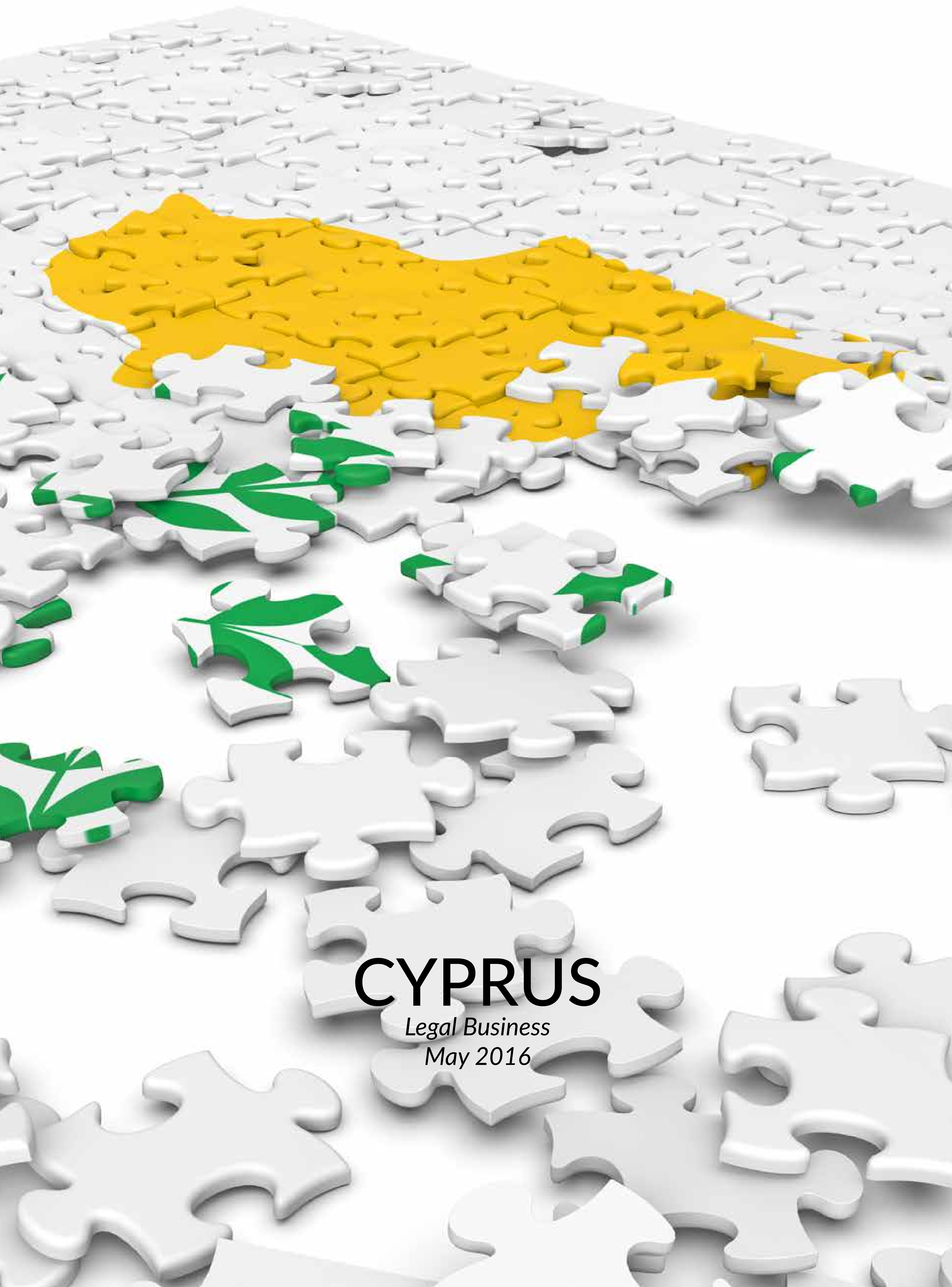

CYPRUS

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Picking up the pieces

As Cyprus emerges from its Troika-imposed three-year economic adjustment programme, *Legal Business* assesses how the country's constantly fluctuating fortunes are affecting the legal market

ANTHONY NOTARAS

On the face of it, Cyprus has much to celebrate. In March, the country completed the three-year economic adjustment programme that followed 2013's €10bn bailout package agreed with the European Commission, European Central Bank and the International Monetary Fund. That the country has finally wrested back control of its finances was coupled with the Commission's prediction of a 1.4% rise in GDP for Cyprus in 2015 – the first year of economic growth since 2011.

This good news provides a psychological boost following years of financial turmoil, but even the most ardent optimist would concede that Cyprus has a long way to go. The island is mired in debt and faces a lengthy period of post-programme surveillance (PPS) by the Commission, which will continue until it has paid at least 75% of the €7.25bn in loans it received from the bailout. The Commission estimates that, 'barring any early repayments', the PPS will continue till at least 2029. Alongside this are the €26.7bn of non-performing loans (NPLs) that the country's banks must deal with. According to the World Bank, in 2015 these NPLs accounted for 44.8% of the country's total gross loans, a figure much higher than Greece's 34.4%. These factors will define Cyprus's economic future for many years to come, both on a macro and micro level. Fundamental to this is how Cyprus positions itself in the global economy, particularly now that one of its key investment partners, Russia, can no longer be relied upon to generate previous levels of work.

RUSSIAN CRISIS

The most recent Russian legislative hit came in December 2015 where, similar to the US Foreign Account Tax Compliance Act (FATCA), it requires foreign banks to notify the Russian authorities when a Russian opens an account with them. This followed 2014's 'deoffshorisation' law, which tightened rules on how Russians must report and pay tax on their offshore income. With Cyprus the preferred offshore jurisdiction for Russian investors, these changes have taken their toll.

'Unfortunately the work in Russia has slowed down considerably and we have been affected by several major factors,' says Elias Neocleous, head of the corporate department at Andreas Neocleous & Co. 'The first is the Russian sanctions. Business has been reduced because of the sanctions and because of the devaluation of the rouble. Then there are the deoffshorisation laws, and a Russian FATCA, which make it difficult for entrepreneurs to channel their investments through other countries.'

For many Cypriot law firms that provided corporate services to Russian clients who structured and registered their companies through Cyprus, this has cut off a major revenue stream. It is estimated that some

Illustration 3D-SPARROW/SHUTTERSTOCK

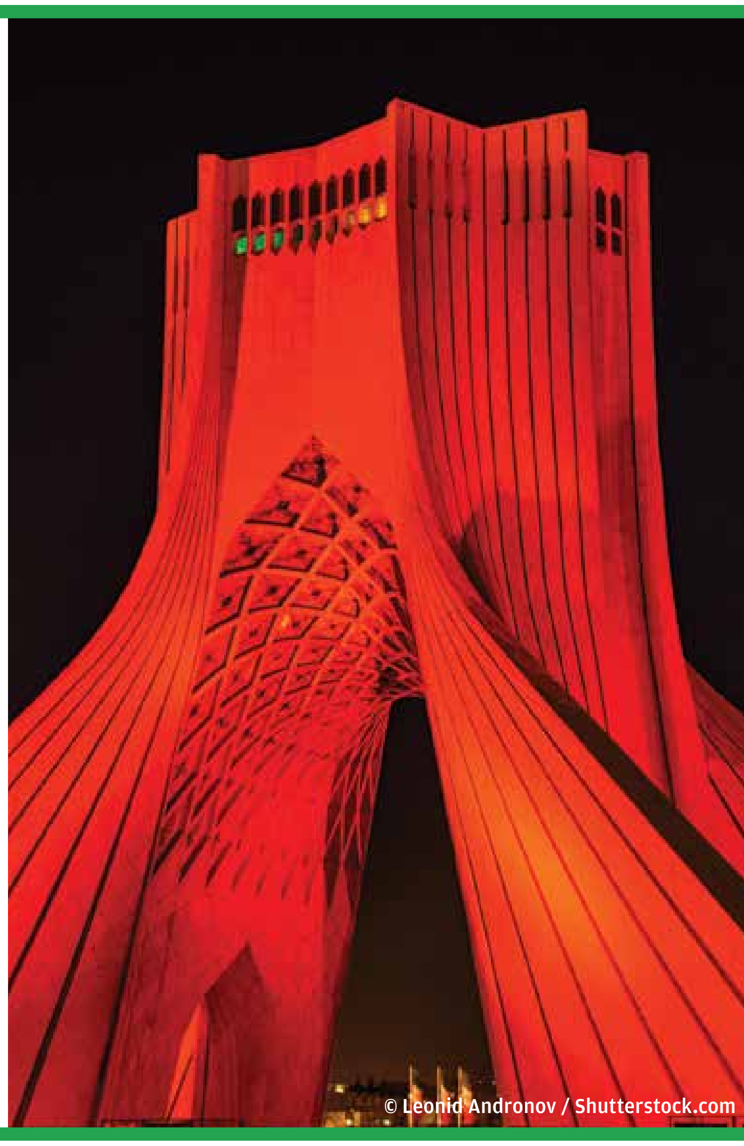
FUNDS TO IRAN

The EU already has a number of jurisdictions favoured by the investment funds industry, with Luxembourg and Ireland being among the most high profile. Now, through the introduction of new non-dom laws to attract high-net-worth individuals and fund managers, as well as a lighter touch of regulation, Cyprus is also trying to establish itself as another hub for the funds sector.

'What we've seen here is Cyprus trying to distinguish itself, not so much as a competitor, but through pursuing policies that benefit the local environment,' says Aki Corsoni-Husain, Harneys' Cyprus-based head of tax and regulatory. 'Because of the way that the Alternative Investment Fund Managers Directive works, funds that don't invest in highly-liquid assets generally benefit from a lighter touch of regulation. Cyprus is going for these less-liquid fund policies.'

This pitch to the funds industry, as well as Cyprus's entrepreneurial approach to finding new jurisdictions to do business with, came together in November 2015 when the Cyprus Securities and Exchange Commission allowed the Turquoise Variable Capital Investment Fund to invest directly into Iran, making it the first EU-approved, Iran-oriented alternative investment fund. 2015 also saw Iran and Cyprus sign a double taxation treaty and, with the recent lifting of sanctions, it is expected that stronger economic links will be forged between the two countries.

'With emerging markets in mind, such as Iran, the key is finding the niche for Cyprus,' says Corsoni-Husain, who led the Harneys team that advised on the fund's establishment. 'I do believe the local government here is trying to establish Cyprus as the go-to location for Iran and various facets of EU legislation help in that way.'



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150,000 companies with Russian beneficial owners are registered in Cyprus, and prior to the Cypriot banking crisis in 2013, the ratings agency Moody's estimated that there was about £21bn of Russian money in Cypriot bank accounts. However, since many Russian depositors got stung by the 2013 bail-in, which took uninsured bank deposits over €100,000 and converted them into shares in the Bank of Cyprus, trust in the Cypriot banking system unsurprisingly has diminished.

'The combination of tougher Russian laws and the deterioration of the local economy has meant that a lot of Russians have decided not to keep their foreign structures,' says Neocleous. 'Most liquidate their structures and repatriate their money in Russia, as the taxes aren't too bad there. The more sophisticated clients keep their structures but make them more open and transparent. Some would like to keep some money abroad for safety and security reasons, particularly for their non-Russian investments. Some keep their assets abroad, fearing bad developments in their mother country, so we see some setting up businesses, combined with private wealth and a home. In general, things are much tougher for professionals. Clients are very price-sensitive, so margins are lower.'

Most of the major full-service firms claim that the decline in new company registrations has been offset by other areas, such as disputes.

'In a nutshell, the Russian market doesn't bring fresh corporate work,' says Andreas Haviaras, managing partner of Haviaras & Philippou. 'It's bringing a hell of a lot of fresh litigation. For firms like us, that are mainly litigators, we are very happy. I would say about 70% of our work is Russia-based. It should be there for at least three to five years. That is how long it takes to clear a court case. From that point onwards, I don't know.'

The nature of the disputes, and the role that Cypriot lawyers are playing in them, is also starting to change. Traditionally, the cases were in support of foreign proceedings and international arbitration, but litigators are now seeing a rise in cases led through the domestic courts. This is largely due to the rise in internal shareholder disputes where the articles of association won't allow for arbitration.

'In the past I would say that 90% of the cases we had were LCIA [London Court of International Arbitration] arbitrations in London and the Cyprus proceedings were in aid of that application,' says Haviaras. 'Now we also have direct claims before the Cyprus courts without LCIA

applications in the middle. This is because we've seen a growth in internal conflicts within Cyprus companies owned entirely by Russian shareholders.'

Aside from the rise in domestic-led court actions, the fact that many firms are so experienced in cross-border disputes also helps contribute to the sense that Cypriot lawyers provide a safe pair of hands.

'We have a very good legal system based on English common law,' says Menelaos Kyprianou, managing partner of Michael Kyprianou & Co. 'This, combined with the fact that Cyprus has become an attractive place for companies to set their bases, is why we've seen a number of cross-border disputes. This has been maintained, despite the recent issues in the economy.'

KEEPING IT CLEAN

The quality of Cyprus's legal infrastructure and the experience of its top practitioners is key to how the country positions itself for future foreign investment. And even though there has been a drop-off in the volume of Russian corporate instructions, the quality of the mandates are not suffering.

'The offshore industry is changing significantly,' says Pavlos Aristodemou, the managing partner of Harneys' Cyprus office. 'What we see now is the big groups and conglomerates using international structures, so more groups coming to Cyprus with real substance, and being managed and controlled from Cyprus. This is changing and is in line with the OECD [Organisation for Economic Co-operation and Development] guidelines. In terms of the legal market, the revenues that you get from such a group are 20 times larger, but then you have 20 times less volume.'

This comes as Cyprus and its professional services industry tries to shake off the perception that it is part of a nebulous offshore network, particularly where Russians and Russian companies are involved.

'The key is that Cyprus has decided to move upscale, which means we're trying to target a different audience as a potentially new jurisdiction for bigger clients,' says Neocleous. 'We'll be looking at bigger, more sophisticated companies. Companies can't come here to set up brass-plate operations and mailbox companies.'

At the time of writing, the massive data breach suffered by the Panamanian law firm and offshore specialist Mossack Fonseca & Co was dominating global headlines. Most

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Andreas Neocleous & Co

Cypriot lawyers, however, balk at the notion that what they do is in any way comparable to the situation in Panama.

'We want to operate in a transparent manner,' says Demosthenes Mavrellis, a corporate partner at Chrysses Demetriades & Co. 'We want good corporate clients. We favour quality clients. We are a jurisdiction with a competitive edge in tax and service, a good price-to-quality ratio, and furthermore an EU state. We are what I call "mid-shore".'

The hope is that Cyprus will establish a position similar to Ireland or Luxembourg, as a convenient entry point for companies and investment funds investing in and seeking investment from the EU. It won't necessarily take business from those two jurisdictions, but Cyprus is certainly positioning itself for more respectable work coming from other markets, and not just Russia and the CIS. For those firms with a strong track record representing international clients, it is an opportunity to cement their position in the market and expand the scope of their advice, away from the narrow-margin work and towards more lucrative, value-added areas, such as regulatory and finance.

'It is encouraging for major law firms,' says Mavrellis. 'There is a need for legal advice and, as the banks and corporates are trying to comply with all the new rules and regulations in a more stringent environment, they are also requiring more sophisticated legal advice from firms that have done international work in the past, know the proper forms of financial transactions, work within the framework of all EU treaties regulations and have good compliance.'

The country's geographic location certainly helps it position itself as a convenient entry point into the EU. Its proximity to the Middle East also carries advantages. The Cypriot government is actively wooing new markets and it was one of the first European countries to try to build trade relations with Iran when sanctions were lifted at the start of the year (for more details, see box, 'Funds to Iran', page 82). Other key jurisdictions include Israel and South Africa. In 2015, a South African property company, the Atterbury Group, was behind one of the year's largest transactions, the €180m acquisition of The Mall of Cyprus and the Mall of Engomi from the Cyprus-based Shacolas Group. Andreas Neocleous & Co advised Atterbury on the transaction and has continued to do so since it subsequently established a regional office in Cyprus.

BAD CREDIT

The Mall of Cyprus buyout illustrates that good deals can be found for foreign investors, particularly as Cypriot companies look to clean up their balance sheets. More transactions are likely to follow in the coming year, as banks, including the Bank of Cyprus, look to restructure their loan portfolios. This restructuring work will provide a good deal of activity for lawyers, although it also serves as a reminder that Cyprus is a long way from being fully solvent.

'Although there are a lot of encouraging figures about the economy, the one issue that remains is the NPLs,' says Kyprianou. 'This has generated legal work in relation to banks taking action against debtors, and also debtors who wish to renegotiate and restructure their loans with the bank.'

'A lot of these loans are no longer recoverable, not because people are unwilling to pay, but because they are unable to pay,' adds Stavros Pavlou, senior and managing partner at Patrikios Pavlou & Associates. 'As a result, companies producing for the local market are severely restrained. I have a prime candidate for non-payment, which is a leading local manufacturer. It has loans that can never be repaid because its turnover has halved to what it was before the crisis.'

For the most part, lawyers report that the banks are taking a pragmatic view and litigation against bad debtors has not been as high as might have been expected.

'The banks know that if they are too aggressive with taking people's assets, and especially their homes, this will very easily lead to a recession of even greater magnitude,' says Kyprianou. 'They are showing flexibility and they know that everyone will lose something from this issue. They will give discounts and they will try to give better repayment terms.'

On a national level, these restructurings are echoed through the government's own privatisation programme, which was among the conditions attached to the Troika bailout. So far, only the privatisation of the country's largest port at Limassol has gone through, with the government announcing in February that a consortium led by EuroGate International (and advised by Chrysses Demetriades) had won the concession for the port's container terminal and a consortium led by Dubai's DP World would take over the port's maritime services. Other targets for privatisation include the Cyprus Telecommunications Authority, the Electricity Authority of Cyprus and the government lottery, although political wrangling has delayed any progress on the first two.

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Andreas Haviaras, Haviaras & Philippou

Even when they do go ahead, with the exception of a small handful of law firms advising the bidders, the direct impact of the privatisations on the legal market is fairly minimal.

'They are very specific matters,' says Kyprianou. 'It's important for the law firms actually involved in the process, which are limited. I can't say for the legal services sector as a whole that it has an impact. However, the privatisation policies, the fiscal policies, the trimming of the public sector will help the economy as a whole, and the legal sector as a consequence.'

The other prize that the Cypriot market is holding out for is the potential of its offshore natural gas fields. Any plans to fully exploit these, however, are largely beholden to the ongoing negotiations with Turkey regarding the 'Cyprus question' and the country's potential reunification.

Discussions between Cyprus and Turkey resumed in 2015 and are considered to have gone well, although nothing concrete has yet to be agreed. There is also the suspicion that Turkey has become distracted by problems closer to home, including the implosion of Syria and its subsequent refugee crisis. Should a deal ever be struck, it would be a significant game-changer for the country and its lawyers, and provide a huge boost to the country's economy. In the meantime, however, the Cypriot legal market will focus on establishing a firmer footing as a place to do business in Europe.

'In a lot of instances, the market is what's driving the jurisdiction and not the other way around,' says Aristedemou. 'The big challenge for Cyprus is how to transform itself for the new era of tax, structuring and financing and to maintain its position in the European market.' **LB**