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Showing substance

More emerging market fund managers are seeking the services of offshore non-executive directors. David Lloyd of Walkers Management Services explains some of the intricacies around their function.

The demand for offshore non-executive independent directors for private equity funds has increased significantly with a growing number of private equity funds from Asia, Latin America and Europe turning to established offshore jurisdictions like the Cayman Islands for experienced and qualified independent directors.

Taking China as an example, private equity funds typically include a Cayman Islands exempted partnership ("ELP") in the fund structure or a BVI business company with the appointment of Cayman resident directors to the boards of the Cayman General Partner and Manager. This has occurred, in large part, from the February 2010 clarification by the Hong Kong Inland Revenue Department ("IRD") on the tax exemption rules for non-resident or offshore funds when it denoted that residency for Hong Kong tax purposes for companies, trusts and partnerships would be defined by the "central management and control" test.

This test is well documented for other jurisdictions that have utilised the benefits for the facilitation of capital. For Hong Kong's IRD, the locality of central management and control was indicated to be a question of fact and if exercised by the directors in board meetings, the relevant locality is where those meetings are held. Private equity funds whose central management and control is exerted in Hong Kong may be judged to be resident for tax purposes in Hong Kong.



David Lloyd

Engaging experienced directors resident in Cayman (emphasis placed on "experienced"), holding board meetings outside of Hong Kong, and demonstrating that the highest level of oversight is exercised by the board of directors in and from Cayman can be beneficial in determining the offshore tax presence. Moreover, the appointment of experienced independent directors may also improve the general corporate governance of the fund and can therefore enhance investors' confidence and an inclination to further invest.

Cayman directors also increasingly act for BVI funds and related holding companies with investment advisors in Russia and the Commonwealth of Independent States. Typically, a Cypriot company is interposed by virtue of the tax treaty with the former Soviet Union. Cyprus is the clear choice for Russia, the Ukraine and other CIS nations, and the BVI Company typically calls for experienced independent directors to be approached.

The enhanced flexibility of the BVI corporate regime, coupled with the low cost, is attractive to Russia and other jurisdictions alike. There are no restrictions in the BVI for a company providing financial assistance to any person associated with an acquisition of its shares; this abrogates concerns that a transaction would be unenforceable under common law.

In Latin America, and Brazil in particular, managers looking to gain access to international investors recognise that sophisticated investors are comfortable investing through funds established in the Cayman Islands. A Cayman Islands exempted limited partnership is often used as the investment vehicle which sits above wholly owned subsidiaries established in Delaware in order to invest in Brazil. Brazilian managers are also increasingly turning to Cayman to create offshore funds to invest in overseas markets outside of Brazil or to hedge their portfolios. Cayman service providers and directors, in particular, are likely to be well positioned in the coming years.

Independent directors act as a "watchdog" over fund managers and other service providers, and it is incumbent on them to bring objectivity and experience to the board. Fundamentally, the director's responsibility is concentrated on the high level oversight ensuring that the fund is appropriately structured from a legal and operational perspective, whilst delivering an acceptable level of service to its investors. Should the need occur, such as when disputes arise, the directors are obliged to proactively safeguard the interests of investors.

Directors of Cayman companies have a duty of care, diligence and skill in addition to a fiduciary duty to act honestly, bona fide and in the best interests of the company. The Walker Report, commissioned by the UK government and published in November 2009, investigated the deficiencies in the banking system and advocated that non-executive directors "have the knowledge and understanding of the business to enable them to contribute effectively".

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In essence, the benefits of experienced offshore directors located in Cayman are evident for funds and investors globally. It is likely that the requirement for their services will continue, particularly in light of Cayman's disposition to embrace the requirements of new regulatory regimes in Asia, US, Latin America and Europe, as well as its reputation for preserving a robust regulatory, AML and tax information exchange regime.

David Lloyd is a senior vice president at Walkers Management Services and acts as an independent non-executive director to several private equity funds

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