



# COMMITTEE REPORT: INTERNATIONAL PRACTICE

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## Family Offices in **Russia**

The preservation of inherited wealth and education of successors have become very important

**T**hese days, there's substantial awareness of and interest in family office services all over the world. The family office wealth management industry is growing faster than ever before. But in Russia, the family office as a set of services rendered to wealthy people has appeared comparably recently. This phenomenon can be easily comprehended by anyone who's familiar with Russian history: For a long time, the country subsisted in the form of the Union of Soviet Socialist Republics (USSR), where capitalistic values were denied and there was no place for private businesses.

Starting from the early 1990s when the USSR ceased to exist, the first Russians who could publicly declare their wealth began to appear. Given a very unstable and not fully fledged legal framework and the overall situation in the country, such individuals didn't look to find ways to manage their assets properly, as they were mostly busy with generating their wealth. Moreover, most of the new Russian millionaires were young and could tackle their problems without the need for permanent support.

By the end of the 1990s, the legal framework had become fairly stable and predictable, while Russian laws had become much more sophisticated. Russian high-net-worth (HNW) individuals made their big money legitimate by investing in various businesses, which required new efforts to maintain, multiply and transfer the capital to their heirs. Furthermore, wealthy individuals were dealing with many issues unrelated to their businesses, such as vacation planning, education,

traveling, visas and citizenship. It became clear that there were opportunities for various institutions to assist HNW individuals and wealthy families with most of the tasks associated with managing their wealth and lifestyles and to help them define and achieve their personal and financial goals.

Now, the average age of HNW Russians has reached 50 and above, and the focus of their objectives is changing accordingly. They're aiming not only to preserve or spend their money, but also to ensure that the family's wealth is well-managed to achieve necessary compliance with local and international legal and tax requirements: safely transfer the wealth to their children from generation to generation; and involve other members of the family in their businesses. Thus, the preservation of inherited wealth and education of the successors have become very important in Russia.

### Current State of Family Offices

In Russia, family office services still aren't used in all applicable situations, and there's no clear understanding of what a traditional family office is and how it works. There's no universal model in Russia, not because of the peculiarities of the Russian market, but because most wealthy Russians aren't ready to accept this new type of service in its traditional form and format. In general, the development of sufficient local services addressed specifically to private clients in Russia is still in progress. Family office services are part and parcel of such local services and open new horizons and opportunities.

In most cases, when the patriarch and his family realize that they need and are ready to use a full range of traditional family office services, they'll first seek such services abroad. This approach isn't a perfect one because it's only suitable for those with considerable wealth, who have assets located mainly internationally, and families who already spend most of their time abroad. On the



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other hand, the market for family office services and an adequate range of professionals available in Russia are only now emerging, and it's difficult to find or to offer locally the range of services, opportunities and quality provided by foreign experts. In addition, Russians are obsessed with maintaining confidentiality, and therefore, they may seek assistance abroad regardless of the price and availability of such services in Russia.

Family offices services as a separate business usually aren't advertised in the Russian mass media. The need for local family office services in one or another form may arise when the capital of an individual and his family exceeds the equivalent of \$15 million. The scope of the services provided by Russian family offices or their equivalents are usually not as wide as they are globally. As a rule, they're confined to the legal and tax aspects of asset management, local real estate management and concierge services.

### Regulation and Types of Offices

Currently, there are no specific Russian rules or regulations with respect to family office services. Moreover, information on particularities of the family office services can be obtained only from very limited and fragmentary public sources and from the practices of consulting firms and banks that deal with private clients. We'll therefore describe the current situation, available options and corporate forms used for the provision of such services to the extent known to us.

In Russia, the ways and corporate forms in which a family office can be established and operate depend on the type and location of the assets being managed, as well as the nature and number of users of such services.

The family office in Russia as a separate unit providing such services is established as a limited liability company, a branch of a foreign company or a department of a financial institution, including banks, typically with foreign shareholders.

In addition, the family office often takes the form of a virtual or isolated group of professionals (lawyers, accountants and financial managers) employed by the patriarch's firm but exclusively dealing with family

matters. Such an in-house group can seek advice from outside professionals, including tax and legal consulting firms, which may offer some family office services as well within the existing services offered to private clients. Big Russian banks render private banking and family office services to their clients.

**Family office as part of a business group company.** Structuring services in this way is a standard solution for

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wealthy individuals who have a big business locally and are able to use its resources. At best, it can be formed as a separate department within an existing company of the business group. Another frequent practice is to vest certain employees with additional responsibilities, sometimes without extra remuneration.

Wealthy individuals usually engage different types of specialists in the operation of such departments. For instance, these can be accountants, legal and tax advisors, security service managers or investment experts. A private assistant and a team of secretaries render concierge services.

Having a family office as part of an existing corporate unit has its obvious pros and cons. One of the main advantages is its cost, as it doesn't involve a lot of additional expenditures for a HNW individual and his family. Therefore, employment costs won't be as considerable as they would be with a single professional family office. For many Russians (even HNW individuals), cost still remains the principal criterion. Other important factors can be the minimum time spent on dealing with an



in-house family office, because it's always at the disposal of the patriarch with a dependable staff.

The main disadvantage of having the family office as part of a business structure in Russia is the same as everywhere else—there's a high risk of failure to ensure confidentiality of information disclosed to the in-house staff. The risk of disclosure is higher if several individuals own the business.

Moreover, in-house specialists usually don't have particular experience and expertise in family office services and private wealth management. There's also a problem of motivation of staff, and conflicts of interest can arise.

### **Family office services rendered by consulting**

In Russia, wealthy families tend to wish to exercise overall control over the experts advising them, which maximizes their privacy.

**firms.** In Russia, this type of family office can be compared to (but isn't the same as) the multi-family office (MFO) concept found in international practice. Some consulting companies render family office services to multiple families. They provide wealth management programs that are a combination of financial and investment advice, accounting and legal services, as well as tax and estate planning. The management services offered may vary depending on the profile and resources of such firms.

Russian consulting firms (and private bank departments) usually provide high quality services under terms of strict confidentiality. Additional obvious benefits arising from providing family office services in this form are a high level of professional expertise, easy access to international experience and practice and independence. Such important aspects as succession planning are also taken into account by consulting firms.

Nevertheless, Russian consulting companies don't usually focus on family office services. They render such services to clients in addition to legal and tax services, with only occasional support.

**Family office as a separate legal entity.** The fullest range of asset management and family support services of the best possible quality can only be provided by a single-family office (SFO).

In Russia, the most common services provided by an SFO are legal and tax support, wealth management, administrative and concierge assistance, as well as training of the younger generation. Usually a Russian SFO (as in international practice) is comprised of administrative, legal, accounting, investment and other professionals involved in providing SFO services exclusively for the benefit of any particular single family. One of the primary advantages of an SFO is the focus on the needs of one family and its representation. Having one consolidated group of professionals means that a family member need only interact with one central source and not a number of different service providers.

Even though most of the services that may be provided by an SFO aren't licensed, some types of services, such as securities management and brokerage, are subject to licensing.

It should also be noted that when one of the activities of the family office is managing the wealthy individual's foreign assets on his instruction, certain tax risks (described in detail below) arise when such assets are effectively managed from the Russian Federation.

The obvious advantage of an SFO is the fullest control and privacy. In Russia, wealthy families tend to wish to exercise overall control over the experts advising them, which maximizes their privacy.

The main obstacle to having an SFO is the high cost. Separate premises, technology, highly qualified personnel and access to the best services and investment vehicles are very costly. Therefore, if the scope of the services required is limited, it makes sense to use an MFO or any other options rather than to establish one's own SFO.

**Family office as part of private banking services.** Currently, there are a number of local banks and financial institutions in Russia that render special private banking services to large and prominent clients. Sometimes, you may find information on their websites saying that family offices services are provided. But in practice, it's primarily about lifestyle management services for very important clients (for example, assistance in finding high quality medical support or prestigious schools for children, arranging exclusive luxury journeys and acquisition of art objects). Such services are



indeed part of standard family office services, but not the most important ones.

Of course, private banks in Russia also provide wealth management services. These services usually relate to the clients' finances (such as asset management, investments, deposits and the like), but quite often, private banks try to sell different investment products that are of doubtful use to wealthy individuals or their families.

In addition, a bank saying that it offers wealth management services as part of a family office model is, in most cases, dependent on the choice of products and suppliers.

One of the main advantages of private banking services for the investor is that there's no need to obtain a separate licence regarding the services rendered.

The other benefits of purchasing family office-type services from a private bank or financial institution are a high level of confidentiality and the ability to have a wide range of services in one package.

### Ideal Set-Up for Wealthy Russians

Family offices are often global in their geographical presence and investments. A perfect set-up for a family office is the availability of separate SFOs in several target countries being independent from each other and dealing only with the issues arising in each particular jurisdiction. The special nature of the Russian market requires a Russian team to tackle problems arising in Russia and to manage assets in Russia.

If there are global or multinational tasks, it's vital to allocate them among different family offices in the jurisdictions in question. Moreover, there are considerable risks related to the management from Russia of foreign assets held by Russian HNW individuals because in such a scenario, Russia may be considered as the effective place of management of the assets, which leads to tax risks. In practice, if there's no way of establishing a foreign family office for such activity, we recommend engaging an independent foreign advisor or professional manager.

As mentioned above, most of the activities likely to be undertaken by a family office aren't subject to licensing requirements in Russia. However, if an HNW individual is in need of services in Russia that are subject to licensing (such as professional activity on a stock exchange or the purchase and sale of securities), external contractors

holding the necessary licenses may execute such operations, or the family office itself should obtain the license.

### A Promising Framework

Wealth is always accompanied with a lot of responsibilities, such as the obligation to manage complicated local and international assets, invest wisely and protect the family. Russian private wealth still is one of the fastest growing in the world. While the first generation of Russian businessmen is in place, the next generation requires professional attention and care. So, the need for professional family office services is apparent.

Nevertheless, we can't say that a family office is a standard set of services provided by numerous professionals in Russia and available widely. The principal source of such services offered in Russia is still foreign or international providers or at least their practice and experience. But, a growing need for domestic experts (first and foremost, with regards to local assets and affairs) will rapidly build up the market of family office services in Russia. The options, legal and tax opportunities described above constitute a very promising framework for such business activities. 