

## Client Alert

April 2022

### EU Sanctions on Trusts Connected to Russian Persons – Major Impact on Wealth Management Industry and Clients

#### Executive Summary:

- On 9 April 2022, the EU significantly expanded its sanctions against Russia.
- The new Regulation, aimed at preventing circumvention of sanctions on Russia, prohibits many transactions between trusts connected to Russian persons and service providers connected to the EU.
- The Regulation is likely to be an issue for many structures, as it is not about specifically listed persons, but rather about the wider class of persons connected to Russia.
- The Swiss government intends to implement similar restrictions, while the US and the UK are actively contemplating such restrictions.
- There is an immediate need for “management services” providers connected with the EU to wind down prohibited activities by 10 May 2022.
- Also, as of 10 May 2022, the prohibition will extend to acting, or arranging for another person to act, as a trustee, nominee shareholder, director, secretary or a similar position, for such trusts.
- Citizenship and residency by investment programs in the EU create opportunities for Russian persons to circumvent restrictions.
- Due diligence measures for trust structures are likely to be enhanced for the purpose of identifying in-scope ultimate beneficial owners or control by an in-scope person, such as via a protector or equivalent role, as well as through other governance structures.
- EU connected service providers should understand the broad scope of activities covered and how they are affected; conflicts could exist between their sanctions obligations and their fiduciary obligations.

#### Background:

A new EU Regulation regarding Russia-related sanctions including specific measures for Russian-connected trusts was published on 8 April 2022 and came into effect the following day on 9 April 2022. Among other measures, the new Regulation imposes a ban on EU service providers who provide certain services to trusts with specified trustors (defined below) or beneficiaries with connections to Russia. The new Council Regulation (EU) 2022/576 amends Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, as already amended by other recent EU Regulations on Russia-related sanctions.

The Regulation is far reaching and applies to trusts with trustors - persons who establish a trust (i.e. settlors) - or beneficiaries who fall into a broad range of categories, without regard to status as listed persons for sanctions purposes.

Previously, it was not prohibited to act as a trustee or in similar capacities for trusts connected to Russian persons and entities, or to provide other trust, legal and





business services to trusts connected to non-listed Russian persons and entities. EU persons could act as a trustee for a trust or similar arrangement and provide services to such trusts, at least where they were not controlled or owned by listed persons. Under the Regulation, this will no longer be the case.

### **Scope of the New Regulation**

Starting from 9 April 2022, the Regulation prohibits EU persons and non-EU persons doing business within EU territory or under the jurisdiction of a Member State, from registering, providing a registered office, business or administrative address, and providing management services to, a trust or similar legal arrangement having as a trustor (i.e. settlor) or a beneficiary any of the following:

- 1) Individual Russian nationals or residents
- 2) Legal persons, entities or bodies established in Russia
- 3) Legal persons, entities or bodies owned directly or indirectly more than 50% by a Russian person (individual or legal person)
- 4) Legal persons, entities, or bodies controlled by a person (individual or legal) under categories 1-3 above, and
- 5) An individual or legal person, entity or body acting on behalf or at the direction of a person (individual or legal) under categories 1-4 above.

As of 10 May 2022, the prohibition will also extend to acts as, or arranging for another person to act as, a trustee, nominee shareholder, director, secretary or a similar position, for a trust or similar legal arrangement meeting the above criteria.

An exemption from the prohibition applies where the relevant trustor or beneficiary is also a national of an EU Member State or an individual having a temporary or permanent residence permit in an EU Member State.

The Member State competent authorities charged with enforcing the Regulation may authorize further exemptions for the services to be carried out on a limited basis if for either: (1) humanitarian purposes, such as delivering or facilitating the delivery of assistance, including medical supplies, food, or the transfer of humanitarian workers and related assistance or for evacuations; or (2) civil society activities that directly promote democracy, human rights or the rule of law in Russia.

There is also a limited exception for operations that are strictly necessary for the termination by 10 May 2022 of contracts which are not compliant with the new rules concluded before 9 April 2022 or ancillary contracts necessary for the execution of such contracts.

### **Swiss, US and UK Implications**

The Swiss Federal Department of Economic Affairs, Education and Research announced on 13 April 2022 that Switzerland will adopt the new EU measures, including the restrictions on trusts, and it is preparing the relevant legal instrument. Previous acts by the Swiss government would indicate that although it will fully adopt the EU measures, there is likely going to be space for nuanced interpretation of similar, or even identical, measures.

While the United Kingdom and the United States have not announced parallel restrictions relating to trusts, as of the date of this writing, those are being actively contemplated. And as common-law jurisdictions with developed trust industries,



they could have equally far-reaching consequences for families, family offices and others in the private client industry doing business in those jurisdictions.

### **Room for Interpretation in the EU Regulation**

The Regulation specifically prohibits those subject to EU law (including EU entities and citizens wherever located (i.e. both inside and outside of the EU), any person while being on EU territory and any business done in whole or in part within the EU) from providing management services to a trust or similar legal arrangement having as a trustor (i.e. settlor) or as a beneficiary an in-scope person. What constitutes management services for purposes of the Regulation is yet to be determined.

Similarly, the Regulation provides an exemption for a trustor or beneficiary who is a Russian citizen, and either a national of an EU Member State or an individual with a temporary or permanent residence permit for an EU Member State. Whereas Swiss measures have typically exempted citizens and residents of Switzerland and the EEA, the EU Regulation appears to exempt only residents or nationals of EU Member States. This limited scope of the exemption means that residents or nationals of those states bound to enforce the EU treaties, specifically by Part 5, External Action by the Union, of The Treaty on the Functioning of the European Union, and related articles of The Treaty on European Union, may still fall within the scope of the categories of persons specified by the Regulation.

### **Implications for the Wealth Management Industry and Clients**

The EU Regulation is broad and could place onerous demands on service providers with small offices in relation to new and existing clients and corresponding due diligence. Trustees must ensure compliance where they have doubt as to the identity of a beneficial owner or trustor or else they may risk enforcement action. Service providers, including trustees, fiduciaries, asset managers, investment advisers and corporate service providers, among others, will need to exercise caution and expand their due diligence obligations to ensure that they do not violate the prohibition on providing services to such trusts or similar legal arrangements, including foundations, with in-scope trustors (i.e. settlors) and beneficiaries.

At the same time, high net worth individuals, families, and family offices that are potentially in-scope may be targeted for further review. Service providers should approach these situations with caution, while the private clients should be prepared in advance for substantial further due diligence review.

### **Points of contention in the new rules**

Citing circumvention risks, some commentators note problems with the exemption in the Regulation for EU nationals and residents. In particular, citizenship by investment (CBI) and residence by investment (RBI) programs exist in certain EU Member States. Some of these programs have been used by Russian persons. Under such programs, non-EU citizens who make a minimum investment in a Member State (e.g. in Cyprus it was approximately 2 million Euros prior to termination of that program) can obtain citizenship in that Member State. Trusts connected to such persons may thereby be exempt from application of the Regulation. While there are many legitimate reasons to obtain citizenship or residency by investment, the remaining programs are already facing mounting pressure from the public and politicians alike, who would like to curtail such



programs due to the possibility they create for abuse and circumvention of sanctions and other anti-money laundering provisions.

The Regulation may require additional due diligence for certain claims of tax residency or citizenship under CBI/RBI programs. It also remains to be seen to what extent service providers will be expected to act to ensure trustors or beneficiaries with a tax residence in any Member State would qualify for the exemption.

Further, although self-executing as regulation rather than a directive, enforcement of the Regulation is done at the Member State level, which can lead to substantial differences in how the rules are interpreted and/or enforced. It may take significant time to work out the consistent application of the Regulation.

It becomes clear that due diligence procedures associated with claims of residence in an EU Member State may vary, but in any case these are likely to continue to be enhanced. We can expect that such enhanced due diligence measures for structures will be put into place for the purpose of identifying in-scope ultimate beneficial ownership or control by an in-scope person of an entity that is a beneficiary or a settlor. While the focus should be on identifying in-scope ultimate economic settlors and beneficial owners, service providers will also need to keep an eye out for issues involving exercise of control in other forms, such as via a protector or equivalent role, as well as through other governance structures.

Further, as implemented at the level of financial institutions, these concepts should align with applicable EU AML/KYC regulations and guidance, also at the Member State level, consistent with the standards set forth in the FATF Recommendations.

### **Potential Timing Issues**

Service providers to in-scope trusts will need to make arrangements quickly between April 9 and May 10 to process an orderly resignation from prohibited positions and contracts and, in keeping with any fiduciary obligations they may have under applicable trust or corporate law, arrange for an alternative according to the terms of the governing instrument(s) and applicable local law and practice. There could be situations where, particularly given the short time frame to act, a conflict arises between the new sanctions obligations under the Regulation on the one hand and the fiduciary obligations of the trustee or other service provider on the other hand. Trustees and other service providers should certainly act promptly to ensure the proper discharge of their fiduciary obligations.

There is no stated limitation on the type of person acting as trustee or in another capacity who may be captured by the Regulation in connection with an in-scope trust. Thus, even individuals and others acting outside of a professional trustee or service provider context will need to review and comply with the Regulation, if they are EU residents or nationals, or conducting activities in this regard in the EU.

Potential additional points. Service providers will be responsible for determining whether the Regulation applies to more complex arrangements, such as a trust or similar legal arrangement (e.g., trusts in Ireland, foundations in Liechtenstein (if covering EEA) or other jurisdictions with foundations, etc.) where the provider is located outside the EU and conducts all activities there. Presumably the application of governing law of an EU Member State should be sufficient to bring such trusts or other legal arrangements within scope, even if the provider is not within the EU.



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## What Can Trustees and Other Service Providers and Private Wealth Clients Do?

While the EU Regulation does not expressly ban the creation or maintenance of trusts and similar legal arrangements for in-scope persons, the Regulation seems to effectively make such arrangements impossible if involving service providers located or doing business in the EU or a trust or similar legal arrangement involving EU governing law. In these cases, one could not act in the essential position of a trustee or equivalent, or to provide other necessary services, if the settlor or any beneficiaries are in-scope persons.

In such cases, what can an existing provider do to meet its existing fiduciary obligations with respect to the settlor and beneficiaries of an in scope trust or other legal arrangement?

First, the parties should come to a general understanding of the prohibitions, being familiar with the scope of application of the Regulation.

Second, the parties should assess the structure with complete and accurate due diligence. It will be important to determine if there are in-scope persons involved, and their roles. Such persons may include future but not current beneficiaries, in which case some planning may be possible.

Third, trustees and service providers should research their options under the relevant trust instrument and local law, and confirm how the Regulation is applied in their jurisdiction and with respect to the specific structure. Some options might include withdrawing or resigning, or restructuring the terms of an existing trust, provided there is adequate and necessary substance to any changes made. In cases involving in-scope settlors, however, mitigation options may be substantially more limited or not available.

Given the wide scope and potential for wider adoption, the Regulation is likely to be an issue for many structures, as it is no longer about specifically listed persons, but rather about the wider class of persons connected to Russia.

Trustees and other fiduciaries and service providers should be prepared for the new rules with a full understanding of the broad scope and activities that are covered and how the Regulation may apply to their specific mandates.

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