

STEP Position Paper: EU sanctions against trusts with a ‘Russian connection’

Purpose of this Position Paper

This Position Paper aims to provide some guidance for trust and company service practitioners on the prohibition that the European Commission has imposed in relation to European Union (EU) Member States providing certain services to trusts and similar legal arrangements with a Russian connection. The paper is structured in the following way:

- Section (A) Background (paras 1-4)
- Section (B) Trusts with a ‘Russian connection’ (paras 5-12)
- Section (C) Prohibited services (paras 13-16)
- Section (D) Termination of trusteeships: some practical issues (paras 17-25)
- Section (E) Practical examples (paras 26-32)
- Section (F) STEP contacts and disclaimer (paras 33-34)
- Schedule: Article 5m of the Regulation

(A) Background

1. On 8 April 2022, the Council of the EU adopted *Regulation 2022/576* (‘the Regulation’), which contains a fifth round of sanctions against the Russian Federation in view of its military attack on Ukraine.
2. Article 5m of the Regulation contains some restrictions in relation to trusts with a ‘Russian connection’ as described in Section (B) below. The full text of article 5m, in its English language version, is published in the Schedule to this Position Paper.
3. The Regulation has been directly applicable to all EU Member States since 9 April 2022, the day following its publication, and provides for a deadline of 10 May 2022 to terminate all services to trusts and similar legal arrangements with a ‘Russian connection’. Equivalent measures were adopted in Switzerland on 13 April 2022¹ and are expected in Liechtenstein. When reference is made to the sanctions implemented in the EU, this paper will impliedly refer to the equivalent ones in force in other countries of the European Economic Area (EEA).

¹ <https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-88028.html>

4. The urgency to take action in relation to the ongoing conflict in Ukraine and an impression in the media that Russian oligarchs may use trusts to circumvent sanctions may have led to a hasty drafting of article 5m of the Regulation, which gives rise to uncertainties both in relation to its literal meaning and to its actual enforcement in compliance with trust law.

(B) Trusts with a ‘Russian connection’

5. Article 5m of the Regulation specifically targets trusts and any similar legal arrangements with a ‘Russian connection’, i.e., those where the ‘trustor’ or any beneficiary are:
 - a. Russian nationals or natural persons residing in Russia.
 - b. Legal persons, entities or bodies established in Russia.
 - c. Legal persons, entities or bodies whose proprietary rights are directly or indirectly owned for more than 50 per cent by a natural or legal person, entity or body referred to in points (a) or (b).
 - d. Legal persons, entities or bodies controlled by a natural or legal person, entity or body referred to in points (a), (b) or (c).
 - e. A natural or legal person, entity or body acting on behalf or at the direction of a natural or legal person, entity or body referred to in points (a), (b), (c) or (d).
6. A significant exception is provided under article 5m (4) of the Regulation when the ‘trustor’ or a ‘beneficiary’ are ‘a national of a Member State or a natural person having a temporary or permanent residence permit in a Member State’.
7. The words ‘trustor’ and ‘beneficiary’ are not defined in the Regulation. Their meaning must therefore be construed according to trust law. A ‘trustor’ is the person creating a trust, more often referred to as a ‘settlor’ or ‘grantor’. In this paper, the expression ‘settlor’ will be used to refer to this person. A ‘beneficiary’ should include both the holder of an equitable interest in the trust property or its income (i.e., a beneficiary of an ‘interest in possession trust’ or ‘fixed trust’), and the object of a discretionary power by the trustee (i.e., a beneficiary of a ‘discretionary trust’). Accordingly, the word ‘beneficiary’ does not appear to correspond to the notion of a ‘beneficial owner’ under article 3 (6) (b) of the *EU Directive 2018/843* (‘the Fifth AML Directive’), which would extend to trustees, protectors and ‘any other natural persons exercising ultimate control over the trust’.
8. As a result, the trusts with a ‘Russian connection’ targeted by the Regulation are only those where the settlor or any beneficiaries are Russian nationals or residents, or legal entities controlled by them, according to the list drawn up at article 5m (1). The nationality or residence of protectors or ‘any other natural persons exercising ultimate control over the trust’ are not relevant for the purposes of these restrictions.

9. Article 5m refers to trusts and ‘any similar legal arrangements’. No definition or examples are provided for such ‘similar legal arrangements’ in the Regulation. Some guidance may be found to this effect in a report by the European Commission published on 16 September 2020 (COM (2020) 560²) to assess whether the EU Member States have identified the legal arrangements similar to trusts governed under their laws pursuant of article 31(10) of the Fifth AML Directive (‘the Report’). The following legal arrangements are identified in the Report (in the order in which they are reviewed):
- a. Trusts governed under the laws of Cyprus, Ireland and Malta (in the case of Cyprus, this also includes ‘international trusts’ under the *International Trusts Law 1992*).
 - b. Trusts recognised under Book 4, Part I, Chapter 6 of the *Civil Code of Lithuania*.
 - c. Trusts recognised under the *Hague Convention of 1st July 1985 on the Law Applicable to Trusts and on their Recognition* in Italy, Luxembourg and the Netherlands.
 - d. Trusts recognised under Chapter XII of the *Code of Private International Law of Belgium*.
 - e. *Fiducies* under article 2013 of the *Civil Code of France*, the *Law of 27 July 2003 relating to Trusts and Fiduciary Contracts of Luxembourg*, and articles 773 – 791 of the *Civil Code of Romania*.
 - f. Fiduciary agreements (*mandato fiduciario*) practised under Italian law as well as under article 1255 of the *Civil Code of Spain*.
 - g. Fiduciary property management contracts (*bizalmi vagyonkezelő*) under Book VI, Title XVI of the *Civil Code of Hungary*.
 - h. Bonds by appropriation (*vincolo di destinazione*) under article 2645-ter of the *Civil Code of Italy*.
 - i. *Treuhand* under the laws of Austria and Germany.
 - j. Fiduciary funds (*svěřenský fond*) under section 1448 and following of the *Civil Code of the Czech Republic*.

A number of arrangements are mentioned in the Report as not being ‘similar to trusts’ for the purposes of the Fifth AML Directive. These are:

² <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0560&rid=5>

- a. Private foundations to the extent that they are incorporated legal persons (with the exception of *nichtrechtsfähige Stiftungen* under German law, which lack legal personality).
 - b. Life insurance contracts, which are governed by specific regulations.
 - c. Escrow agreements, where the escrow agent acts as guarantor for the parties to a transaction and is not a party to it.
 - d. Nominees, who act on the instructions of a beneficial owner in relation to certain assets.
 - e. Silent partnerships, as the information on them is not conclusive as to whether they are similar to trusts or not.
10. We recommend that the legal arrangements listed in the Report as being similar to trusts should be considered as such for the purposes of the Regulation. Some caution may have to be exercised in relation to those that are not included in the Report. The purpose of the Report was to recognise the legal arrangements governed by the laws of the various EU Member States that should be subjected to the same rules as trusts under article 31 of the Fifth AML Directive (the creation of a register of their beneficial owners). Austrian and German foundations, due to their incorporated nature, are listed in the beneficial ownership registers for companies. Insurance contracts are subject to specific regulations for AML purposes. In relation to nominees, the Report expressly mentions that ‘The transfer of assets requires a trust, a similar legal arrangement or civil contract to govern the nominee relationship’.
11. In light of this and with a view to adopting a purposive construction of article 5m, it appears that in addition to all the legal arrangements that are recognised as being ‘similar to trusts’ under the *European Commission Report COM (2020) 560*, the following legal entities and arrangements should be included:

- a. Private foundations incorporated in an EU Member State.
- b. Nominee agreements governed by the laws of a Member State or where the nominee is a national or a resident of a EU Member State (in some cases such nominee agreements may be organised as ‘bare trusts’).
- c. Escrow agreements where one of the parties is a Russian national or resident or any other entity mentioned under article 5m (1) of *Regulation 2022/576*.

This interpretation appears to be supported by the express mention of a ‘director’ and a ‘nominee’ in the list of prohibited services at article 5m (2) of the Regulation as is further discussed in Section (C) below.

12. Subject to the exception of private foundations, article 5m does not appear to extend to commercial companies and other corporate entities. Its target is expressly limited to

'trusts and similar arrangements' with a 'Russian connection' as defined under article 5m (1). Commercial companies cannot be construed as 'legal arrangements similar to trusts' and if the prohibition under the Regulation had to be extended to the services provided to companies and other corporate entities, a direct mention would have been required.

(C) Prohibited services

13. Article 5m prohibits a number of services in relation to trusts and other legal arrangements with a 'Russian connection' as defined in Section (B) above.

More specifically, article 5m (1) states that 'It shall be prohibited to register, provide a registered office, business or administrative address as well as management services' to trusts and similar legal arrangements with a 'Russian connection' as defined in Section (B) above. In particular, the express mention of 'a registered office, business or administrative address' confirms that the 'legal arrangements similar to trusts' must include private foundations.

14. Article 5m (2) goes on to state that 'It shall be prohibited as of 10 May 2022 to act as, or arrange for another person to act as, a trustee, nominee shareholder, director, secretary or a similar position, for a trust or similar legal arrangement' with a 'Russian connection' as defined in Section (B) of this paper.

Again, the express mention of a 'nominee shareholder', 'director', 'secretary' or a similar position appears to confirm that the 'legal arrangements similar to trusts' must include nominee agreements and private foundations. At the same time, the fact that such services are prohibited to the extent that they are provided to 'a trust or similar legal arrangement' appears to exclude that the Regulation extends to commercial companies and other corporate entities.

15. Article 5m (3) indicates that 'paragraphs 1 and 2 shall not apply to the operations that are strictly necessary for the termination by 10 May 2022 of contracts which are not compliant with this article concluded before 9 April 2022 or ancillary contracts necessary for the execution of such contracts'.

A combined reading of the prohibitions spelt out in paragraphs (1), (2), and (3) of article 5m appears to suggest that:

- a. No new trusts and 'similar legal arrangements' with a 'Russian connection' (as defined in Section (B) above) can be created or entered into by a national or resident of a EU Member State since 9 April 2022.
- b. Any trusts and 'similar legal arrangements' with a 'Russian connection' in existence in the EU (or with a EU national or resident person acting as trustee, nominee, director, secretary, or holding a similar position) as of 9 April 2022 must be terminated by 10 May 2022.

- c. By way of exception, any ancillary contracts or more generally ‘operations’ that are required to terminate the relevant trusts and ‘similar arrangements’ by 10 May 2022 are permitted.
16. An additional exception may be admitted to some special types of trusts and ‘similar legal arrangements’ under article 5m (5) provided that they are necessary for:
- a. 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
 - b. civil society activities that directly promote democracy, human rights or the rule of law in Russia.

(D) Termination of trusteeships: some practical issues

17. Article 5m (3) 6 refers to ‘the termination by 10 May 2022 of contracts which are not compliant’ with the prohibition contained in the article. This may be feasible in a number of cases, particularly where the relevant legal relationship is contractual in nature, but it is not warranted in the case of a trust with a single trustee. Some related issues may apply in respect of private foundations and will be reviewed in Section (E).
18. Where the contractual relationship to the ‘trust or similar legal arrangement’ can be terminated with a specified notice period, it appears to be reasonable to conclude that if a termination notice is issued in compliance with the required contractual formalities by the due date of 10 May 2022, the provision under article 5m (2) is satisfied, even though the relevant notice period has not yet expired. This must usually be the case with nominee agreements or bare trusts.
19. Nonetheless, it is a common principle under trust law that a sole trustee cannot validly retire until a successor trustee is identified and takes office. Some additional restrictions may exist under the governing law of the trust or a specific trust instrument. An example is section 39 (1) of the England and Wales *Trustee Act 1925*, which requires at least two individuals or a trust corporation to act as trustees.

In many instances, the terms of the trust expressly provide for the case of a retiring trustee. The most likely arrangements allow the retiring trustee to appoint a successor or provide that another officer (e.g., a protector or the settlor) has the power to appoint new or additional trustees.

The power to appoint new or additional trustees is fiduciary and must be exercised in the best interest of the beneficiaries. Not just anyone can be appointed as new trustee of a trust. A trustee holding office is liable to the trust beneficiaries to appoint a suitable successor in order to be able to retire and be discharged from the fiduciary obligations relating to the trust. The same is true for an officer having the power to appoint a new trustee.

The case law on this matter has been consistent since the 19th century, as is evidenced by the decision in *Re Skeats' Settlement* [1889] 42 ChD 522 and more recently *In the Matter of the Piedmont Trust and in the Matter of the Riviera Trust* [2021] JRC 24.

20. To the extent that no new trustee can be found by 10 May 2022 to take over a trust in existence as of 9 April 2022 and exhibiting a 'Russian connection' as defined in Section (B) above, the existing trustee will continue to hold office. We would recommend that any trustees finding themselves in such a situation should keep accurate records of the actions they undertook in order to cease to be trustees. They should continue such exercise even after 10 May 2022 with a view to being able to effectively retire and be discharged as soon as possible.
21. Care must be taken with regard to the express mention under article 5m (3) that the prohibition extends to arranging for another person to act as trustee or hold a similar position.

This provision does not appear to be triggered to the extent that a trust instrument empowers the existing trustee to appoint a successor in order to retire and be discharged of the fiduciary obligations of a trust. Otherwise, there would be no other way to comply with the prohibitions under articles 5m (1) and (2) of the Regulation.

Caution may have to be exercised when the new trustee is an affiliated entity to the retiring trustee. In other words, if the transfer of trusteeship takes place within the same group of companies, the retiring trustee must not retain any direct or indirect ability to control the administration of the trust after the new trustee has taken over.

The phrases 'affiliated entity' and 'group' may be extensively construed so to indicate entities that have some established business relationships between themselves, whether or not they have some common shareholders.

Of course, the issues discussed in this paragraph must also be taken into account when the successor trustee is completely independent of the retiring trustee.

22. The retirement of a trustee and the transfer of trusteeship to a successor is usually a complex process under which the retiring trustee requires a proper indemnity for any liabilities that may be incurred after the trust fund has been transferred to the new trustee. STEP published a handbook to this effect, which includes templates of instruments of indemnity under the laws of various jurisdictions³.

A retiring trustee must ensure that the exposure to any liabilities resulting from the trust being transferred are adequately covered in a properly drafted instrument of indemnity. The successor trustee will have to review the latest available trust accounts to assess the extent of any latent liabilities and to reflect such situation in the instrument of indemnity.

³ R. Williams, A. Murphy, T. Graham, *A Practical Guide to the Transfer of Trusteeships*, 3rd ed, Globe Law and Business, 2017.

The deadline of 10 May 2022 imposed by the Regulation must be met to the extent possible, but the transfer of trusteeship is likely to require more time. In light of this, substantial compliance appears to be achievable if the process is irrevocably commenced before 10 May 2022.

23. A trustee is the legal owner of the trust property. In some civil-law jurisdictions, the trustee is the sole owner of such property. In the Czech Republic, the trustee is not an owner but the property held in the name of a 'fiduciary fund' (*svěřenský fond*) may be registered in the name of the trustee.

As a result, a transfer of trusteeship involves the transfer of the trust property to the successor trustee. In very few cases, a vesting order can be included in the instrument of retirement and appointment of trustees (often referred to as a 'DORA' if it takes the form of a 'deed' as is understood under English law).

In the majority of cases, each asset held by the retiring trustee must be transferred to the new trustee in compliance with the required formalities.

In the case of company shares, a new entry must be made in the register of shareholders and possibly in the register of commerce or the equivalent public register in the jurisdiction of incorporation of the company. In some civil-law jurisdictions, this process requires a notarial deed.

In the case of real estate, an entry must be made in the land register of the jurisdiction where the property is situated. Again, in many civil-law jurisdictions this process requires a notarial deed or sometimes a court order.

In the case of bank accounts, some banks may simply update the signatory authorities to the account in the name of the trust. In some cases, the account will have been opened in the name of the trustee as trustee of a certain trust. This is a formally correct approach, to the extent that the trust is a legal relationship and has no legal personality. The only person in the relationship is the trustee and it is therefore appropriate for a bank account to be in the trustee's name with an express mention of the specific trust. The consequence is that a new account must be opened by the successor trustee and the retiring trustee must transfer the balance to such new account.

The transactions required to transfer the trust fund to a successor trustee are unlikely to be completed by 10 May 2022 in all circumstances. It appears that substantial compliance with the provisions of the Regulation can be achieved if the process is irrevocably started before the deadline of 10 May 2022 with a view to promptly finalising it as early as reasonably possible.

24. An alternative to appointing a new trustee and transferring out the trust fund would be to terminate the trust and distribute the trust fund to the beneficiaries. In many cases, the trust instrument may confer a discretionary power on the trustees to declare that the trust period has come to an end and distribute the trust property to the beneficiaries.

Even though this option may be possible in some cases, it is doubtful that such a course of action can be considered compliant with the Regulation and the other sanctions imposed on Russia since the beginning of the war in Ukraine.

We recognise that article 5b prevents the acceptance of any deposits from Russian nationals or residents or legal persons, entities or bodies established in Russia for an amount in excess of EUR100,000. The same prohibition applies to the provision of crypto-asset wallets, accounts or custody services. The prohibition is always subject to the exception of Russian nationals holding the nationality or being permanently or temporarily resident in an EU Member State, in a State of the European Economic Area or in Switzerland.

However, freeing significant resources that were previously held on trust and making them directly available to Russian national and resident beneficiaries does not appear to be in line with the spirit of the sanctions that have been imposed on Russia since the beginning of its military attack on Ukraine on 24 February 2022.

25. On 13 April 2022, the Cypriot Minister of Finance issued an informal clarification note suggesting that the Regulation prohibits only the creation of new trusts as of 10 May 2022, and does not require the termination of those that were in existence before 9 April 2022. Although this approach may be helpful in light of the difficulties mentioned in this section, a more prudent approach appears to suggest that trustees (and similar office holders) who are nationals or resident of an EU Member State should try to the best of their efforts to extricate themselves of any existing trusts and legal arrangements with a 'Russian connection' (as defined in Section (B) above) before that deadline.

Of course, Cypriot national and resident trustees may wish to rely on the construction suggested by the local Minister of Finance in the event that they were exposed to the penalties following their alleged breach of the Russian sanctions. However, the Minister of Finance has indicated that these guidelines were provided on an informal basis and that only the Court of Justice of the EU is competent for providing interpretation of European legal documents. Nonetheless, for the trustees operating in other EU Member States, we would recommend a more careful approach.

(E) Practical examples

26. The following practical examples could be likely in the daily practice of professional trust and corporate service providers based in the EU.
- a. Trusts, nominee agreements and private foundations where the settlor (respectively the founder) and all the beneficiaries are Russian nationals holding a second passport and/or a permanent or temporary residence permit in an EU Member State.
 - b. Nominee agreements where the beneficial owner is a Russian national holding only Russian nationality and residing in Russia (or holding a passport and/or a permanent or temporary residence permit in another jurisdiction outside the EU).

- c. Trusts and private foundations where the settlor (or respectively the founder) is a Russian national holding a second passport and/or a permanent or temporary residence permit in a EU Member State and some of the beneficiaries are Russian nationals holding only Russian nationality and residing in Russia.
- d. Trusts where the settlor and some beneficiaries are Russian nationals who do not hold a passport or a permanent or temporary residence permit in an EU Member State.
- e. Private foundations where the founder and some beneficiaries are Russian nationals who do not hold a passport or a permanent or temporary residence permit in an EU Member State.
- f. Companies held on a trust with a non-EU trustee and a Russian settlor and Russian beneficiaries (whether or not holding a passport and/or a permanent or temporary residence permit in an EU Member State or in another jurisdiction outside of the EU).

For the purposes of these examples, we assume that the trustee of the trust, the nominee of the nominee agreement or the directors of the private foundation are nationals and/or residents of an EU Member State. The governing law of the arrangement is irrelevant for our purposes and the term 'trust' may be understood as referring to any of the 'similar legal arrangements' covered in Section (B) paragraphs (9) and those listed above.

It is also assumed that none of the persons referred to as the settlor, the founder, the beneficial owner and the beneficiaries are expressly targeted in a list of sanctioned persons. In other words, none of them are a 'blocked person', as the phrase is understood for the purposes of the United States sanctions, in any national or supra-national list.

The discussion of these practical cases relies on these assumptions. Specific action may have to be taken in the event that any of the concerned persons were individually targeted in any sanctions list. These aspects are not considered in this paper, but all trust and corporate service providers operating in the EU must regularly review their client lists against the evolution of the sanctions lists relating to Russia.

Trusts, nominee agreements and private foundations where the settlor (respectively the founder) and all the beneficiaries are Russian nationals holding a second passport and/or a permanent or temporary residence permit in a EU Member State.

- 27. In these cases, nothing has to be done as this exception is expressly contemplated under article 5m (4) of the Regulation.

Of course, if any of the persons referred to as the settlor (or the founder), the beneficial owner or the beneficiaries of these trusts and similar legal arrangements were to be

individually targeted under a sanctions list, appropriate corresponding actions should be taken, but this would not be a consequence of the prohibition under the Regulation.

Nominee agreements where the beneficial owner is a Russian national holding only Russian nationality and residing in Russia (or holding a passport and/or a permanent or temporary residence permit in another jurisdiction outside the EU).

28. Article 5m (4) provides only for the exception of nationality or permanent or temporary residence in an EU Member State. This is different from article 5b (3) where the exception in relation to deposits and crypto-assets is extended to the European Economic Area (i.e., Iceland, Liechtenstein and Norway) as well as Switzerland.

If the beneficial owner of a nominee agreement is a Russian national or resident who does not hold a passport and/or a permanent or temporary residence permit in an EU Member State, the arrangement is directly targeted by the prohibition under the Regulation and must be terminated by 10 May 2022.

A new nominee must be identified before the deadline of 10 May 2022 so that the assets held under nomineehip are transferred out within such due date. Some formalities may have to be respected to that effect and as a result, it may be impractical to complete the process within such deadline.

Substantial compliance appears to be ensured to the extent that an instrument of retirement and appointment of nominees is executed with an effective date prior to the deadline of 10 May 2022. Any subsequent transactions will then be carried out with a view to making the effects of such instrument enforceable against third parties and, if necessary, may take place after the due date of 10 May 2022.

The new nominee will have to be a national or resident outside the EU where no comparable restrictions apply in relation to trusts and similar arrangements with a 'Russian connection' as defined in Section (B) above.

Caution should be exercised for the outgoing EU nominees not to be seen as arranging for another person to act as nominee on their behalf for the purposes of article 5m(2).

Nominee agreements can usually be unilaterally terminated either by the beneficial owner or by the nominee. This could be an alternative solution where a new nominee cannot be suitably identified before the due date of 10 May 2022. Even in this case, an instrument of termination should be executed with effective date before the deadline of 10 May 2022 so that any subsequent transactions intended to transfer the assets held under nomineehip to the beneficial owner can take place even after the due date if it is not possible to complete them before.

A special case may be that of a nominee agreement where the beneficial owner is a Russian national who also holds another nationality and resides in another jurisdiction outside the EU. Some nominees may have entered into this business relationship under the assumption that the beneficial owner is a national and resident of the other

jurisdiction. In other words, that beneficial owner may be a person of Russian origin holding another nationality and residing in a jurisdiction outside the EU, which is not Russia. A strict reading of the Regulation may suggest that even these cases should be considered as being caught by the general prohibition under article 5m. Nonetheless, it may be legitimate for some trust and corporate service providers to retain such business relationships based on the circumstances of each specific case. For example, a person born outside Russia but holding Russian nationality because of his or her parents may be a different case from that of persons who were born in Russia, lived there for a substantial part of their lives and only recently left the country.

Trusts and private foundations where the settlor (or respectively the founder) is a Russian national holding a second passport and/or a permanent or temporary residence permit in an EU Member State and some of the beneficiaries are Russian nationals holding only Russian nationality and residing in Russia.

29. To the extent that the settlor (or respectively the founder) and some beneficiaries hold a passport and a permanent or temporary residence permit in an EU Member State, the trust (or respectively the private foundation) can be maintained.

The beneficiaries who are only Russian nationals residing in Russia will have to be excluded by the due date of 10 May 2022.

Many trust instruments confer on the trustee a power to revocably or irrevocably exclude beneficiaries, which may have to be exercised in these cases. The revocation may be subject to a condition subsequent that the prohibition under article 5m will be lifted.

The exclusion of such beneficiaries may be accompanied by a new provision in the terms of the trust stating that any Russian national and resident who does not hold a passport or a permanent or temporary residence permit in an EU Member State shall be excluded from all and any benefits under the trust so long as the prohibition under article 5m shall remain in force.

The addition of such a provision will be possible to the extent that the trustee has the corresponding power under the terms of the trust. Even in the absence of such a power, a trustee can pass a resolution to the effect that no beneficiaries shall be added to the extent that they are Russian nationals residing in Russia and not having a passport or a permanent or temporary residence permit in a EU Member State for so long as the prohibition under article 5m shall remain in force.

If the trust instrument does not confer a power on the trustees to exclude beneficiaries, the beneficiaries can usually disclaim their interests under the trust. Some conditions on this disclaimer may exist under the governing law of the trust but a beneficial interest can usually be disposed of and as a result, it can be disclaimed or renounced. Any Russian beneficiaries who do not hold a passport or a permanent or temporary residence permit in an EU Member State may have to disclaim their interests under the

trust. The trustee will have to explain the situation and indicate that their disclaimer will be the condition for the trust to remain in existence.

To the extent that the prohibition under article 5m does not extend to protectors, some excluded beneficiaries, or beneficiaries who have disclaimed their interests, may be appointed protectors of the trust, possibly forming a protector committee. This appointment will be possible to the extent that it is contemplated under the terms of the trust and it may enable such beneficiaries to satisfy themselves that the trustees will continue to discharge their fiduciary obligations under the governing law of the trust.

It must be borne in mind that in addition to the provisions imposed under article 5m, a trustee will continue to be bound by the fiduciary obligations resulting from the terms of the trust and the governing law, and will be personally liable for any breach of trust.

In light of this, some trustees may prefer to retire and in this case the issues referred to at paragraph (30) will apply.

Most of the issues referred to the trustees of a trust in this paragraph can be extended to the directors of a private foundation. Some issues that are specific to private foundations are discussed at paragraph (31) below.

Trusts where the settlor and some beneficiaries are Russian nationals who do not hold a passport or a permanent or temporary residence permit in an EU Member State.

30. This trust is expressly targeted by the prohibition under article 5m of the Regulation.

An EU national or resident trustee therefore only has two options in order not to be in breach of the Regulation:

- terminating the trust and distributing the entire trust fund to the beneficiaries; or
- retiring as trustee and transferring the trust fund to a suitable successor trustee.

In any event, an EU trustee must reach out to the settlor and the beneficiaries of a trust with a 'Russian connection' as defined in Section (B) of this paper pointing out the different solutions available to comply with these provisions. This contact should be properly documented, as it may be relevant for the purposes of the personal liability of the trustee if no solution could be achieved by the due date of 10 May 2022.

The option of terminating the trust may be seen as the easiest one to the extent that the trustee has the power to unilaterally declare an early termination of the trust period. In some cases, it may not be feasible however. It is not uncommon for the terms of the trust to provide that such a power may be validly exercised by the trustee with the consent of the settlor or of a protector. If such consent is withheld, the trustee may not be able to terminate the trust without incurring personal liability for the invalid exercise of a power.

More generally, an early termination of the trust may raise some doubts as to its compatibility with the spirit of the sanctions against Russia. The result of such an early termination would be to free resources and make them available to Russian national and resident beneficiaries when they could have been safely administered under the control of a trustee based in the EU, who could have frozen them in the event that such persons were directly targeted by new sanctions.

Such an option, even though it may be feasible, should be considered with utmost care.

An alternative along similar lines would be for the settlor to revoke the trust if such power was retained under the terms of the trust. To the extent that this is a more likely occurrence in relation to private foundations than to trusts, it is discussed at paragraph (31) below.

The alternative option is for the EU trustee to retire and for a new trustee to be appointed in a jurisdiction that does not entertain a prohibition comparable to article 5m.

Many jurisdictions appear to be eligible to this effect, ranging from the United Kingdom and the United States to some international financial centres in Australasia (Hong Kong, Singapore, New Zealand), in the Middle East (the United Arab Emirates) and in the Caribbean.

As is discussed in general terms at section (D) above, the appointment of a new trustee is a complex process, which consists of at least three phases:

- The selection of a suitable new trustee.
- The agreement of the terms of an instrument of retirement and appointment of trustees and the related indemnity.
- The transfer of the trust fund from the retiring to the successor trustee.

The issues reviewed in Section (D) above will not be repeated here, but it is important to note that:

- The person empowered to appoint a successor trustee (which in many cases may be the very retiring trustee) has a fiduciary duty to select an officer that is suitable to the beneficiaries; the appointment of an unsuitable candidate may be challenged by the beneficiaries and may expose the retiring trustee to a personal liability for breach of trust (either for the appointment of an unsuitable successor or for any acts unduly facilitating such successor taking office).
- When a suitable successor trustee has been identified and is willing to take over the trust, an instrument of retirement, appointment and indemnity must be negotiated and concluded with a view to minimising the exposure of the retiring trustee to liabilities that may be incurred after the trust fund will have been handed over to the successor trustee; the new trustee may wish to review a

recent financial statement of the trust before accepting to take office; in some cases all this will make it unlikely for the procedure to be completed within the due date of 10 May 2022.

- Finally, after the terms of an instrument of retirement and appointment of trustees will have been agreed and a suitable indemnity will have been granted to the retiring trustee, various formalities will have to be complied with in order to transfer the trust fund to the successor trustee; some of the issues relating to various classes of assets have been discussed at paragraph (23) above.

The complexities surrounding the appointment of a successor trustee make it unlikely for existing trustees to extricate themselves of the relevant trusts within the due date of 10 May 2022.

A reasonable solution appears to be that an instrument of retirement and appointment of trustees should be signed before the due date of 10 May 2022 and possibly be subject to several conditions precedents, such as the review by the successor trustee of the latest accounts of the trust, the extension of an adequate indemnity to the retiring trustee, etc.

This process is likely to be easier if the retiring trustee can rely on an affiliated entity belonging to the same group of companies or having an established business relationship. Nonetheless, in this case care must be taken to the prohibition under article 5m to arrange for another person to act as trustee. In other words, the retiring trustee should retain no influence on the administration of the trust after the hand-over to the successor trustee.

A problem may arise if no successor trustee can be identified within the due date of 10 May 2022. A single trustee cannot cease to hold office until a successor trustee is identified and takes over the trusteeship. The existing trustee will therefore continue to be the sole trustee of the relevant trust or trusts and will have to continue to perform the fiduciary duties associated with the office.

In this case, it appears that the existing trustee will have to carefully document the steps taken to identify a suitable successor and the reasons why such actions did not lead to a transfer of trusteeship within the due date of 10 May 2022. A trustee acting in the exercise of a regulated profession may wish to inform its internal and external auditors (if any) of this situation and may consider informing its regulator.

This case is not contemplated under article 5m, but it may be an inconvenient situation for a professional trustee who, on the one hand, would be forced to carry on with the administration of the trust and to be accountable to the beneficiaries for it, and on the other hand, would risk being in breach of the sanctions against Russia despite its attempts to terminate the trusteeship within the due date.

The case described in this paragraph appears to extend to a situation where the settlor is a Russian national holding neither a passport nor a permanent or temporary

residence permit in an EU Member State, regardless of the situation of the beneficiaries.

If the settlor is dead and some of the beneficiaries hold the nationality or are permanently or temporarily resident in an EU Member State, the trust may be maintained and the issues discussed under paragraph (29) above may apply.

If the settlor is alive, even though the settlor may have not retained any powers or beneficial interests in relation to the trust, it appears that any EU national or resident trustee should cease to hold office by 10 May 2022 under article 5m, subject, of course, to all the issues reviewed in this paper.

Private foundations where the founder and some beneficiaries are Russian nationals who do not hold a passport or a permanent or temporary residence permit in an EU Member State.

31. Similar to the case of a trust reviewed in the preceding paragraph, a private foundation where the founder is a Russian national holding neither a passport nor a permanent or temporary residence permit in an EU Member State is caught by the prohibition under article 5m.

The two options available to the EU national or resident directors of such private foundations are:

- to terminate the foundation and distribute its assets to the beneficiaries; or
- to transfer the foundation to another jurisdiction.

Before setting out some of the issues that relate to these two options, it may be useful to note that unilaterally retiring as directors of the foundation and terminating all the other administration and management services would usually not be the solution.

An exception may be that of an EU national or resident acting as an independent director of a private foundation, who can probably retire with no further consequences.

However, if the foundation is administered by a trust and corporate service provider offering a number of services, such as 'a registered office, business or administrative address as well as management services', as is expressly mentioned under article 5m (1), all such services should be terminated by the due date of 10 May 2022. To the extent that the service agreement allows the provider to unilaterally terminate the services subject to a certain notice period, this option may be pursued but it is unlikely that the notice period will have come to an end by 10 May 2022. Substantial compliance with the prohibition under article 5m can be obtained if a termination notice is issued within the due date of 10 May 2022.

As a result of the termination of all administration and management services, the private foundation will no longer have a registered office and directors. At the same time, it will

be impossible for the founder and the beneficiaries to restore the registered office in the relevant EU Member State. In the absence of a board of directors in place, it may be very difficult to transfer the registered office of the foundation to another jurisdiction outside the EU and as a result, the foundation may be placed into judiciary liquidation. The retiring directors and more generally the service provider may be held liable by the beneficiaries for any damages following this unorderedly procedure.

For this reason, it appears to be desirable for the concerned trust and service providers to terminate their services in an orderly manner either by terminating the foundation or by facilitating its transfer to another jurisdiction outside of the EU.

In any event, an EU trust and corporate service provider must reach out to the founder and the beneficiaries of a private foundation with a 'Russian connection' as defined in Section (B) of this paper pointing out the different solutions available to comply with the new provisions. This contact should be properly documented, as it may be relevant for the purposes of the personal liability of the service provider if no solution could be achieved by the due date of 10 May 2022.

The termination of a private foundation may be operated by its board of directors if it has the power to distribute all its assets to the beneficiaries. A formal procedure of voluntary liquidation of the foundation and its cancellation from the commercial register of its jurisdiction of incorporation will have to follow. These transactions will be unlikely to be completed within the due date of 10 May 2022, but substantial compliance may be achieved if the relevant resolutions have been taken before such date.

The compatibility of this course of action with the spirit of the sanctions against Russia raises some doubts as in the case of trusts. Reference is made to this effect to the discussion at paragraphs (24) and (29) above.

One of the reasons why some people opt to use foundations over trusts is that private foundation law often allows founders to retain more extensive powers than provided to the settlors of trusts. For example, the founder of an Austrian or a Liechtenstein foundation may validly retain the power to revoke the foundation.

If the founder has retained a power of revocation in relation to a private foundation with a 'Russian connection' as defined in Section (B), the power may be exercised within the due date of 10 May 2022 and the foundation may be terminated accordingly. Some formalities may be required with a view to transferring the foundation assets back to the founder and in some cases they may not be perfected within the due date of 10 May 2022, but substantial compliance with article 5m may be achieved if an instrument of revocation is executed by the founder with effective date before 10 May 2022.

There may be reasons for the founder to be reluctant to revoke the foundation and as a result, the only feasible option may be to transfer the registered office of the foundation to another jurisdiction outside of the EU.

A number of jurisdictions that do not entertain the same Russian sanctions as the Regulation may be selected to transfer the registered office of the foundation. They include the United States (more specifically the states of New Hampshire and Wyoming), the United Arab Emirates (Abu Dhabi and Dubai), Mauritius, Panama and some international financial centres in the Caribbean.

A private foundation can generally transfer its registered office from a jurisdiction to another provided that certain formalities are respected. This procedure may extend beyond the due date of 10 May 2022, but substantial compliance may be achieved if at least the relevant resolutions are adopted by the board of directors of the foundation prior to 10 May 2022.

An alternative procedure, which in some cases may be swifter, could be to terminate the foundation by transferring its assets to a newly established trust in a jurisdiction where it can be lawfully accepted such as those mentioned in paragraph (30) above.

Companies held on a trust with a non-EU trustee and a Russian settlor and Russian beneficiaries (whether or not holding a passport and/or a permanent or temporary residence permit in an EU Member State or in another jurisdiction outside of the EU).

32. The prohibition under the Regulation does not extend to commercial companies.

The provision of services such as a registered office, business or administrative address as well as management services to a commercial company where the shareholders are Russian nationals and residents is not prohibited under article 5m.

Accordingly, the same services can be provided to a company held on trust where the trustee is not resident in the EU and the settlor and the beneficiaries are Russian nationals and residents (whether or not they also hold a passport or a permanent or temporary residence permit in an EU Member State).

If an EU trust and corporate service provider offers its services to both a trust with a 'Russian connection' as defined in Section (B) and to its underlying company, the services relating to the trust must be terminated within the due date of 10 May 2022 (subject to the issues referred to in this paper) but the corporate services to the underlying company can continue to be provided with no restrictions.

(F) STEP contacts and disclaimer

33. It is hoped that this Position Paper provides some useful guidance in relation to the most likely issues that arise for members as a consequence of *Regulation 2022/576*.

For any queries, comments, clarifications, corrections or to notify the position taken by the competent authorities of any EU Member State please contact: policy@step.org.

34. This guidance is intended to be informative and not an exhaustive statement of the law. While reasonable endeavours are taken to ensure that information is accurate and up-to-date as at the date of publication it does not represent legal advice. STEP and its contributing authors do not accept liability or responsibility for any loss or damage occasioned to any person acting or refraining from acting on any information contained therein.

Schedule

Council Regulation (EU) 2022/576 of 8 April 2022 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine

Article 5m

1. It shall be prohibited to register, provide a registered office, business or administrative address as well as management services to, a trust or any similar legal arrangement having as a trustor or a beneficiary:
 - (a) Russian nationals or natural persons residing in Russia;
 - (b) Legal persons, entities or bodies established in Russia;
 - (c) Legal persons, entities or bodies whose proprietary rights are directly or indirectly owned for more than 50 per cent by a natural or legal person, entity or body referred to in points (a) or (b);
 - (d) Legal persons, entities or bodies controlled by a natural or legal person, entity or body referred to in points (a), (b) or (c);
 - (e) A natural or legal person, entity or body acting on behalf or at the direction of a natural or legal person, entity or body referred to in points (a), (b), (c) or (d).
2. It shall be prohibited as of 10 May 2022 to act as, or arrange for another person to act as, a trustee, nominee shareholder, director, secretary or a similar position, for a trust or similar legal arrangement as referred to in paragraph one.
3. Paragraphs one and two shall not apply to the operations that are strictly necessary for the termination by 10 May 2022 of contracts, which are not compliant with this article concluded before 9 April 2022, or ancillary contracts necessary for the execution of such contracts.
4. Paragraphs one and two shall not apply when the trustor or beneficiary is a national of a Member State or a natural person having a temporary or permanent residence permit in a Member State.
5. By way of derogation from paragraphs one and two, the competent authorities may authorise the services referred to therein, under such conditions, as they deem appropriate, after having determined that this is necessary for:

- (a) 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
- (b) Civil society activities that directly promote democracy, human rights or the rule of law in Russia.