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Thévenoz, Luc

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The Restriction on Trust Services: A New Sanction in Need of Improvement

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Luc Thévenoz*

The sanctions against Russia are unprecedented in their scope and impact. They are also rife with innovation. The ban on trust services for Russian individuals and companies is one such innovation for which the EU takes credit. While it appears to target private trusts for wealthy Russian individuals, it affects many other trusts that have other commercial or financial purposes and should not be in scope. This chapter compares the specific restrictions adopted by the EU Council and the UK government. The UK sanction on trust services, which was adopted nine months after the EU, addresses several problems that are not satisfactorily resolved by EU Regulation 833/2014. Contrary to expectations, the problems identified in this chapter affect not only Russian settlers, beneficiaries, and trustees, but also all European financial institutions that service trust assets. An excessive restriction on trust services creates a competitive hurdle for the European banking and financial industry. The policy for restricting trust services should be more thoroughly clarified and its material scope narrowed in line with this policy.

Keywords: sanctions; trust; trust services; banks; financial institutions.

Freezing assets is an integral part of most sanction programs. So is restricting access to the sanctioning State's financial markets or services. The sanction regime developed by the European Union in response to the second war waged by Russia against Ukraine since February 2022 has brought many interesting innovations to the field.¹ For the

* Professor at the University of Geneva and director of its Centre for Banking and Financial Law

¹ When Russia first occupied part of the Ukrainian territory in 2014, the EU adopted two regulations. The first, Council Regulation (EU) No 269/2014 of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty, and independence of Ukraine [2014] OJ L78/6 (**EU Regulation 269/2014**) orders the freezing the assets of designated persons whose list is periodically supplemented. The second, Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine [2014] OJ L229/1 (**EU Regulation 833/2014**), sets out extensive commercial and financial sanctions. Since Russia launched its "special military operation" in Ukraine, the EU Council has been iteratively amending both regulations.

first time to the author's knowledge,² it includes an explicit prohibition to provide trust services to persons connected with Russia. This restriction was introduced as part of the "Fifth Package" on 8 April 2022.³ Some of the questions and issues it raises have been addressed by official guidance published as "Frequently Asked Questions" on the website of the EU Commission.⁴ Considering that this guidance section on trust services was last updated on 8 July 2022, it would seem that the restriction on trust services has not raised significant problems. As discussed in this chapter, however, many questions remain unaddressed or unsolved.

Norway,⁵ a member of the Economic European Area, and Switzerland⁶ have promptly followed suit and essentially replicated the EU sanction.

On 29 June 2022, the government of the United Kingdom announced it was "acting alongside international allies to introduce new measures that will prevent Russia from accessing UK trusts services."⁷ would impose a similar restriction. The measure was long in the making and was finally adopted on 14 December 2022.⁸ While the EU restriction is very broad and undifferentiated in its scope, the UK restriction is finely tuned to the complexity of its object.

Except for the United States,⁹ it does not seem that other jurisdictions — including traditional common law jurisdictions such as Australia, Canada, and New Zealand

² Who would be glad to be challenged on that account and will welcome any information on prior occurrences of some form of trust-specific sanction.

³ Art 5m has been added to the EU Regulation 833/2014 by Council Regulation (EU) 2022/576 of 8 April 2022. The consolidated text of the EU is available at <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0833-20230624>>. All URLs referred to in this chapter have been accessed or verified on 9 August 2023.

⁴ These Frequently Asked Questions (**EU FAQs**) are accessible at <https://finance.ec.europa.eu/eu-and-world/sanctions-restrictive-measures/sanctions-adopted-following-russias-military-aggression-against-ukraine/frequently-asked-questions-sanctions-against-russia_en>.

⁵ Forskrift om restriktive tiltak vedrørende handlinger som undergraver eller truer Ukrainas territoriale integritet, suverenitet, uavhengighet og stabilitet, s 8p <[https://lovdata.no/forskrift/2014-08-15-1076/\\$8p](https://lovdata.no/forskrift/2014-08-15-1076/$8p)>.

⁶ Ordonnance instituant des mesures en lien avec la situation en Ukraine du 4 mars 2023 (RS 946.231.176.72), art 28d <www.fedlex.admin.ch/eli/cc/2022/151/fr#art_28_d> (**Swiss Regulation**).

⁷ Foreign, Commonwealth & Development Office, 'UK sanctions Russia's second richest man' (Press release, 29 June 2022) <<https://www.gov.uk/government/news/uk-sanctions-russias-second-richest-man>>.

⁸ The Russia (Sanctions) (EU Exit) (Amendment) (No. 17) Regulations 2022, introducing inter alia Reg 18C (Trust Services) and Reg 60ZZB (exceptions relating to trust services) into The Russia (Sanctions) (EU Exit) Regulations 2019. For the consolidated version of UK sanctions against Russia, see <www.legislation.gov.uk/uksi/2019/855/contents>. The provisions in this instrument are referred to as **UK Regulation** or **UK Reg**. For a broader presentation, see Sonya Branch, 'Evolution of the UK financial sanctions framework following the UK's withdrawal from the EU', in this book.

⁹ On 8 May 2022, the Office of Foreign Assets Control prohibited "the supply... of... trust and corporate formation services... to any person located in the Russian Federation" as of 7 June 2022. See OFAC's Determination Pursuant to Section 1(a)(ii) of Executive Order 14071: Prohibitions Related to

— have specifically restricted trust services as part of their sanction program against Russia.

Whether the prohibition on trust services is an effective financial sanction is a matter of debate. Extensive empirical data would be needed. This chapter will not conclude this issue. Rather, it will reflect on the optimal design of the measure through a comparative analysis of the EU and the UK regimes. So far, there has been virtually no relevant literature beyond official guidance, client newsletters, and various notes published by the Society of Trust Practitioners (STEP),¹⁰ the worldwide professional organisation of trustees and other trust service providers.

[BOX]

What are trusts?

In its simplest form, a trust is created when a settlor transfers some property to a trustee for the benefit of one or more beneficiaries. The trustee acquires legal title to the property which it is obliged to hold, administer, and ultimately dispose of in accordance with the terms set out by the settlor. The trustee is bound by strict duties to act in the exclusive interest of the beneficiaries (often called fiduciary duties). In English law and legal systems derived from it, the position of beneficiaries is protected by rules and remedies developed by courts of equity over centuries. Beneficiaries have personal rights against the trustee in case of a breach of the trustee's duties (breach of trust). They also have proprietary rights over the trust property, which they can trace and follow when it has been transferred to third parties in breach of trust. Trusts also exist in many legal systems that do not derive from English law, where the rights and remedies available to beneficiaries are not defined by reference to equity in the English legal meaning of the word.

A broad, functional definition of trusts can be found in the Hague Convention on the Law Applicable to Trusts and Their Recognition.¹¹

Certain Accounting, Trust and Corporate Formation, and Management Consulting Services dated 8 May 2022. This restriction is clarified by FAQs 1034 and 1063 published at <<https://ofac.treasury.gov/faqs>>. See also the STEP USA Note published by the US chapter of the Society of Trusts and Estate Practitioners, last revised on 11 July 2022, STEP, 'The prohibition of accounting, trust and corporate formation, and management consulting services from the United States or by a US Person, wherever located, to persons located in the Russian Federation' (11 July 2022) <www.step.org/system/files/media/files/2022-07/step-note-on-sanctions-11.07.22.pdf>.

¹⁰ EU Sanctions against trusts with a 'Russian connection' (**STEP EU Note**) last updated on 3 May 2022; STEP Guidance Note: The Trust Services Prohibition in the UK Russia Sanctions Regime (**STEP UK Note**) last updated on 14 April 2023; STEP Note on Sanction (US) published 11 July 2022 (**STEP US Note**). These notes and other material are available at <www.step.org/knowledge-hub/russia-ukraine-conflict>.

¹¹ Art 2 of the Hague Convention on the Law Applicable to Trusts and Their Recognition of 1 July 1985 (adopted 1 July 1985, entered into force 1 January 1992) reads: "For the purposes of this Convention, the term "trust" refers to the legal relationships created—*inter vivos* or on death—by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose. A trust has the following characteristics: (a) the assets constitute

This chapter discusses so-called express trusts, ie trusts created voluntarily by a settlor, as opposed to constructive trusts and other trusts created by the operation of law. As discussed below, trusts (often called private trusts) may be used by wealthy persons to structure all or part of their assets for governance, estate planning, or tax purposes. Trusts are also used for many other purposes, such as pension schemes, investment funds, secured transactions, etc.

In most jurisdictions, professional trustees are subject to regulation and supervision, including for anti-money laundering purposes.

1. Asset freezes, the mother of all financial sanctions

The freezing of “funds and other economic resources”¹² is a powerful measure, whether it reaches the assets of a State or those of designated individuals or entities that are closely associated with it. Typically, freezing provisions are drafted in a way that not only includes assets owned by designated persons but also assets that they indirectly hold or control.

Article 2 (1) of EU Regulation 269/2014 applies to assets “belonging to, owned, held or controlled by any [designated] natural or legal persons, entities or bodies, or natural or legal persons, entities or bodies associated with them.” Article 2 (2) prohibits that assets be “made available, directly or indirectly, to or for the benefit of” such persons.

Each jurisdiction has its specific wording for asset freezes.¹³ It is reasonable to assume that they all take a broad view of how assets can be held for, controlled by, or made available, directly or indirectly, to a designated person. For example, UK Regulation 11 (6) states that “owned, held or controlled” by a person includes assets “in which the person has a legal or equitable interest, whether or not the interest is held jointly with another person and whether or not another person has an interest in the assets”. The reference to an equitable interest clarifies that an asset subject to a trust of which a designated person is a beneficiary is subject to the freeze. It could also be argued that if the designated person is the trustee of a discretionary trust or has certain powers in

a separate fund and are not a part of the trustee's own estate; (b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee; (c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.”

¹² Referred to as “assets” for convenience purposes.

¹³ See European Council, *Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU common foreign and security policy* (5664/18, last updated 4 May 2018), stating standard wordings for legal instruments at 25 ff.

the trust, he or she exercises a degree of control over the assets so that they are subject to the freezing provision.¹⁴

The EU Commission has not provided guidance on the application of asset-freezing provisions to assets held on trust.¹⁵ EU Regulation 269/2014 was adopted in March 2014 and the wording of the asset freezing provisions in Article 2 has not changed since 12 May 2014.¹⁶ While the “owned, held or controlled” language should be broad enough to include trust assets.

However, the nature and intensity of the required link between the assets and a designated person is a complex issue that concerns both trustees and the banks with which the assets are deposited. In July 2002, the EU Court of Justice received a request for a preliminary ruling from an Italian administrative court.¹⁷ The request is about a trust created in 2007 over the shares of a holding company that controls four companies engaged in commercial activities. The settlor of the trust was initially one of the beneficiaries, together with his sister and nephew. Sister and nephew were removed from the list of beneficiaries in December 2017. The settlor himself was removed on 7 February 2022, just two weeks before 28 February 2022, when the settlor was placed on the EU's list of designated persons, with the result that his assets were frozen.

The Court is asked to interpret Article 2(1) of EU Regulation 269/2014. Is the connection between the settlor and the trust such that the trust assets must be deemed to be “owned, held or controlled” by the settlor? Should the trustee be considered “associated with” the settlor? Who should be regarded as controlling the assets? These are questions of first impression for the Court whose decision will be closely watched.

2. Why prohibit trust services?

However, the efficacy of asset freezes does not require a specification prohibition to provide trust services in respect of frozen assets. Frozen is frozen, whether in the

¹⁴ Many private trusts created for wealth structuring and estate planning purposes are discretionary. In discretionary trusts, beneficiaries do not have fixed entitlements to certain assets or income distribution. The trust instrument typically identifies beneficiaries (by name or by class) and confers a very broad discretion on the trustee to decide when and to whom distributions will be made. In discretionary trusts, it is very common that the trust instrument confers certain powers of decision, veto, or supervision on a protector. Protectors and other holders of powers over trust assets often play a significant, sometimes decisive role in the governance of the trust. See Emily Campbell, Robert Ham, Jonathan Hilliard & Michael Tennet, “Protectors” in David Hayton (ed), *The International Trust* (Jordans 2011) 195–212; Henry Brandts-Giesen & Jeremy, ‘Third-party power holders under trusts—types, duties, powers, and use cases’ (2023) 29 *Trusts & Trustees* 274.

¹⁵ See notably EU FAQ ‘Asset Freeze and Prohibition to Make Funds Available and Economic Resources Available’ (updated 24 July 2023) <https://finance.ec.europa.eu/system/files/2023-07/fags-sanctions-russia-assets-freezes_en.pdf>.

¹⁶ As amended by Council Regulation (EU) No 476/2014 of 12 May 2014.

¹⁷ Case C-483/23 *T Trust* (26 July 2023) request for a preliminary ruling.

hands of a designated person or in those of a trustee acting for that person's benefit. The prohibition on trust services impacts a much wider group of Russian persons and businesses than freezing the assets of designated persons.¹⁸ What is the policy behind this novel measure?

2.1. European Union

Though the EU is undoubtedly the creator of the trust service restriction, explanations of why it was introduced are scarce. Article 5m of Regulation 833/2014 was adopted on 8 April 2022. The only formal explanation we find is one sentence in point 6 of the preamble to the Council Decision (CFSP) 2022/578 of the same date:¹⁹ “It is also appropriate to introduce a prohibition on being a beneficiary, acting as trustee or in similar capacities for Russian persons and entities, as well as a prohibition on providing certain services to trusts.”²⁰ In the context, the measure supplements an array of financial restrictions directed at all (natural and legal) Russian persons, such as prohibiting banks from accepting deposits over EUR 100'000, or forbidding access to securities denominated in Euro or another official currency of a member state.²¹

A more revealing explanation appeared in a factsheet, “EU sanctions against Russia following the invasion of Ukraine”,²² speaking of prohibiting “advice to wealthy Russians regarding financial planning and trusts and banning their big deposits in EU banks.” The measure thus targets “wealthy Russians”, an ill-defined group within the Russian population.

The effects of these restrictions are quite different, however. Russian persons are not allowed to create or top up a bank deposit beyond EUR 100'000, but they can maintain and use the deposits they already have. They may not purchase new securities denominated in euros, but they are not forced to sell or forfeit the ones they already own. The restriction on trust services works differently: it requires trust service providers to very promptly stop providing their services but leaves the trusts in limbo. In its guidance the Commission goes so far as stating that “the prohibition requires [the] dissolution [of trusts], the resurfacing of all assets as well as the restitution of

¹⁸ See section 3 below on the personal scope of the restriction.

¹⁹ As explained by René Smits ‘The Development of European Sanctions’ in this book, sanctions are part of the security policy as well as of single market policy. Every measure is thus adopted by way of two legal acts, one of the EU Council acting by unanimous decision (CFSP) and another by majority (single market).

²⁰ This cursory statement does not seem to meet the requirements set out in Council of the European Union, *Sanctions guidelines–update* (5664/18, 4 May 2018) 5: “The objective of each measure should be clearly stated and consistent with the Union's overall strategy in the area concerned. Both the overall strategy and the specific objective should be recalled in the introductory paragraphs of the Council legal instrument through which the measure is imposed.”

²¹ EU Regulation 833/2014, arts 5b and 5f, both part of the First Package of 28 February 2023.

²² As updated in June 2023. That mention disappeared from subsequent versions, see <<https://www.consilium.europa.eu/media/69022/eu-sanctions-against-russia-over-ukraine-factsheet.pdf>> accessed 26 January 2024..

assets to the trustor or distribution to beneficiaries (subject to a derogation ...)”.²³ That statement is jumping the gun. A trust may be maintained if its connections to Russian persons are severed or if a new trustee is appointed in a jurisdiction that has not adopted a similar prohibition. All solutions however are fraught with difficulties, as we shall see in section 6.

2.2. United Kingdom

The British government adopted its own trust services prohibition on 14 December 2022.²⁴ A narrow policy consideration is given in the impact assessment of the same date referring to the prevention of avoidance or evasion of UK sanctions using trust services.²⁵ That risk was named in a July 2022 Red Alert published by enforcement agencies, suggesting that UK-based trust service providers offered their services to enable avoidance of sanctions before or shortly after the designation of persons for asset freezing purposes.²⁶

The rationale is only partly convincing. Unless designated persons are concerned,^{27 28} the UK restriction only applies prospectively, that is to trust services that were not provided before 16 December 2022.²⁹ For example, a trust created in April 2022 with a UK trustee appointed before in March or April 2022 may continue to operate; distributions may be made to beneficiaries under the terms of the trust instrument, including to persons connected with Russia (as long they are not designated persons); new beneficiaries may even be added if so provided in the trust instrument (except again for designated persons).

²³ Directorate-General for Financial Stability, Financial Services and Capital Markets Union, ‘Trust services: FAQs on sanctions against Russia and Belarus, with focus on the following provision: Article 5m of Council Regulation (EU) No 833/2014’ (*European Commission*, 8 July 2022) <https://finance.ec.europa.eu/publications/trust-services_en> para 2 (EU FAQ ‘Trust services’).

²⁴ See n 8 above.

²⁵ Commonwealth & Development Office, ‘The Russia (Sanctions) (EU Exit) (Amendment) (No.17) Regulations 2022’ (Impact assessment No FCDO2210, 14 December 2022) <https://www.legislation.gov.uk/ukia/2022/97/pdfs/ukia_20220097_en.pdf>.

²⁶ National Crime Agency and others, ‘Financial Sanctions Evasion Typologies: Russian Elites and Enablers’ (0697-NECC, July 2022) <<https://www.nationalcrimeagency.gov.uk/who-we-are/publications/605-necc-financial-sanctions-evasion-russian-elites-and-enablers/file>>.

²⁷ UK Reg 18C (1) states that a person must not provide trust services to or for the benefit of a designated person. However, the termination of such a trust and the distribution of its assets is likely to violate the freezing of the assets of that designated person. UK Reg 60ZZB (1)(b) therefore allows the continuation of trust services for the purposes of complying with the provisions on asset freeze.

²⁸ UK Reg 18C (1)(1) was originally designed to apply to its separate list of designated persons. On 21 March 2023, the OFSI announced that the 1730 persons that were then designated under Reg 11 (asset freeze) were also designated under Reg 18C (trust services), see Office of Financial Sanctions Implementation, ‘Trust Services Sanctions update’ (*gov.uk*, 21 March 2023) <<https://ofsi.blog.gov.uk/2023/03/21/trust-services-sanctions-update/>>.

²⁹ UK Reg 18C (2) reads: “A person (‘P’) must not provide trust services to or for the benefit of a person connected with Russia (‘C’) unless pursuant to an ongoing arrangement pursuant to which P provided those trust services to or for the benefit of C immediately before 16th December 2022.”

In short, except where there is an asset freeze the EU purports to, but does not really, require trustees to immediately terminate existing trusts for Russian persons while the UK regime prohibits the provision of new trust services to persons connected with Russia, but does not interfere trust services provided before the restriction was adopted.

3. Personal scope and the Russia-connection test

Who are the providers and the beneficiaries of the restricted trust services?

As far as providers are concerned, the EU and UK are aligned. Both regulations apply to services provided by anyone on or from their territory,³⁰ or by their nationals acting outside the territory.³¹

The EU and UK follow different approaches as to beneficiaries of the service and their connection with Russia.

The EU restriction applies whenever a “trustor”³² or a beneficiary of a trust is a Russian national or a natural person residing in Russia. Where legal persons are concerned, it applies to persons “established” in Russia, or whose proprietary rights are directly or indirectly owned or controlled by such persons.³³ For natural persons, the Russian nationality or residence test would significantly overreach and apply to many persons whose connection with Russia is less relevant than their connection with the EU. Thus a beneficiary (or a trustor) who has the citizenship of, or a permanent or temporary residence permit in, the EU, the European Economic Area, or Switzerland does not trigger the prohibition.³⁴

UK Reg 18C has a narrower focus on beneficiaries but a wider definition of the same. It applies whenever a designated person³⁵ or a “person connected with Russia” is a beneficiary of a trust, or is referred to as a potential beneficiary in a document from

³⁰ The UK's sanction regime is also given effect in the Overseas Territories (such as the British Virgin Islands) and the Crown Dependencies (such as Jersey and Guernsey).

³¹ EU Regulation 833/2014, art 13; UK Reg 3. By contrast, Swiss sanctions (see n 6 above) only apply on the Swiss territory and do not extend to Swiss nationals acting abroad.

³² The French *fiduciant* and German *Treugeber* words for “trustor” refer to fiduciary arrangements that are not trusts in the traditional, Anglo-American sense, but fall within the broader category of “similar legal arrangement” discussed in section 4.2 below. In that respect the restriction applies to trust and other fiduciary services, see Laila Arstall, ‘Managing sanctions risk in the fiduciary industry—a view from Guernsey’ (2023) 29 *Trusts & Trustees* 101.

³³ The test comprises five different limbs and is found in EU Regulation 833/2014, art 5m (1).

³⁴ *Ibid* art 5m (4).

³⁵ As noted above, no trust services may be provided for the benefit of a designated person, while services provided to a person connected with Russia before 16 December 2022 may be maintained, UK Reg 18C (1) and (2).

the settlor (eg letter of wishes³⁶) or, “having regard to all the circumstances, [that person] might reasonably be expected to obtain, or to be able to obtain, a significant financial benefit from the trust”.³⁷ Settlers are not relevant to the application of UK Reg 18C unless they also qualify as beneficiaries as defined. For individuals, the “connected with Russia” test is based on ordinary residence or location³⁸, not on nationality.³⁹

It is worth noting that, true to the legal analysis that a settlor is merely the creator of a trust, but as such has no rights against the trustee or over the assets of the trust, the person of the settlor is irrelevant to the application of the UK regime, unless of course if she qualifies as a beneficiary as defined above. In other words, the UK regime does not look at the origin of the trust assets. Conversely, the person of the trustor⁴⁰ is relevant to the application of the EU restriction. One reason is that the latter applies to contractual fiduciary relationships where the principal and the beneficiary of the two-party contract are the same. Another reason might be that the EU provision is concerned about persons who are not beneficiaries but might be able to exercise some degree of control over the trust. If this was the policy, then the restriction should also take into consideration protectors and holders of powers over trust assets,⁴¹ which it does not.

In both regimes, the prohibition applies if at least one beneficiary (or trustor in the case of the EU) has a relevant connection with Russia. As the prohibition restricts the provision of specific services but is not an asset freeze in disguise, it ceases to apply when, if at all possible, that person ceases to be a beneficiary or severs its connection with Russia.

4. Material scope: trusts

4.1. Trust is a much broader category than so-called private trusts

While the EU and UK regimes differ to some degree regarding their personal scope of application, their respective material scopes contrast sharply. As discussed above the EU targeted the measure at “wealthy Russians” who might use trusts as a way of protecting their assets. The EU failed to take into consideration that a trust is a legal

³⁶ A letter (or memorandum) of wishes is a non-binding declaration by the settlor of a discretionary trust (see n 41 below) to guide the trustee in the exercise of their discretion. See Nigel Sanders & Charlotte Yates, ‘Letters of wishes and their ongoing importance in a trustee’s decision-making’ (2022) 28 *Trusts & Trustees* 386.

³⁷ UK Reg 18C (5).

³⁸ For the interpretation of ordinary residence and location, see STEP UK Note (n 10) 14–17.

³⁹ UK Reg 19A (2).

⁴⁰ See n 32 above.

⁴¹ See n 14 above.

institution used in a vastly larger number of arrangements and transactions than the so-called private trusts created by and for wealthy individuals for estate planning purposes (and potentially for tax or sanction evasion). Many pension schemes and investment funds are legally structured as trusts. The issuance of a great number of government and corporate bonds involves a debenture trustee.⁴² The depository infrastructure of the securities market, ie the intermediated holding of securities, relies in several jurisdictions on trusts.⁴³ Such is the case for digital assets as well.⁴⁴ Trusts are also a common ingredient in secured transactions and asset securitisation.

Article 5m of EU Regulation 833/2014 applies to trusts generally and extends to “any similar legal arrangement” (more on that in section 4.2 below). That includes all forms of trusts for beneficiaries; it also applies to trusts for charitable or other purposes if the settlor is a Russian person. It is reasonable to think that all express trusts⁴⁵ fall within the material scope of the EU prohibition. The words “similar legal arrangements” capture other legal relationships that are similar to trusts. They refer to institutions such as civil law *fiducie* and *Treuhand* where a person legally owns some property that it is obliged to manage for the benefit of and ultimately transfer to, either the other contracting party or a third party. That potentially includes all contractual forms of collective investment schemes (such as *fonds communs de placement*).

When adopting the measure, the EU Commission intended to prohibit Russian individuals from accessing trust services within the EU. It failed to appreciate the number of other arrangements and transactions that qualify as trusts. One might have expected amendments exempting categories of trusts that are clearly not within the intended purpose of the restriction. This has not been the case so far. Investment funds have been addressed in the Commission's guidance. Retail funds, the so-called Undertaking for Collective Investment in Transferable Securities (UCITS) "should normally not be deemed to be covered by the term 'trust or similar legal arrangements' since UCITS is a regulated financial product." The Commission's position on alternative investment funds (AIF) is very dubitative. While alternative investment fund managers are subject to regulation and supervision under the Alternative Investment Funds Managers Directive (AIFMD)⁴⁶, there are no harmonised rules at the EU level governing the operation of the funds themselves. The FAQ points to the lack

⁴² A striking example is the USD 3 billion bond issued by Ukraine in 2017, whose repayment is strenuously litigated in English courts by the debenture trustee acting for the benefit of Russia as the sole bondholder, see *The Law Debenture Trust Corporation plc v Ukraine* [2023] UKSC 11.

⁴³ Philipp Paech, ‘Market needs a paradigm—breaking up the thinking on EU securities law’, in Pierre-Henry Conac, Ulrich Segna and Luc Thévenoz (eds) *Intermediated Securities: The Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge University Press 2013) 31 ff.

⁴⁴ *Ruscoe v Cryptopia Ltd (in liq)* [2020] NZHC 728; [UK] Law Commission, *Digital assets: final report* (Law Com 412, 2023) 7.25 ff.

⁴⁵ That is "trusts created voluntarily" within the meaning of Art 3 of the Hague Convention (n 11), as opposed to trusts arising by the operation of law or by a decision of a court.

⁴⁶ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers [2011] OJ L174/1 (as amended).

of supervision and transparency of many such funds but does not provide any guidance on how the trust services restriction applies.”⁴⁷

On one significant aspect of its material scope, Art 5 of EU Regulation 833/2014 was supplemented with power for national competent authorities (NCAs), under such conditions as they deem appropriate, to authorise "the operation of trusts whose purpose is the administration of occupational pension schemes, insurance policies or employee share scheme, charities, amateur sports clubs, and funds for minors or vulnerable adults".⁴⁸ Unregulated investment funds, debenture trusts, and trusts used for secured or other commercial transactions do not enjoy the possibility of such special licenses.

The UK government was more careful in designing its own restrictions. Regulation 60ZBB (2) and (3) exempts numerous categories of trusts – including charitable trusts, pension schemes, authorised investment funds, secured transactions, etc. – if, but only if, the trust services “are not provided primarily to, or for the benefit of, a designated person or a person connected with Russia.” This long list of exemptions reflects the fact that trusts are put to many more uses in England and other common law jurisdictions than is familiar to civil law jurisdictions which, after Brexit, account for 25 of the 27 EU member states. Nonetheless, trusts are used for commercial or financial purposes in many international markets in which EU firms are competing. For them, an over-extensive prohibition on trust services may turn out to be a significant competitive hurdle. Even if this does not necessarily play out in the context of the sanctions against Russia, the risk that the EU might adopt similar overreaching restrictions in other sanction programs might hurt EU businesses significantly.

4.2. The uncertain notion of “similar legal arrangements”

The EU restriction applies to "any similar legal arrangement", and the UK sanction to "similar arrangement".⁴⁹ This assimilation probably traces its roots to anti-money laundering regulation. The Recommendations of the Financial Action Task Force⁵⁰ distinguish between legal persons (including foundations, limited partnerships, and

⁴⁷ EU FAQ ‘Trust services’ (n 24) [7]: “The generic term ‘AIF structures’ may, in principle, be deemed to fall within the notion of ‘trusts or similar legal arrangements. That is particularly relevant for situations where AIFs are constituted in accordance with trust law or contract law, for non-EU AIFs, AIFs with no legal personality, self-managed AIFs and certain offshore AIF structures of third countries which may happen to be largely unsupervised and non-transparent or non-reporting vehicles with opaque nature/function of the management mandate, assets and their location and/or beneficial owners. In this context, it is particularly relevant to refer to Article 12 of Council Regulation (EU) 833/2014, which seeks to prohibit activities the object or effect of which is to circumvent the prohibitions set out in that Regulation.”

⁴⁸ Art 5m (6)(c), introduced on 3 June 2022.

⁴⁹ Cf EU Regulation 833/2014, art 5m; UK Reg 18C (5)(A).

⁵⁰ Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (November 2023) 129 <<https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Fatf-recommendations.html>>.

Anstalten) and legal arrangements⁵¹. Customer due diligence obligations of financial intermediaries⁵² and transparency requirements⁵³ are essentially identical but take account of relevant legal differences. Yet, for the FATF Recommendations, legal persons such as foundations or *Anstalten* are legal persons, not legal arrangements similar to trusts.

Contrary to the FATF Recommendations, the EU Anti-Money Laundering Directive (AMLD)⁵⁴ does not draw a clear line between legal persons and legal arrangements similar to a trust, which are treated as a general category of its own.⁵⁵ It is incumbent on each Member State to identify the relevant arrangements in their implementing legislation, to notify them to the Commission,⁵⁶ and to subject them to all obligations under AMLD. A 2020 report of the Commission provides a survey of the legal arrangements identified by member states,⁵⁷ and correctly notes that having legal personality, foundations "cannot fall under the category of similar legal arrangements to trusts."⁵⁸

The question then arises as to which other arrangements are subject to the EU prohibition on trust services. Are foundations and other legal entities in scope? Guidance from the Commission is contradictory in its reasoning, if ultimately conclusive in its result. Addressing first the general notion of similar legal arrangements, the FAQ evokes the "establishment of a fiduciary bond between parties

⁵¹ Legal arrangements are defined as "express trusts and other similar legal arrangements. Examples of other similar arrangements (for AML/CFT purposes) may include but are not limited to *fiducie*, certain types of *Treuhand*, *fideicomiso*, and *Waqf* ... Similarity is assessed having regard to Article 2 of the Hague Convention on the law applicable to trusts and their recognition based on whether legal arrangements have a similar structure or perform a similar function to an express trust." See Financial Action Task Force (n 51) 129.

⁵² Ibid 14-15, especially FATF Recommendation 10; see also ibid 33, comp. Section 5 of Interpretative Note to Recommendation 10.

⁵³ Ibid 22, especially FATF Recommendations 24 and 25.

⁵⁴ Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC [2015] OJ L145/73 (as amended).

⁵⁵ Legal persons, trusts, and similar arrangements are mentioned throughout the AMLD in a very unsystematic manner, cf art 2(3)(b)(v) ("trusts, companies, foundations, or similar structures", art 3(6)(c) ("legal entities such as foundations, and legal arrangements similar to trusts"), and art 13(1)(b) ("legal persons, trusts, companies, foundations, and similar legal arrangements").

⁵⁶ List of trusts and similar legal arrangements governed under the law of the Member States as notified to the Commission, last published in [2020] OJ C434/27.

⁵⁷ European Commission, *Report of 16 September 2020 assessing whether Member States have duly identified and made subject to the obligations of Directive (EU) 2015/849 all trusts and similar legal arrangements governed under their laws* (COM(2020) 560 final, 16 September 2020) <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0560>>.

⁵⁸ Ibid ch III.2.f. The report also notes that one notification of foundations with legal personality was made by a Member State, which has since been withdrawn.

and a separation or disconnection of legal and beneficial ownership of assets” and refers to the AMLD and the 2020 Report.⁵⁹ This would point to foundations being treated as legal entities, not as trusts. However, barely two weeks later, an addition to the FAQ, referring to the AMLD, formally states that foundations are in scope.⁶⁰

It may be interesting to note that Switzerland’s restriction on trust services, which applies to “other similar legal institutions”,⁶¹ raised the same issue but resulted in a different guidance. Foundations are in scope, except if their registered office is in Switzerland or an EEA member state if they pursue a public utility purpose and are subject to governmental supervision.⁶²

The same question can also be raised for “similar arrangement” to UK Regulation 18C (3) applies. Reg 18C (7) specifies that “trustee”, in relation to an arrangement similar to a trust, means a person who holds an equivalent or similar position to a trustee of a trust. No official guidance can be found. The note published by STEPS accepts in two short sentences that a foundation is a similar arrangement, before inconclusively discussing at some length whether nominee shareholders are.⁶³

Scope issues necessarily arise with the implementation of any financial or trade restriction. Sanctions and anti-money laundering have different purposes, and it is perfectly acceptable that definitions or scopes may differ. However, financial institutions must rely on their customer due diligence to identify which of their clients, beneficial owners, and legal entities or arrangements, are subject to sanctions. Customer due diligence, the information collected, and the way it is collected, are deeply influenced by 30 years of increasingly specific and detailed AML regulation. Where the scope of a specific sanction relies on different categories than the ones underlying customer due diligence, it is incumbent on the drafters of the regulation to make that clear. Exemptions should be part of the sanction regulation itself, or granted by way of general licenses. Informal guidance does not provide a sufficient degree of certainty.

⁵⁹ EU FAQ ‘Trust services’ (n 24) [1].

⁶⁰ Ibid [8]: “Foundations are regarded as the civil law equivalent to a common law trust, as they may be used for similar purposes. This equivalence is reflected in Directive (EU) 2015/849 which imposes on foundations the same beneficial ownership requirements as on trusts and similar legal arrangements. Accordingly, persons holding equivalent positions in foundations as settlors and beneficiaries should be construed as being subject to the same restrictions under Article 5m.”

⁶¹ Swiss Regulation (n 6), art 28d.

⁶² Guidance issued by the Swiss State Secretariat for Economic Affairs (SECO), last updated 12 December 2023

https://www.seco.admin.ch/dam/seco/fr/dokumente/Aussenwirtschaft/Wirtschaftsbeziehungen/Exportkontrollen/Sanktionen/Verordnungen/Russland,%20Ukraine/auslegungshilfe_fuer_sanktionsmassnahmen.pdf.download.pdf/Aide%20%C3%A0%20l%E2%80%99interpr%C3%A9tation%20des%20sanctions.pdf accessed 26 January 2024.

⁶³ STEP UK Note (n 10) 4 and 9. Nominee shareholders are included in EU Regulation 833/2014, art 5m (2).

4.3. Trust services are the object of the restriction

The prohibition does not apply to trusts as such but to the provision of trust services. The EU and UK regulations are essentially identical in this regard and prohibit the following services:⁶⁴

- creating a trust⁶⁵
- providing a registered office, or a business, correspondence, or administrative address, for a trust
- managing or operating a trust
- acting as trustee
- arranging for another person to act as trustee.

That list is inspired by the definition of trust and company service providers in the anti-money laundering regulation.⁶⁶ This evidences the close connections between the implementation—if not the purposes—of financial sanctions and the prevention of money laundering and finance terrorism. The main difference between the EU and the UK list is the express assimilation of nominee shareholder, director, secretary, or similar position to the function of a trustee in the EU regulation, a question left to the construction of a "similar arrangement" in the UK regulation.

5. Implementation and transitional provisions

All things considered, the main policy difference between the EU and the UK regimes in respect of trusts is the application of the former, but not the latter, to trust services provided at the time the restriction was adopted. Setting aside the presence of designated persons,⁶⁷ the EU regulation requires the termination of existing trust services provided to Russian persons while the UK regulation prohibits the provision of new services.

The termination of ongoing services needs transitional provisions. Originally, the EU regulation required all trust services to be terminated on 10 May 2022, one month and one day after the effective date of the restriction. But prohibiting trust services is not identical to terminating the trust itself—even though this seems to have been the

⁶⁴ Cf EU Regulation 833/2014, art 5m (1) & (2); UK Reg 18C (7).

⁶⁵ EU Regulation 833/2014, art 5m (a) oddly refers to the registration of a trust, wrongly focusing on registration (registration of beneficial owners is now required by anti-money laundering regulation) as the key element of its creation.

⁶⁶ See notably AMLD, art 3 (7), and the definition of trust and service company providers in FATF Recommendations (n 50) at 124.

⁶⁷ Trusts over assets frozen because they are owned or controlled by a designated person are discussed at the end of this section.

purpose of the Commission⁶⁸— and no provision of EU regulation 833/2014 mandates, or specifically authorizes, the termination of the trusts serviced by an EU person: EU trustees are legally required to stop their services, not to terminate the trusts.

Trusts are governed by their own law.⁶⁹ Their duration is determined by that law, by the provisions of the trust instrument, and by the duties of the trustees, including the duty to act impartially between beneficiaries and to act in their best interest. In most cases the prohibition for the trustee to continue its service does not make the immediate distribution of all assets to existing beneficiaries in their best interest, nor in the best interest of yet unborn beneficiaries. EU trustees have thus three main possibilities to comply with the restriction without acting in breach of their duties under the trust instrument and the applicable trust law. First, beneficiaries with a connection to Russia could sever that connection by changing their residence or citizenship. Second, those beneficiaries could relinquish or be removed from their position as beneficiaries. Third, a new trustee might be appointed who is not subject to the same prohibition, and the assets transferred to the new trustee.

If at all possible, the first scenario may require more time than is available under transitional provisions.

The second scenario is only available if the Russian beneficiaries freely and permanently relinquish their interest under the trust, or if the trustee, the protector, or someone else, has the power under the trust instrument or the applicable law to remove those beneficiaries and exercise that power without breaching its duties and thus incurring a strict liability to the excluded beneficiaries.

The third scenario, ie the change of trustee, creates fewer risks concerning beneficiaries but requires a time-consuming and often long process, including:

- the search for and selection of a new reliable trustee in a jurisdiction that has not adopted and is unlikely to adopt a restriction on trust services;
- the exercise by the relevant person of the power to appoint a new trustee (if no such power is granted by the trust instruments, it is part of the inherent jurisdiction of the court, but this non-contentious proceeding will take time);
- the transfer of all trust assets to the new trustee;
- the execution by the new trustee of an instrument relieving the resigning trustee from the liabilities incurred as trustee.

In virtually all cases, going through this process takes many months. A one-month transitional period was too short. It was extended to 10 July 2022 (3 months after the restriction was adopted) and the possibility for the national competent authority to authorise the completion by 5 September 2022 of operations strictly necessary for the termination of the relationship. The NCA may also authorize the continuation of trust

⁶⁸ See section 2.1 above.

⁶⁹ The determination of the governing law is addressed by arts 6 to 10 of the Hague Convention (n 11). Most trust instruments contain a choice of law clause.

services indefinitely “provided that the service providers do not accept from, or make available to, the [Russian beneficiaries] any funds or economic resources, directly or indirectly, or otherwise provide such persons with any benefit from assets placed in a trust.”⁷⁰

Trusts with frozen assets for designated persons are a very different situation. The freeze requires that the integrity of the assets and their legal status be strictly maintained and completely removed from the disposition or benefit of the designated person. Assets may not be distributed to non-designated beneficiaries. Designated persons may not be cut off from the trust, because it would in effect free the assets from the freeze. The transfer of trusteeship outside of sanctioning States would have the same effect. As a result, a trust over frozen assets should in most cases be maintained, but any distribution and other benefits must be suspended as long as the assets are frozen. The UK and EU regimes both recognise that fact, the UK by granting a general exemption “for the purposes of complying with the prohibitions and obligations in Chapter 1 of Part 3 (asset freeze etc.)”,⁷¹ and the EU by allowing NCAs to authorise the continuance of trust services as described in the previous paragraph.⁷² Certain situations may nonetheless allow the winding down of a trust while upholding the freeze of its assets.⁷³

6. Conclusion

The EU’s restriction on trust services is part of a wider array of sanctions severely limiting the access of Russian persons and Russian companies to the EU market for financial and certain professional services. While those measures have less drastic effects than an asset freeze, their personal scope of application is vastly larger.

It is not unlikely that the restriction on trust services will be used again in future (or existing) sanction programs. For this reason, the design of the restriction matters because the mere possibility of imposing this particular restriction in other international situations might have significant adverse effects on EU financial institutions.

The restriction was conceived as a measure targeting individuals rich and sophisticated enough to structure and protect their wealth using trusts. It seeks to prohibit or terminate any trust services provided by EU professionals. Trust and company service providers are affected, but so are all financial institutions providing banking or financial services to them. Trustees and bankers alike run the risk of criminal prosecution if they run afoul of the restriction.

⁷⁰ EU Regulation 833/2014, art 5m (5)(b).

⁷¹ UK Reg 60ZZB (1)(b).

⁷² See n 70 above.

⁷³ On 21 March 2023, the OFSI issued General Licence INT/2023/2589788 “to permit the wind down of Trust Services provided to Designated Persons otherwise prohibited by Regulation 18C of the Russia Regulations.”, see Office of Financial Sanctions Implementation, *General Licence - INT/2023/2589788*

As it now stands the EU restriction on trust services is too extensive: it applies to numerous categories of trusts such as investment funds, pension schemes, bond issuances, or secured transactions, which are very different from the private trusts that the EU seeks to disrupt. It took the UK government nine more months to design its own trust services prohibition, allowing it to carefully carve out the multiple situations that do not fall within the original, intended scope of the measure.

Admittedly, trusts are much more common in the commercial and financial practices of England and other common law jurisdictions than in continental Europe. However legal structures and arrangements first used in the Anglo-American legal practice have a profound and enduring influence on international and sometimes domestic transactions within or outside of the European Union.

The risk that future EU sanction programs might include an overly broad restriction of trust services might well deter parties to a commercial transaction from using the services of banks and other financial institutions potentially subject to similar future restrictions. The scope of Art 5m of EU Regulation 833/2014 as it now stands is undoubtedly overreaching. Exemptions should not rely on official guidance or special licenses which must be obtained in each case from national competent authorities. When they are predictably necessary, exemptions need to be stated clearly in a form that is binding for market participants and enforcement agencies alike.

One should hope that the EU – and other governments that have followed suit, such as Switzerland – will carefully reconsider the drafting of their own restriction on trust services before that measure is implemented in another sanction program.