established by deed of incorporation and investment funds established by civil society contract, without creating a legal entity, which operate on the principle of risk sharing and whose activity consists in collecting financial resources from natural and/or legal persons, by issuing participation securities, for the purpose of their subsequent investment according to the provisions of the *law*. The *law* establishes the legal framework regarding the establishment, approval, necessary appointments and operation of alternative collective investment undertakings, the requirements for the organization, licensing and activities carried out by investment management companies, including the obligations related to the management of collective investment undertakings with risk capital and long-term investments, as well as the rules relating to depositories of assets of alternative collective investment undertakings. By the right and frequency of redemption, the *law* provides for *OPCA* of open-ended and close-ended ones. Likewise, in the EU, Moldovan AIFs shall be managed by a management company or a managing partner, depending on the form of legal organisation.

The National Financial Market Commission (hereinafter *CNPF*) is the authority empowered to implement *Law no. 2/2020* in accordance with the powers established by *Law no. 192/1998 regarding the National Commission of the Financial Market*.

It is to mention, that *Law no. 2/2020* partially transposes the provisions of the known AIFMD<sup>41</sup>, *Regulation No 1060/2009*<sup>42</sup> and *Regulation (EU) No 1095/2010*<sup>43</sup>. However, this did

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<sup>40</sup> Originally: *Legea Nr. 2 din 06-02-2020 privind organismele de plasament colectiv alternative*

<sup>41</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 Text with EEA relevance

<sup>42</sup> Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (Text with EEA relevance)

not rise the same level of applicability compared to the EU market, especially in some particular countries, where AIFs are for decades been successfully used for investments. Finding all the factors conditioning the weak AIF market in Moldova require complex analysis, although many of them may seem obvious, for the purpose of this paper there would be analysed the strengths of a successful example of Cyprus, in order to formulate potential issues to improve on the national market.

## **2.2. Analysis of the Republic of Cyprus AIFs framework**

Cyprus is known as one of the most internationally active business centres for decades, and compared to other strong EU financial centres, this is one linked not only to the EU countries but has strong connections with further geographical Europe, Asia, Africa and the Middle East. The positive perception of Cyprus as a reliable and efficient financial centre of course is conditioned not only by efficient regulation, but also by such factors as: good geographical positioning, stable policy, manageable country risk, developed financial and fund services infrastructure, the relationship of business with public authorities, level of justice and transparency, taxation environment and, not least important - level of expertise of local financial specialists.

But *de facto*, regulation is a crucial component and factor of the asset management field since, in order for investors to have confidence in entrusting their money to asset managers, they must observe regulatory compliance and operate in a reliable regulatory system. Before Cyprus's accession to the EU in 2004, there was a clear and transparent regulatory framework modelled in compatibility with the UK law. After the accession, the legislation in the financial sector was harmonised with the EU regulations, which brought a wave of updating and opened the passporting opportunities. Although, once EU regulations in the financial sector were implemented across the EU this decreased the capability of particular countries to offer competitive advantages in terms of different regulatory advantages, this not only did not affect Cyprus' financial sector but contributed to its modernisation and investors protection.

The activity of AIFs in Cyprus is supervised by the Cyprus Securities and Exchange Commission (CySec). In 2014 the first AIF regime law aligned to the EU regulations was adopted. In 2018 this law was substituted by an updated version - *Law on AIFs and other related matters*<sup>44</sup>, which expanded the possible legal forms for AIFs, introduced a new type of fund, and provides for the possibility to have umbrella funds with segregates compartments.

Currently Cyprus provides three types of AIFs, with different levels of regulation burden, categories of investors and diversification rules:

- Registered Alternative Investment Fund (RAIF);
- Alternative Investment Fund with unlimited number of persons (AIFUNP);
- Alternative Investment Fund with Limited Number of Persons (AIFLNP).

As mentioned, the updates Cyprus AIF law provides an opportunity for flexibility in terms of sophistication of investors' intentions and investment strategies. Table 1 maps different combinations of types of funds with the legal forms available in Cyprus.

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<sup>43</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC

<sup>44</sup> Alternative Investment Funds Law of 2018.

**Table 1. Types of AIFs and possible legal forms**

<b>Types of AIFs - Legal Forms</b>		
AIF	AIF For Limited Number of Persons	RAIF
Variable Capital Investment Company (VCIC)	Variable Capital Investment Company (VCIC)	Variable Capital Investment Company (VCIC)
Fixed Capital Investment Company (FCIC)	Fixed Capital Investment Company (FCIC)	Fixed Capital Investment Company (FCIC)
Limited Partnership (LP)		Limited Partnership (LP)
Common Fund (CF)		Common Fund (CF)

**Source:** Joannides+Co Ltd (2019)

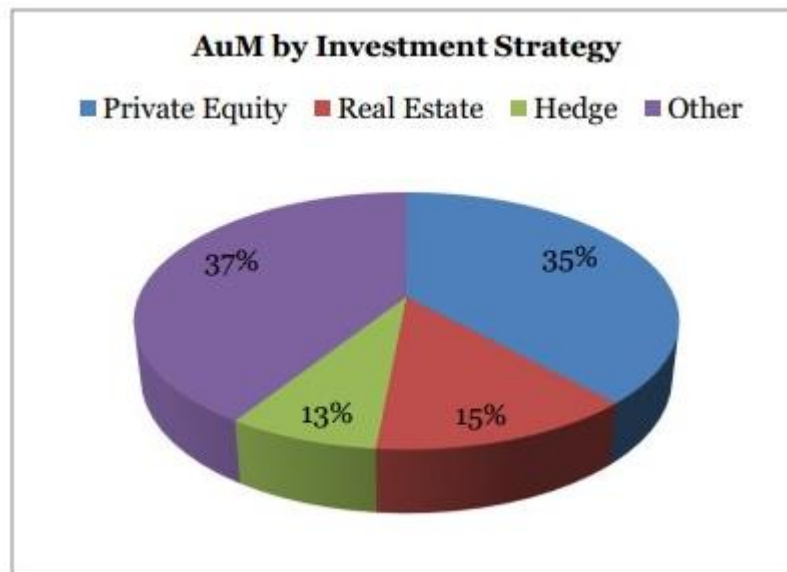
RAIF is the most time and cost-efficient fund, it is not subject to authorisation and has no minimum share capital requirement, but shall be externally managed by an authorised Alternative Investment Fund Manager (AIFM). RAIF is destined for professional and well-informed investors. AIFLNP is lightly regulated compared to the AIFUNP, but the latter can be also offered to retail investors. Both can be managed internally or externally by eligible entities. Cyprus AIFs are part of the passporting rights applicable in the EU, meaning that Cyprus funds can be marketed in the EU without additional authorisations (notification procedure).

It is to mention that Cyprus has in place an attractive tax environment, also AIF-friendly taxation. CIT in Cyprus is 12.5%, which is a little bigger than in Moldova and one of the lowest in the EU. Fund management services offered to authorised funds are in principle exempt from VAT. There is no withholding tax on interest and dividend payments to non-residents and no stamp duty on the issue of units of AIFs. Cyprus also provides possibilities for efficient tax planning, at the same time being compliant with the EU tax regulations and OECD requirements. AML legislation is also compliant with EU and FATF provisions.

Development of the AIF market in Cyprus –120 AIFs in 2020 and 34 AIFMs (CountryProfiler Ltd, 2020), benefits not only the financial sector but directly contributes to the economic growth through the investments made in specific sectors:

- Energy – EUR 111.8 million (1.40% of total Assets under Management (AuM));
- Sustainable Investments – EUR 33.4 million (0.42% of total AuM);
- Shipping- EUR 10.7 million (0.13% of total AuM);
- Fintech – EUR 23.2 million (0.29% of total AuM).

The distribution of AuM by the investment strategy can be seen in Figure1.



**Figure 1. Assets under Management by Investment Strategy on 30.06.2020.**

Source: Stelios Americanos & Co LLC (2020)

## Conclusion

Different types of both interest rates-related and non-related constraints seen in the banking sector in recent years as well as the flexibility of the fund industry conditioned significant growth of a number of funds and assets under management. AIFs gain a more important role in financial intermediation.

The Republic of Moldova's financial sector relies heavily on the banking sector, the capital market is underdeveloped. This hinders investment flows and slows economic growth. For the Republic of Moldova, developing the AIF industry would mean diversification in the financial market, boosting investments and coming to a new level of development.

Since one of the most important factors for the fund industry to prosper is investors' confidence in the market and jurisdiction, a credible regulatory system is a necessary attribute. A too lax regulation can give investors the feeling of uncertainty and that things may be influenced by other forces cresting uncertainty on this channel. Overregulation, on the other side, hinders investors' plans and may have a disincentive effect. Looking at the essence of AIF, this instrument was created namely to make a trade-off and cover the needs of investors willing to have the freedom to capitalise, but still, provide a safe and relatively certain environment for investment. And this is exactly where Cyprus succeeded, for more than 20 years Cyprus has been actively involved in the fund industry.

Starting in 2014 Cyprus AIFs worked under the EU-aligned legislation. Moldova implemented the EU AIF regime in 2020 and according to available statistics, there is no single AIF registered in Moldova.

Regulation is important in funds management, but the success of a country in the efficient employment of AIFs is not determined only by regulation but by other technical and sentimental factors. The latter, being seen objectively, is also heavily influenced by the technical ones. And by the technical, at least an appropriate infrastructure is meant: sound and diverse overall financial

system (banks, custodians, depositaries, insurance companies), availability of professional knowledge, developed audit, tax advisory and other consultancy services, availability of an active rating system, efficient company and civil law, credible institutions, connectivity with other markets, public sector support. On many of these points, Moldova has a still long way to pass.

The creation of an appropriate AIF infrastructure is a long-lasting process, which may take years to build credible and sound participants necessary in an entire AIF lifecycle. It is a continuous process of regulators' hard work on structural issues in many fields (finance, taxation, AML, company and civil law); at the same time regulation could be a good start in the whole process and use them as a tool for boosting AIFs employment and taking benefits of their use.

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