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The original Icelandic text, as published in the Law Gazette (Stjórnartíðindi), is the authoritative text. Should there be discrepancy between this translation and the authoritative text, the latter prevails.

Bill of Legislation

on the treatment of króna-denominated assets subject to special restrictions

(Submitted to the 145th Legislative Session of Parliament 2015–2016.)

CHAPTER I General provisions

Article 1

Objectives

The objective of this Act is to promote the liberalisation of capital controls and create a foundation for unrestricted cross-border trade with Icelandic krónur, in the interest of economic stability and the public good. To this end, provisions are stipulated for the treatment of specified króna-denominated assets, referred to as *offshore króna assets*. These will continue to be subject to special restrictions intended to reduce the risk attached to achieving the objective described in the first sentence.

Article 2

Definitions

For the purposes of this Act, the following terms shall have the following meanings:

1. *Offshore króna assets*:

- a. Deposits denominated in Icelandic krónur and held by the following parties with deposit money banks in Iceland, irrespective of whether they are the actual property of the party in question or whether that party holds them in custody for another:
 1. Foreign legal entities that have an operating licence or that carry out legally defined activities in the financial markets, their branches, and subsidiaries owned by them.
 2. Other foreign institutional investors that invest in financial instruments, including parties that engage in securitisation or other financing activities.
- b. Funds held in a custodial deposit account in the name of the payer, in an escrow account with a deposit money bank in the name of the owner or his representative, or in the form of specified assets of a creditor in the custody of the payer, provided that they have been paid for the benefit of a non-resident entity that has or has had a claim against a legal entity that has undergone winding-up proceedings or insolvency proceedings or has undergone restructuring via composition agreement.
- c. Icelandic Treasury bonds and bills issued in Icelandic krónur or bearing a State guarantee, and owned or held in custody by a party falling under Item (a).
- d. Unit share certificates owned or held in custody by a party falling under Item (a) and issued in Icelandic krónur, in mutual, investment, and institutional investment funds that invest, directly or indirectly, in financial instruments issued by the Icelandic Treasury or bearing a State guarantee.
- e. Shares, bonds, and any type of debt instrument issued in Icelandic krónur by resident entities that underwent restructuring on the basis of a composition agreement according to the Act on Bankruptcy, Etc., after 28 November 2008, and owned by non-resident legal entities as a result of conversion of claims in which they invested after 28 November 2008. The same applies to reinvestment of the proceeds from such assets that have been sold, either partially or in full.
- f. Shares, bonds, and any type of debt instrument issued in Icelandic krónur by resident entities, if the investment took place after 28 November 2008 and payment was remitted, directly or indirectly, by withdrawal from an account in Icelandic krónur with a foreign financial institution.

- g. Unit share certificates owned or held in custody by a party falling under Item (a) and issued in Icelandic krónur, in mutual, investment, and institutional investment funds that, among other things, invest, directly or indirectly, in financial instruments issued in Icelandic krónur by entities other than the Icelandic Treasury or those enjoying a State guarantee; deposits, cash, and derivatives.
- h. Sales proceeds or other payments due to assets according to Items (c)-(g) that accrue during the period from the entry into force of this Act until 1 September 2016.
- 2. *Non-resident legal entity*: A legal entity not considered a resident according to Item 2 of the definition contained in Article 1 of the Foreign Exchange Act.
- 3. *Central Bank of Iceland foreign currency auction*: An auction held by the Central Bank of Iceland, in which the Bank offers to purchase Icelandic krónur in exchange for euros.
- 4. *Deposit money banks*: Commercial banks, savings banks, and deposit divisions of co-operative societies.
- 5. *Resident*: A resident entity according to the definition in Article 1 of the Foreign Exchange Act.
- 6. *Central Bank of Iceland certificates of deposit*: Debt instruments issued by the Central Bank of Iceland to deposit money banks that hold offshore króna assets in accounts subject to special restrictions, or to their owners according to Item 1(a).
- 7. *Electronically registered securities*: Securities that are registered electronically according to the Act on Electronic Registration of Title to Securities.
- 8. *Account subject to special restrictions*: An account denominated in Icelandic krónur, in the name of the owner or custodian of offshore króna assets according to Items 1(a) and 1(b), and held with a deposit money bank in Iceland, which shall be identified with ledger code 21 in Icelandic Banks' Data Centre hf. systems and is subject to special restrictions according to this Act.
- 9. *Administrative account*: An account owned by the Central Bank of Iceland wherein financial instruments are registered in the names of custodians.
- 10. *Reference exchange rate*: An exchange rate of the Icelandic króna versus the euro, set at 220 krónur per euro.
- 11. *Customer*: An entity that authorises a custodian to act on its behalf and to be registered for financial instruments or funds.
- 12. *Custodian*: A financial institution authorised to hold financial instruments owned by its customers.
- 13. *Custodial account*: An account with electronically registered securities held by a custodian.

Article 3 *Exemptions*

The following offshore króna assets are exempted from the provisions of this Act:

- 1. Those owned by governments, central banks, and international institutions of which Iceland is a member.
- 2. Those deriving from payments of premiums according to contractual agreements in domestic currency concerning supplemental insurance for the acquisition of personal pension savings and concerning investment plan insurance, single-premium life insurance, and regular savings on the basis of the exemptions of foreign insurance companies and foreign pension custodians from the restriction set forth in Article 13(b), Paragraph 3 of the Foreign Exchange Act.
- 3. Those held by foreign electronic money institutions and utilised in accordance with these institutions' exemptions from the restrictions set forth in Article 13(b), Paragraphs 1 and 2 and Article 13(c), Paragraph 3 of the Foreign Exchange Act, for the purpose of engaging in payment intermediation in Iceland.
- 4. Those deriving from investments undertaken after 28 November 2008 using new inflows of foreign currency in the sense of Article 13(m), Paragraph 2 of the Foreign Exchange Act, but not including direct or indirect investments in derivatives contracts and claims against entities that are in winding-up or insolvency proceedings or have concluded winding-up or insolvency proceedings via a composition agreement that entails the distribution of assets to creditors.
- 5. Those deriving from participation in Central Bank of Iceland auctions during the period from 28 June 2011 through 10 February 2015.
- 6. Those deriving from the satisfaction, by parties falling under Article 2 of the Act on a Stability Tax at the time that Act entered into force, of claims according to a composition agreement.
- 7. Those offshore króna assets according to Article 2, Item 1(e) that derive from non-residents' claims against residents on the basis of a composition agreement pursuant to the Act on Bankruptcy, Etc., if

the Central Bank of Iceland has granted an exemption from the restrictions set forth in the Foreign Exchange Act, for distributions of foreign currency.

8. Those offshore króna assets that are the basis for foreign exchange transactions with the Central bank of Iceland at the reference exchange rate according to Article 9, Paragraph 2.
9. Those offshore króna assets that are the basis for foreign exchange transactions in the Central Bank of Iceland foreign currency auction held in 2016, at the auction exchange rate, for an amount equal to the market value of the offshore króna assets, so that settlement of the transaction takes place with delivery by the owner of the offshore króna assets of an amount equal to the market value of the offshore króna assets less the product of the market value of the offshore króna assets and a percentage of the Central Bank of Iceland's official central exchange rate of the Icelandic króna against the euro on 20 May 2016 and the auction exchange rate.

CHAPTER II

Segregation and transfer of and restrictions on disposal of offshore króna assets

Article 4

Segregation and transfer of and restrictions on disposal of deposits

Deposit money banks and foreign securities depositaries operating in Iceland are obliged to transfer offshore króna assets according to Article 2, Items 1(a) and 1(b) held in their custody to accounts subject to special restrictions, no later than 1 September 2016. The transferred amount shall be the amount in the deposit account concerned or the amount of the specified holding. The total amount according to the second sentence shall not be less than it was on the date this Act entered into force, after adjusting for returns and for conventional and appropriate administrative costs in instances involving such costs.

Notwithstanding the first sentence of Paragraph 1, foreign securities depositories that operate in Iceland and hold in custody offshore króna assets according to Paragraph 1 in deposit accounts with the Central Bank of Iceland can apply to have them transferred to accounts with the Central Bank of Iceland that are subject to the same restrictions as the accounts subject to special restrictions. Applications according to the first sentence shall be received no later than 1 August 2016.

Withdrawals from accounts subject to special restrictions are authorised only in this instances provided for in Chapter IV.

Article 5

Transfer of custody and restrictions on disposal of electronically registered securities

Financial institutions that hold in custody offshore króna assets according to Article 2, Items 1(c)-1(g) that are electronically registered according to the Act on Electronic Registration of Title to Securities on the date this Act enters into force shall transfer custody of those assets to an administrative account with the Central Bank of Iceland, in the name of the relevant custodian, no later than 1 September 2016.

Upon the transfer according to Paragraph 1, the Central Bank of Iceland shall take over the rights and responsibilities of the financial institution in the sense of the Act on Electronic Registration of Title to Securities. The administrative account shall be established with the Central Bank in the name of the custodian of the offshore króna assets concerned prior to the date of transfer. It is permissible to transfer offshore króna assets according to Paragraph 1 between custodians' administrative accounts with the Central Bank of Iceland, provided that such transfer does not involve a change in registration of title at the securities depository.

Settlement and redemption of offshore króna assets according to Paragraph 1 shall take place in Icelandic krónur, which shall be deposited to accounts subject to special restrictions. If a foreign securities depository has submitted an application according to Article 4, Paragraph 2, payment upon settlement and redemption of offshore króna assets shall be remitted to an account subject to the same restrictions as the accounts subject to special restrictions with the Central Bank of Iceland.

Offshore króna assets according to Paragraph 1 that are held in custody in a customer's nominee account with a custodian shall be transferred to an administrative account of the custodian concerned with the Central Bank of Iceland, in accordance with Paragraph 1. The term *nominee account* refers to a nominee account in the sense of the Act on Securities Transactions.

Upon transfer according to Paragraph 1, the securities depository shall, upon request by the Central Bank of Iceland, provide information on required encumbrances according to Paragraph 3 by assigning the electronic issue of the offshore króna assets a provisional international ISIN identity code for securities. The assignment shall take place as soon as possible after the Central Bank's request has been received by the securities depository, and no later than within three working days.

In case of settlement according to Paragraph 3, where payment takes place using Icelandic krónur not subject to the restrictions set forth in this Act, the securities depository shall lift the encumbrances according to Paragraph 5, upon receiving confirmation from the Central Bank of Iceland.

Article 6

Restriction on disposal of other offshore króna assets

Sales proceeds, instalments of principal, prepayments, final payments, interest, indexation of interest, dividends, and any other payments due to offshore króna assets according to Article 2, Items 1(d)-1(g) that are not electronically registered, cf. Article 5, shall be transferred to accounts subject to special restrictions within three working days of the date the funds deriving from such disposal in connection with offshore krónur were received or could have been received by the owner or the owner's agent.

The owner of offshore króna assets or the owner's agent shall guarantee the endorsement of the encumbrance concerning transfer to accounts subject to special restrictions in a satisfactory manner, as appropriate, so that the offshore króna assets according to this provision are identified as bearing such an encumbrance. In the event of a transfer of the offshore króna assets without the transfer of payments according to Paragraph 1 to accounts subject to special restrictions, the encumbrance according to the first sentence shall continue to apply to the transferee or the party receiving the asset in another manner, irrespective of whether or not that party is aware of the existence of the encumbrance. The owner of the offshore króna assets according to this provision shall notify the Central Bank of Iceland, within three months of the entry into force of this Act, of his or her offshore króna assets and shall specify how the conditions concerning the endorsement of the encumbrance on the offshore króna assets have been satisfied.

Deposit money banks shall notify the Central Bank of Iceland, on the date of payment, of all payments made to accounts subject to special restrictions according to Paragraph 1.

Article 7

Decision-making authority at the administrative level

The Central Bank of Iceland shall resolve disputes and in other respects has decision-making authority concerning the implementation of this Act. A decision made by Central Bank according to the first sentence is final at the administrative level. Appealing the matter to the courts does not postpone the legal effect of the decision.

CHAPTER III

Reserve requirements and prohibition on hypothecation of offshore króna assets

Article 8

Reserve requirements and prohibition on hypothecation

Offshore króna assets held in accounts subject to special reserve requirements are subject to reserve requirements according to this provision.

The reserve requirements shall be met by allocating an amount equal to the total balance of the deposit money bank's accounts subject to special restrictions for investment in Central Bank of Iceland certificates of deposit.

Deposit money banks shall fulfil the reserve requirements according to this provision within the same business day. The Central Bank is authorised to direct-debit the deposit money bank's current account on the following business day for the amount needed to satisfy the reserve requirements according to this provision.

The certificates of deposit shall be held in the deposit money bank's administrative account with the Central Bank.

It is prohibited to hypothecate offshore króna assets according to Article 2, Item 1 and Central Bank of Iceland certificates of deposit according to Article 10.

CHAPTER IV

Authorisation for withdrawal from accounts subject to special restrictions, foreign exchange transactions, and investments

Article 9

Temporary authorisation for withdrawal and foreign exchange transactions

Owners of offshore króna assets according to Article 2, Items 1(a)-1(d) are permitted to withdraw part or all of the funds from accounts subject to special restrictions in order to use the funds for foreign

exchange transactions with the Central Bank of Iceland at the reference exchange rate, until 1 November 2016.

Until 1 November 2016, owners of offshore króna assets according to Article 2, Items 1(e)-1(g) shall be authorised to engage in foreign exchange transactions with the Central Bank of Iceland at the reference exchange rate, for an amount equal to the market value of the offshore króna assets, so that settlement of the transaction will take place with the delivery, by the owner of the offshore króna assets, of an amount equal to the market value of the offshore króna assets less the product of the market value of the offshore króna assets and a percentage of the Central Bank of Iceland's official central exchange rate of the Icelandic króna against the euro on 20 May 2016 and the auction exchange rate.

The market value of the offshore króna assets in the sense of Paragraph 2 shall be determined as follows:

1. When securities are listed on a stock exchange, their market value shall be the market value on the date this Act enters into force.
2. The market value of offshore króna assets other than those according to Item 1 shall be based on a reasoned valuation by an impartial chartered accountant of the fair value or cost value of the asset at the time this Act enters into force, as defined according to the Annual Accounts Act, but never lower than the nominal value. A party wishing to enter into foreign exchange transactions according to the first sentence shall obtain a valuation at its own expense, and the chartered accountant must provide confirmation of impartiality. The Central Bank of Iceland is authorised to request further explanations or reject the results of the valuation if it is considered demonstrated that the valuation is not based on satisfactory premises.

If an owner of offshore króna assets exercises its authorisation according to Paragraph 2, the offshore króna assets underlying those transactions shall be exempt from the restrictions provided for in this Act, upon receipt of confirmation by the Central Bank of Iceland.

Article 10

Authorisation for investment in Central Bank of Iceland certificates of deposit

Owners of deposits held in accounts subject to special restrictions or in accounts subject to the same restrictions with the Central Bank of Iceland, cf. Article 5, Paragraph 2, are authorised to withdraw funds from the accounts for investment in Central Bank of Iceland certificates of deposit.

The certificates of deposit do not have a specified maturity date, they bear variable annual interest, and reimbursement of the principal is authorised only in accordance with the decision of the issuer. Interest is paid at the end of the interest period, once a year. Upon issuance, the certificates of deposit shall bear an annual interest rate of 0.5%, which shall be reviewed by the Central Bank of Iceland on the interest payment date.

The certificates of deposit shall be held in administrative accounts with the Central Bank of Iceland.

Sales proceeds, redemption value, and interest on Central Bank of Iceland certificates of deposit shall be transferred to accounts subject to special restrictions.

Article 11

General authorisation for transfers and withdrawals of interest and dividend payments

Transfers between accounts subject to special restrictions are permissible.

It is permissible to withdraw accrued interest, indexation on interest, and dividends, subject to prior confirmation by the Central Bank of Iceland.

Interest according to Paragraph 2 refers to interest on deposits held in accounts subject to special restrictions, bonds and bills according to Article 2, Items 1(c), 1(e), and 1(f), and Central Bank of Iceland certificates of deposit.

Dividends according to Paragraph 2 refer to dividend payments on profits from a company's regular operations, not on revenues deriving from the sale of assets in excess of sales gains or profits from debt write-offs, asset valuation increases, share capital reductions, or other comparable causes. Dividends shall be financed with cash from operations in available funds and not with asset sales, borrowings, share capital increases, or other comparable measures. If the measure underlying the payment of dividends differs substantially from general practice in such transactions and the main purpose appears to be the circumvention of restrictions provided for in this Act, the Central Bank may refuse confirmation.

Article 12

Authorisation for withdrawal by individuals

An individual who is the beneficial owner of offshore króna assets according to Article 2, Item 1(a) at the time this Act enters into force is authorised to withdraw funds from accounts subject to special restrictions upon obtaining prior confirmation by the Central Bank of Iceland. The term *beneficial owner* refers to an individual who is the owner of deposits denominated in Icelandic krónur and held by parties falling under Article 2, Item 1(a). The requirement for the authorisation provided for in the first sentence is that the deposit balance must have been continuously owned by the beneficial owner since 28 November 2008.

An individual who is the owner of offshore króna assets according to Article 2, Item 1(b) at the time this Act enters into force is authorised to withdraw funds from accounts subject to special restrictions upon obtaining prior confirmation by the Central Bank of Iceland.

Each individual's withdrawals according to Paragraphs 1 and 2 are subject to a combined maximum of 6,000,000 kr. per calendar year.

CHAPTER V

Securities administration fees

Article 13

Securities administration fees

The Central Bank of Iceland is authorised to charge fees for services relating to the custody of securities held in the Bank's administrative accounts, in accordance with a tariff set by the Bank. Fees according to the first sentence shall not exceed the actual cost incurred by the Central Bank in holding in custody and administering the securities, which entails the following expenses, among others:

- a. wages and operating expenses;
- b. expenses incurred by the Central Bank in connection with transactions with securities depositories.

CHAPTER VI

Central Bank supervision and sanctions

Article 14

Oversight and supervision

The Central Bank of Iceland shall supervise the implementation of this Act. It is required, subject to *per diem* fines as set forth in Article 17, to provide the Central Bank of Iceland with all information and documentation that it considers necessary for the purpose. In this context, it does not matter whether the information or documentation pertains to the party to whom the request is addressed or to other parties for which the party in question can provide information and which pertain to investigations and supervision by the Central Bank. Statutory provisions on confidentiality shall not limit the obligation to provide information and access to data.

In connection with its supervisory role according to this Act, the Central Bank may carry out on-site inspections or request information in this manner as often as it deems necessary. A decision to conduct an on-site inspection may be implemented via enforcement proceedings.

Article 15

Confidentiality

Those engaged in implementing this Act are bound by an obligation to observe confidentiality concerning the affairs of individual customers and other knowledge that they may acquire during their work and that should remain secret according to law or the nature of the matter in question, unless a judge rules that such information shall be disclosed in court or to the police, or the disclosure of information is required by law. The obligation to observe confidentiality shall remain in effect even in the event of termination of employment.

Article 16

Acquisition of information

In connection with investigations of specific cases, the Central Bank of Iceland is authorised to acquire information and documentation from other authorities, irrespective of their duty to observe confidentiality.

The Central Bank of Iceland is authorised to seek information from the Financial Supervisory Authority in connection with acquisition of data related to investigations of specific cases, insofar as the Financial Supervisory Authority's authorisations permit.

The Central Bank is authorised to engage in reciprocal exchange of information with public authorities abroad on matters covered by this Act, provided that the information is subject to a corresponding confidentiality requirement in the country concerned.

Article 17

Per diem fines

The Central Bank of Iceland may levy *per diem* fines on parties that fail to provide requested information and documentation, deliberately provide the Bank with incorrect information, or fail to comply with requests for rectification within a reasonable time limit. This provision applies equally to resident and non-resident legal entities and to resident and non-resident individuals. The same applies to parties that can provide information pertinent to investigations pursuant to the provisions of this Act. *Per diem* fines shall be paid until the party in question has complied with the Central Bank's request. *Per diem* fines are imposed from the deadline for submittal of the information until the day the request has been honoured. Fines may range from 50,000 kr. to 50,000,000 kr. per day. In determining the amount of *per diem* fines, consideration may be given to the nature of the negligence or violation and the financial strength of the party in question.

If proceedings are initiated to demand invalidation of a decision according to Paragraph 1 within 14 days of the date the party concerned was notified of it, and the party concerned requests expedited case handling, it is prohibited to collect *per diem* fines before a judgment has been rendered. Notwithstanding the initiation of proceedings to invalidate a decision according to Paragraph 1, *per diem* fines shall continue to accrue against the party concerned.

Uncollected *per diem* fines shall not be cancelled even though parties later accede to the demands of the Central Bank of Iceland unless the Central Bank so decides.

Decisions on *per diem* fines provided for in this Article are enforceable by execution.

Collected *per diem* fines, net of collection costs, shall accrue to the National Treasury.

Article 18

Central Bank of Iceland measures to combat illegal conduct

If the Central Bank of Iceland considers conduct to be in contravention of the provisions of this Act, the Bank may demand that the illegal conduct be discontinued immediately. The Central Bank of Iceland may also demand remedy or correction of measures considered to be in contravention of this Act. The Central Bank is authorised to impose *per diem* fines in accordance with Article 17 until its demands have been met. This provision applies equally to resident and non-resident legal entities and to resident and non-resident individuals.

Article 19

Administrative fines

The Central Bank of Iceland may impose administrative fines on all those who violate the provisions of Articles 4-6, Article 8, or Article 15 and, as applicable, any rules adopted on the basis of those provisions.

Fines imposed on individuals may range from 10,000 kr. to 65,000,000 kr. Fines imposed on legal entities may range from 100,000 kr. to 500,000,000 kr. Notwithstanding the provisions of the first and second sentences, fines due to violations of Articles 4-6 may range up to five times the amount of the transfer or withdrawal. In determining the fine, consideration shall be given, among other things, to the seriousness of the violation, its duration, the violator's willingness to cooperate, and whether the violation is a repeat offense. Decisions on fines are subject to enforcement measures. Fines net of collection costs shall accrue to the National Treasury. If administrative fines are not paid within one month of the date of the decision by the Central Bank of Iceland, penalty interest shall be paid on the amount of the fine. The decision and calculation of penalty interest shall be carried out in accordance with the Act on Interest and Price Indexation.

Administrative fines shall be imposed irrespective of whether the violation is committed through intent or gross negligence.

An attempt to commit a violation or complicity in a violation of this Act and rules adopted on the basis of it is subject to punishment as prescribed by the General Penal Code.

Article 20

Case conclusion by settlement

If a party has violated the provisions of this Act or rules adopted on the basis of it, the Central Bank of Iceland is authorised to conclude the matter by settlement, with the consent of the parties to the case. A settlement is binding upon the party to a case once it has been accepted and its substance confirmed by the party's signature.

Article 21

Right to remain silent

In a case against an individual which could be concluded with the imposition of administrative fines, the individual suspected on legitimate grounds of having violated the law shall have the right to refuse to answer questions or submit data or objects unless it is possible to exclude the possibility that it could be significant to a decision on the violation. The Central Bank of Iceland shall provide guidance to the suspect on this right.

Article 22

Deadline for imposition of administrative fines

The Central Bank of Iceland's authorisation to impose administrative fines in accordance with this Act expires when five years have passed since the conclusion of the conduct concerned.

The deadline according to Paragraph 1 shall be interrupted when the party is notified that his or her case is under investigation. The Central Bank of Iceland shall notify the party of an investigation of an alleged violation unless it is clear that the party has already become aware of it. The interruption of the deadline has legal effect vis-à-vis all parties that have participated in the violation.

Article 23

Authorisations in connection with case investigations

In connection with the investigation of cases, the Central Bank of Iceland is authorised to demand that individuals and legal entities submit all information and documentation that it considers necessary in connection with the implementation of this Act. In this context, it does not matter whether the information pertains to the party to whom the request is addressed or to other parties' transactions with him for which he can provide information and which pertain to investigations and supervision by the Central Bank. Statutory provisions on confidentiality shall not limit the obligation to provide information and access to data. This shall not apply, however, to information that a lawyer acquires during the investigation of the legal position of his client in connection with legal proceedings, including when he has given advice on whether to file suit or avoid legal proceedings, or information that he has acquired before, during, or after the conclusion of legal proceedings if the information relates directly to the case. The Central Bank may summon individuals that it believes to possess information pertinent to the investigation of a case in order to take statements from them.

The Central Bank of Iceland may demand that the assets of an individual or legal entity be impounded, if there are legitimate grounds to suspect that the practices of the party in question violate the provisions of this Act. The conditions for and treatment of such a request shall be subject to the provisions of Article 88 of the Act on Criminal Procedure, as appropriate.

The Central Bank of Iceland is authorised to carry out special investigations and confiscate documentation in accordance with the Act on Criminal Procedure, provided that there is good reason to believe that individuals and legal entities have violated this Act or rules adopted on the basis of it, or there is reason to believe that the Central Bank's investigations and actions will otherwise not achieve the intended results. The provisions of the Act on Criminal Procedure shall apply to the execution of such measures.

Article 24

Deadline for initiating legal action

If a party does not accept the Central Bank of Iceland's decision, that party may initiate legal proceedings to request its invalidation in court. Such legal proceedings must be initiated within three months of the date the party was notified of the decision. The initiation of legal proceedings does not postpone the legal effect of the decision or the authorisation for formal enforcement; cf., however, Article 17, Paragraph 2.

CHAPTER VII

Miscellaneous provisions

Article 25

Regulations

The Minister is authorised to lay down further provisions on the implementation of this Act in a regulation.

The Central Bank of Iceland is authorised to adopt more detailed rules on the implementation of Articles, 5, 8, 11, and 12 and Chapter VI. The rules shall be approved by the Minister and published in the *Law and Ministerial Gazette (Stjórnartíðindi)*.

Article 26

Entry into force

This Act shall enter into force at once. Without prejudice to the provisions of Article 8, Paragraph 2 of the Act on the *Law and Ministerial Gazette* and the *Official Gazette*, this Act shall enter into force upon publication.

Article 27

Amendments to other Acts

Upon the entry into force of this Act, the following amendments shall be made to other Acts:

1. *Foreign Exchange Act, no. 87/1992, with subsequent amendments:*

- a. Article 13(e), Paragraph 2 shall be amended to include a new sentence, which shall read as follows:
The sales proceeds of financial instruments falling under the definition of offshore króna assets according to the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions shall be deposited to an account subject to special restrictions or an account with the Central Bank that is subject to the same restrictions according to the same Act.
- b. The following shall be added to the first sentence of Article 13(g), Paragraph 1 of the Act: and denominated in foreign currency.
- c. Article 13(j), Paragraph 6 of the Act shall read as follows:

Dividends according to Paragraph 1 refer to dividend payments on profits from a company's regular operations, not on revenues deriving from the sale of assets in excess of sales gains, profits due to debt write-offs, asset valuation increases, share capital reductions, or other comparable factors. Dividends shall be financed with cash from operations in available funds and not with asset sales, borrowings, share capital increases, or other comparable measures. If the measure underlying the payment of dividends differs substantially from general practice in such transactions and the main purpose appears to be the circumvention of restrictions on foreign exchange transactions and cross-border movement of capital, the Central Bank may refuse confirmation.

- d. Five new paragraphs shall be added to Article 13(n), and they shall read as follows:

Cross-border movement of capital due to the transfer of offshore króna assets to accounts subject to special restrictions or to accounts with the Central Bank of Iceland that are subject to the same restrictions according to the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions shall be exempt from the prohibition contained in Article 13(b), Paragraph 3.

The sale of offshore króna assets according to Article 2, Items 1(c)-1(g) of the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions shall be exempt from the prohibition contained in Article 13(b), Paragraph 3 in connection with participation by their owners in the Central Bank of Iceland foreign currency auction, or if settlement takes place by transfer to accounts subject to special restrictions or accounts with the Central Bank of Iceland that are subject to the same restrictions in accordance with the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions.

Cross-border movement of capital for investments in certificates of deposit according to Article 10, Paragraph 1 of the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions and their settlement according to Paragraph 4 of the same provision shall be exempt from the prohibition contained in Article 13(b), Paragraph 3.

Foreign exchange transactions and cross-border movement of capital for transactions with the Central Bank of Iceland in accordance with Article 9 of the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions shall be exempt from the prohibition contained in Article 13(b), Paragraph 3 and Article 13(c), Paragraph 1.

Assets that have received confirmation according to Article 9, Paragraph 4 of the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions shall be exempt from the prohibition contained in Article 13(b), Paragraph 3 and Article 13(c), Paragraph 1.

- e. Two new sentences shall be added to Article 13(p), Paragraph 1, and shall read as follows: In connection with its supervisory role according to this Act, the Central Bank may carry out on-site inspections or request information in this manner as often as it deems necessary. A decision to conduct an on-site inspection may be implemented via enforcement proceedings.
2. *Act on Electronic Registration of Title to Securities, no 131/1997, with subsequent amendments:* A new temporary provision shall be added to the Act, which shall read as follows:

Notwithstanding the provisions of this Act, the Central Bank of Iceland has the sole authority to act as intermediary for the registration of title to securities falling under Article 2 Items 1(c)-1(g) of the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions from the time their custody is transferred to the Central Bank of Iceland according to Article 5, Paragraph 1 of the same Act.

Explanatory Notes on this Bill of Legislation

1 Introduction

This bill of legislation was drafted by the Ministry of Finance and Economic Affairs, in cooperation with the Prime Minister's Office and the Central Bank of Iceland. The bill is part of the authorities' capital account liberalisation strategy that was introduced publicly in June 2015. With this bill, it is proposed that provisions concerning the treatment of króna-denominated assets that have been subject to restrictions since the imposition of the capital controls be enshrined in law. The assets concerned are owned or held in custody by non-residents and are likely to seek an exit from the domestic economy when the capital controls are lifted, with negative impact on the exchange rate of the Icelandic króna. These króna-denominated assets have often been referred to as *offshore króna assets*,¹ as they are held in custody by non-residents and will not be sold for foreign currency except in transactions with other non-residents, and the exchange rate in such transactions is different than that applying to trade in goods and services undertaken by residents, which takes place in the domestic foreign exchange market, often referred to as the onshore market. These króna-denominated assets, however, are held in custody by deposit money banks and securities companies in Iceland. The term *offshore krónur* has gained a foothold in discussions of these assets, and the terminology used in this bill takes account of this.

The principal objective of the bill is to segregate the offshore krónur in a secure manner so that it will be possible to take the next step towards lifting the capital controls and re-establishing unrestricted cross-border transactions with krónur without jeopardising financial stability or monetary or exchange rate stability. The stock of offshore krónur currently stands at 319 b.kr., and these krónur have been actively traded in the offshore market (i.e., foreign exchange markets abroad) at an exchange rate well below the exchange rate in the domestic foreign exchange market. The offshore króna assets are potentially more volatile than other króna-denominated assets, as the latter are subject to a home bias.² This applies regardless of whether the beneficial owners are domestic or foreign. As a result, it can be assumed that it would have a significant impact on exchange rate stability and the foreign exchange reserves if restrictions on the transfer of offshore krónur were lifted entirely. In recent years, the Central Bank of Iceland has held foreign currency auctions and engaged in direct transactions so as to facilitate the exit of offshore króna assets without negative effects on either exchange rate stability in the domestic foreign exchange market or the Bank's foreign exchange reserves. The Bank intends to hold a foreign currency auction after the bill of legislation is passed, with the same objective: to offer an exit path to all owners of offshore krónur that wish to leave the domestic economy. The Central Bank will publish more detailed information on the auction after the bill is passed in Parliament.

In spite of the authorities' attempts to solve the problem centring on offshore króna assets, it is not possible to guarantee ahead of time that the problem will be entirely resolved with the proposed foreign currency auction, as participation in the auction is voluntary. Nonetheless, it is critical that further liberalisation of controls not be delayed further and, particularly in view of administrative law and the authorities' duty to protect the interests of Icelandic society, it is considered necessary to adopt the measures outlined in the bill of legislation.

¹ The term was defined, among other things, in the capital account liberalisation strategy of 25 March 2011.

² A term referring to investors' tendency to invest in their home market rather than in foreign markets. This bias can have a strong impact on investment decisions even if increased international asset distribution entails greater risk diversification.

The bill entails obliging custodians of offshore krónur to segregate those offshore krónur that will not be used in the Central Bank's proposed foreign currency auction. According to the bill, custodians will be obliged to transfer offshore krónur to restricted accounts identified with ledger code 21 in the Icelandic Banks' Data Centre hf. system, and to transfer electronically registered offshore króna assets in their custody to so-called administrative accounts with the Central Bank of Iceland. Balances on restricted accounts will be subject to a special reserve requirement according to this bill of legislation. This arrangement will make the Central Bank of Iceland's supervision more effective without requiring substantially increased supervisory expense and will ensure better oversight of offshore króna assets, in addition to reducing the risk of circumvention. Naturally, it is not possible to transfer electronic custody of securities that are not electronically registered, but the bill assumes that all payments deriving from such securities will be deposited to accounts subject to special restrictions.

Owners of offshore króna assets will continue to have the right to dispose of their assets; they can make withdrawals, exchange all interest payments in the foreign exchange market, and trade their krónur in the offshore market. Furthermore, it is recommended that the investment authorisations of owners of offshore krónur be expanded; the same applies to withdrawals from the accounts.

When this phase in the authorities' capital account liberalisation strategy is complete, the ensuing steps will focus on households and businesses in Iceland. Individuals' freedom to transfer capital will be expanded, as will firms' and pension funds' investment authorisations. This emphasis is in line with both the integrated three-step approach of the International Monetary Fund (IMF)³ to capital account liberalisation and the authorities' year-2011 liberalisation strategy. For nearly eight years, the capital controls have put restrictions on risk diversification in resident investors' asset portfolios and have limited domestic firms' ability to participate in profitable collaborative projects with non-residents. The resulting economic complications grow greater over time, and the need for risk diversification in domestic asset portfolios accumulates. As a result, it can take many years to adapt domestic asset portfolios to a favourable balance between domestic and foreign assets. Furthermore, the need for outward foreign direct investment can prove substantial. When resident investors' asset portfolios become better balanced, attention will be directed once again at sequenced liberalisation of capital controls on offshore króna assets. When this happens will depend in part on resident entities' investment need, inward long-term foreign direct investment, the size of the foreign exchange reserves at any given time, developments in the current account balance, and the external position of the economy.

2. Purpose and need for legislative amendment.

2.1. Capital controls

The introduction of the capital controls was an inalienable part of the Icelandic authorities' response to the collapse of the financial system and the Stand-By Arrangement prepared and executed in cooperation with the International Monetary Fund (IMF). Because of the collapse of the commercial banks, it was necessary to take action and prevent large-scale outflows of foreign currency. At that time, the exchange rate of the króna had fallen by more than 50% against the euro since mid-2007, causing inflation to peak at 18.6% at the beginning of 2009, with a substantial negative impact on the balance sheets of Icelandic households and businesses. Act no. 134/2008 amending the Foreign Exchange Act, no. 87/1992, was passed, giving the Central Bank of Iceland the authorisation to adopt rules restricting capital transfers to and from Iceland and related foreign exchange transactions.

On the basis of this statutory authority, the Central Bank of Iceland issued the first Rules on Foreign Exchange, no. 1082/2008, on 28 November 2008, which introduced stringent restrictions on movement of capital to and from Iceland and on related foreign exchange transactions. The objective was to restrict, on a temporary basis, capital transfers and foreign exchange transactions that could cause exchange rate instability while the reconstruction of the Icelandic economy and financial system was underway.

The Rules on Foreign Exchange were amended several times and then incorporated into the Foreign Exchange Act, no. 87/1992, by means of Act no. 127/2011. It was deemed appropriate to enshrine the Rules in law concurrent with the introduction of the capital account liberalisation strategy of 25 March 2011, as it was foreseen that the capital controls would remain in effect for longer than originally intended.

³ See International Monetary Fund, *Liberalizing Capital Flows and Managing Outflows: IMF Policy Paper*, 13 March 2012, pp. 16 and 19.

Since then, the Foreign Exchange Act has been amended several times. Amending the regulatory framework for the capital controls has aimed, on the one hand, at limiting the possibilities for circumvention and, in some instances, tightening the capital controls so that their objective – of bringing about stability – would be achieved. On the other hand, restrictions under the capital controls have been eased, as has been the case with exemptions granted by the Central Bank of Iceland and the exemptions provided for in liberalisation strategies.⁴

In the main, the capital controls are structured so that current account transactions are permitted unless explicitly prohibited, and capital account transactions are prohibited unless explicitly permitted. Therefore, the rules restrict foreign exchange transactions and cross-border movement of capital related to trading and issuance of financial instruments, deposits and withdrawals of bank balances, borrowing and lending, importation and exportation of securities, forward transactions in which the Icelandic króna is a constituent of the transaction, gifts, subsidies, and other comparable capital transfers that are conducive to causing severe and substantial monetary and exchange rate instability. On the other hand, capital transfers and foreign exchange transactions due to trade in goods and services are generally permitted without restrictions, as are foreign exchange transactions based on factor income; i.e., payment of dividends and interest to non-residents. Also adopted with the rules was the requirement to repatriate foreign currency, so that a resident who acquires foreign currency is required to submit it to a domestic financial institution within a specified time limit. It has been permitted to continue holding such currency in deposit accounts in Iceland.

The capital controls have without doubt contributed to the progress made in recent years in turning a deep economic downturn around into an economic recovery, enhancing the resilience of the reconstructed financial undertakings, and contributing to greater economic sustainability among domestic entities. In this context, the following should be noted:

1. The capital controls contributed to exchange rate stability, which was a prerequisite for interrupting the vicious cycle of capital outflows, currency depreciation, inflation, a deteriorating capital position, an increased payment problem, declining demand, and continued deepening of the economic crisis. It is clear that, without the introduction of the capital controls, outflows would have been much more pronounced and the exchange rate would have fallen much more than it did.
2. The controls supported asset prices by placing restrictions on the sale of assets by financial institutions, firms, and even individuals at fire sale prices, which would have led to even further losses, with the associated impact on the scope of the problem being addressed.
3. The Central Bank was enabled to raise interest rates less than would otherwise have been necessary, thereby supporting the economic recovery, reducing the public sector's financing costs while the necessary fiscal adjustment was underway, and supporting domestic asset prices.
4. The Central Bank was enabled to lower interest rates sooner than would otherwise have been possible after the steep rise in interest rates during the aftermath of the financial crisis.
5. The controls provided an important source of shelter, including vis-à-vis the instability in international markets, providing the scope to restructure the balance sheets of domestic financial institutions, households, and legal entities, which had been severely damaged by the financial crisis, not least because of the currency depreciation and the resulting spike in inflation.
6. The authorities were given the scope to undertake fundamental economic reforms and to formulate a sound economic policy structure for the post-capital controls period.
7. From March 2012 until the composition agreements were finalised, the capital controls prevented the settlement of the failed banks' and savings banks' estates from jeopardising economic stability.

At the outset, the capital controls were intended as a short-term measure, as long-term capital controls have a variety of negative effects, as well as being in contravention of Iceland's obligations under the Agreement on the European Economic Area (EEA).

⁴ Further discussion of the background to the capital controls can be found in the explanatory notes to the bill of legislation passed as the Act on a Stability Tax, no. 60/2015 (Case no. 785 at the 144th legislative session).

2.2. *Undesirable effects of the capital controls*

The capital controls provide for restrictions on foreign exchange transactions and cross-border movement of capital, with the objective of reducing the negative impact of market transactions. In the long run, such restrictions have a negative impact on the economy, eroding economic prosperity and living standards. These effects come to the fore in various ways:

1. The controls tend to reduce foreign investors' participation in domestic investment projects.
2. They restrict residents' outward foreign direct investment, which in many instances are an important aspect of taking advantage of foreign business opportunities and fostering domestic firms' growth.
3. Restrictions on domestic investors' risk diversification, including that of pension funds, can have adverse effects of price formation in domestic financial markets, with the associated risks for financial stability.
4. The controls tend to stimulate abnormal business practices and even foster the destruction of business ethics. A variety of parties will attempt to circumvent the controls, and the general public will pay the price for it.
5. Protracted capital controls could jeopardise Iceland's important participation in international cooperation of various types, including the EEA and the European single market.

Successful liberalisation of the capital controls in a manner ensuring that economic stability is not threatened is therefore a foundation for increased output growth, stronger foundations for financial stability, and increased general well-being.⁵

2.3. *Offshore króna assets.*

Until now, offshore króna assets have been defined as funds in domestic currency that are owned or held in custody by foreign financial institutions or held in custody by domestic deposit institutions or securities companies, or certificates for such assets, which are subject to restrictions under the Foreign Exchange Act. The beneficial owners of offshore króna assets are residents or non-residents, however. In this bill of legislation, offshore króna assets are defined more broadly than has been done before because, since the imposition of the capital controls, it has become clear that more categories of króna-denominated assets could cause monetary and exchange rate instability upon liberalisation of the capital controls. The bill of legislation does not make a distinction according to the form of the assets but considers instead their origins, with non-discrimination as a guiding principle.

The origins of the offshore króna assets are twofold. First of all, the origins of offshore króna assets according to Article 2, Items 1(a), 1(c), 1(d), 1(f), and 1(g) of the bill of legislation can be traced back to 2005-2008, a period of large-scale carry trade with the Icelandic króna. One of the major contributors was foreign entities' issuance of bonds in Icelandic krónur – so-called glacier bonds. Issuers of glacier bonds were primarily international financial institutions with strong credit ratings. Glacier bond issuers' use of interest rate swaps and currency swaps alongside the issues actually provided them with favourable foreign funding. The end purchasers were international investors seeking bonds issued by known issuers and within an international legal framework. The bonds bore high interest rates in international context, but they entailed exchange rate risk for investors with a settlement currency other than the Icelandic króna. At the beginning of 2008, the stock of outstanding glacier bonds amounted to about 361 b.kr., whereas the value of marketable Icelandic Treasury bonds issued in Icelandic krónur was less than 120 b.kr. at the same time.⁶ After the glacier bonds matured, the capital that had been invested in them was used to invest in deposits of domestic financial institutions or marketable Icelandic Treasury bonds, as the capital controls prevented the conversion of the krónur to foreign currency in the domestic foreign exchange market. Second of all, the origins of offshore króna assets according to Article 2, Items 1(b) and 1(e) of the bill of legislation can be traced to the financial restructuring of Icelandic companies after the introduction of the capital controls, which entailed payment of claims from bankruptcy estates and payment of contractual claims according to composition agreements, cf. Act no. 21/1991, where payment takes place in Icelandic krónur by means of withdrawal from the payer's account with a financial institution in Iceland. In all

⁵ Further discussion of the negative effects of the capital controls can be found in the explanatory notes to the bill of legislation passed as the Act on a Stability Tax, no. 60/2015 (Case no. 785 at the 144th legislative session).

⁶ See Government Debt Management's *Market Information* newsletter, Volume 9, no. 1, January 2008.

likelihood, once such payments are remitted to creditors, they will be converted to foreign currency, which will be exported from Iceland, with the associated pressure on the exchange rate.

After the capital controls were introduced, the Central Bank of Iceland came to the conclusion that offshore króna assets were potentially volatile assets with limited home bias, which sought an exit, and the stock of offshore króna assets was then estimated at 41% of Iceland's GDP. At around that time, there developed an offshore króna market where it was possible to buy Icelandic krónur at an exchange rate much lower than was customary in the onshore market at that time. The difference between the offshore exchange rate, on the one hand, and the onshore rate, on the other, created a significant incentive to circumvent the capital controls in spite of the prohibition on capital transactions between residents and non-residents. As a result of this, foreign currency was not repatriated to Iceland, and the exchange rate of the króna fell even though the current account balance was positive at the time, significantly undermining the purpose and objectives of the capital controls.

In order to stem the tide of this massive importation of offshore krónur, which had become a common way to circumvent the capital controls at the general public's expense, cross-border transfers of krónur were restricted at the end of October 2009. At the time, this restriction was vital to strengthening the foundations of the capital controls, and it is likely that it played a role in halting the virtually uninterrupted slide in the exchange rate of the króna, which had begun in March 2009.

In spite of a general prohibition on the importation of offshore krónur, their owners have been authorised since the introduction of the capital controls to use offshore krónur to invest in certain types of financial instruments – primarily Treasury and municipal issues, but also funds that invest in such issues. As issued and outstanding glacier bonds matured, the resulting offshore krónur sought out investments in these financial instruments, but the importation of these instruments has been prohibited, just as the importation of offshore krónur has been prohibited. On the other hand, owners of offshore króna assets have been authorised to export interest payments on these investments, and since the prohibition on importation of offshore króna assets was imposed, the Central Bank of Iceland has been notified that 84 b.kr. have been converted in the foreign exchange market in connection with them. Since March 2015, owners of offshore krónur have been even further restricted in their investment authorisations.

Offshore króna assets are highly liquid króna-denominated assets and have been actively traded in the offshore market at an exchange rate well below the rate in the onshore market, and the offshore exchange rate has been used by owners of offshore krónur when the value of their assets is converted to the original currency. It can be assumed that it would have a significant impact on exchange rate stability and the foreign exchange reserves if restrictions on the transfer of offshore króna assets were lifted entirely. This risk exists regardless of whether the beneficial owners of the assets are domestic or foreign.

The Central Bank of Iceland, in consultation with the Financial Supervisory Authority, requested information and documentation on the composition of beneficial owners of offshore króna assets. More specifically, with the intermediation of the Financial Supervisory Authority, it requested information and documentation from foreign financial institutions, which gave information on the number of beneficial owners, their addresses, and whether they were considered legal entities or individuals. Data collection requests were sent to official financial supervisors in 11 countries in Europe, and responses were received from five institutions. The Central Bank has also sent special data requests to domestic financial institutions, requesting information on the non-residents' assets in the form of deposits and securities. According to the information that has been received, the beneficial owners of offshore króna assets are resident and non-resident individuals and legal entities.

2.4. Offshore króna assets and capital account liberalisation.

The authorities presented a comprehensive capital account liberalisation strategy in June 2015, which stated that the second phase of the strategy would provide for an auction designed to solve the problem created by the offshore króna assets. The first phase of the 2011 liberalisation strategy solved the problem to a degree, with a series of foreign currency auctions and bilateral transactions undertaken by the Central Bank. Both were measures intended to minimise the negative impact on domestic foreign exchange market stability and the Central Bank's foreign exchange reserves. The objective of the foreign currency auctions was to put short-term króna-denominated assets owned by parties wishing to exit the local economy into the hands of patient investors. With this, owners of offshore krónur gained access to the foreign currency that became available because of inflows that have been used for long-term investment in the domestic economy and have not been available to other owners of krónur. The auction structure governing the

Central Bank's purchase of krónur for foreign currency is not a multi-currency practice according to the IMF definition and is a recognised market-based solution used in capital account liberalisation.

The Central Bank held a total of 21 foreign currency auctions over a period of just over three years, where owners of offshore króna assets according to Article 2, Items 1(a), 1(c), and 1(d) of the bill of legislation released about 158 b.kr. of their assets in exchange for euros. The weighted average price in these auctions was 219 krónur per euro (see Table 1). After the introduction of the capital controls, through offshore transactions, ownership of offshore króna assets has become somewhat more concentrated. In several auctions, there were signs of collusion between owners of offshore krónur in connection with bids in the auctions, and it is likely that foreign currency inflows were reduced as a result, thereby reducing the size of the auctions, with fewer krónur available per euro.

Auction no.	Auction date	Auction exchange rate	Auction portion (b.kr.)
1	7.6.2011	219	13.4
2	12.7.2011	216	14.9
3	28.3.2012	235	4.9
4	9.5.2012	239	9.1
5	20.6.2012	246	7.5
6	29.8.2012	236	3.8
7	3.10.2012	235	4.9
8	7.11.2012	236	4.7
9	18.12.2012	233	6.8
10	5.2.2013	231	5.7
11	19.3.2013	226	8.2
12	30.4.2013	210	6
13	11.6.2013	221	9.9
14	3.9.2013	224	4.4
15	15.10.2013	227	4.9
16	3.12.2013	216	8.7
17	4.2.2014	210	9.9
18	14.5.2014	196	6.4
19	24.6.2014	186	6.7
20	2.9.2014	181	5.1
21	10.2.2015	200	11.8
Weighted	average	219	158
prices and total volume			

Table 1. Results of Central Bank foreign currency auctions for offshore krónur seeking to exit

Offshore króna assets have also been released in bilateral transactions. For example, in 2010 the Central Bank of Iceland, on behalf of the Treasury, entered into the so-called Avens agreement with LBI hf. and the European Central Bank (ECB), as LBI hf. was the largest single owner of króna-denominated assets outside Iceland, and the assets were pledged to the ECB. The market value of the króna-denominated assets bought by LBI hf. in exchange for euro-denominated bonds was about 120 b.kr. at that time. The average exchange rate in the transactions was ISK 288 per euro. That same year, bilateral trades were made with other owners of offshore krónur for about 30 b.kr., at an average exchange rate of ISK 275 per euro.

In addition to this, the Central Bank has granted resident and non-resident entities exemptions in order to import offshore króna assets to Iceland. In decisions on exemptions, consideration has been given to whether the offshore króna assets have been owned continuously by the party in question since before 28 November 2008 – i.e., the krónur in question must not have been bought using foreign currency after the capital controls were imposed – but transfers between asset classes (such as cash and financial instruments) have been ignored. Consideration has also been given both to the interests of the applicant in being able to

use assets acquired before the capital controls were imposed to pay obligations in Iceland and to the objectives underlying the controls and the impact an exemption would have on monetary and exchange rate stability. These exemptions amount to a total of 24 b.kr.

Today, the majority of the offshore króna assets are held as foreign financial institutions' deposits with domestic financial institutions or in the form of marketable securities. Therefore, a large share of the offshore krónur retained their value because of the protection afforded by the so-called Emergency Act (i.e., the Act on Authorisation for Treasury Disbursements due to Unusual Financial Market Circumstances, Etc., no. 125/2008) when deposits were transferred to the new banks together with domestic loan portfolios.

The stock of offshore króna assets now totals about 319 b.kr., including about 177 b.kr. in Treasury bonds and Housing Financing Fund bonds, and about 94 b.kr. in deposits, money market instruments, and escrow payments. Ownership of offshore króna assets has grown somewhat more concentrated since the capital controls were introduced, through offshore transactions. About 80% of the value of bonds will mature in the next three years, and offshore króna assets invested in Treasury bonds therefore account for the vast majority of shorter Treasury bonds. In addition to these are other offshore króna assets not owned or held in custody by foreign financial institutions or institutional investors, which amount to at least 48 b.kr.

The 2011 capital account liberalisation strategy aimed to reduce the amount of offshore króna assets that could exit the economy suddenly upon liberalisation of the capital controls. Considerable progress has been made in scaling down the problem that the offshore króna assets could cause upon liberalisation, as the stock of offshore krónur has shrunk from 41% of GDP in the autumn of 2008 to 15% of GDP as of end-March 2016.

In spite of these measures, it is clear that if all remaining offshore króna assets were granted unrestricted access to the domestic foreign exchange market, they would create the risk of a steep drop in the exchange rate unless the Central Bank sold large amounts of foreign currency from its reserves in order to counteract it. Such a depreciation would weaken households' and businesses' equity position, reduce their collateral capacity, cut into demand, and thereby reduce economic activity, which could lead to even further declines in the exchange rate and in asset prices. Owners of offshore króna assets would feel these negative effects to some extent, particularly those that did not have domestic assets after having closed out their positions through the foreign exchange market. Therefore, these transactions would also have a negative external effect on other parties not involved in them. This detrimental effect would emerge in the market where Iceland's most important asset price is determined – the foreign exchange market – and would thereby have a systemic impact.

In spite of the authorities' attempts to solve the problem represented by the offshore króna assets, it is impossible to guarantee that it will be resolved in full with the voluntary measures that have been and will be offered to owners of offshore króna assets. In view of the foregoing, it appears inevitable that, other things being equal, lifting the capital controls without preventative measures vis-à-vis the offshore króna problem will lead to system-wide adverse effects that could pose a threat to economic stability. At the same time, it is clear that prolonged capital controls will tend to lead the domestic economy onto a path of weaker GDP growth than is desirable, owing to other negative effects that will be amplified as the controls remain longer in effect. For this reason, it is imperative to lift the controls, to do it efficiently, and to take measures that will ensure, as well as possible, predictability and economic stability.

Clearly, it has taken longer than originally estimated to create the conditions required to lift the capital controls without causing significant instability. The measures proposed in this bill of legislation create the conditions for liberalisation of the capital controls without negative implications for monetary and exchange rate stability and without the need for vastly expanded capital controls surveillance. Furthermore, they create a clear framework for owners of offshore króna assets that do not choose to avail themselves of the exit measures.

2.5. Amendments to other Acts

The bill of legislation also proposes amendments to the Foreign Exchange Act. Chief among them are amendments designed to harmonise the Act with the substance of the bill of legislation. It is also proposed to incorporate into the law the exemptions from the restrictions in the Foreign Exchange Act for the foreign exchange transactions and capital transfers of offshore króna assets provided for in the bill of legislation. Moreover, amendments are recommended that aim to restrict the possibilities for circumvention of the capital controls, which could undermine the objectives of the authorities' measures upon liberalisation, and

to grant the Central Bank of Iceland increased powers to supervise the implementation of the Act. Finally, the bill proposes that the Act on Electronic Registration of Title to Securities be amended, so as to ensure that the Central Bank of Iceland has the sole authority to act as an intermediary in the registration of title to securities classified as offshore króna assets.

3. Main contents of the bill

The bill is part of the authorities' capital account liberalisation strategy, and its main contents are as follows:

- The term offshore krónur (and offshore króna assets) is defined, and it is recommended that offshore krónur continue to be subject to special restrictions and segregated more completely than they are at present.
- Therefore, offshore króna assets held as deposits will be transferred to restricted deposit accounts with domestic deposit money banks or the Central Bank of Iceland, in the case of foreign securities depositories, if they request it. The same applies to payments deriving from other assets included under the category of offshore króna assets.
- Furthermore, offshore króna assets in the form of electronically registered securities held in custody with domestic and foreign financial institutions will be transferred to administrative accounts with the Central Bank of Iceland, in the name of the custodian concerned.
- Financial institutions and securities custodians are required to transfer the offshore króna assets no later than 1 September 2016, subject to *per diem* fines.
- Deposit institutions are required to allocate an amount equal to the total balance of restricted accounts held by them for investment in Central Bank of Iceland certificates of deposit (reserve requirement). The certificates of deposit will bear 0.5% interest, which will be reviewed by the Central Bank of Iceland every twelve (12) months.
- Withdrawals from restricted accounts are generally prohibited except in the following instances:
 - Temporary authorisations for withdrawal:
 - For foreign exchange transactions with the Central Bank of Iceland at the reference exchange rate, until 1 November 2016.
 - For illiquid offshore króna assets, provided that the owner has paid to the Central Bank of Iceland the difference, calculated in euros, between the value of the assets according to the reference exchange rate, on the one hand, and the value of the assets according to the official central exchange rate of the króna versus the euro on 20 May 2016, on the other. The authorisation remains in effect until 1 November 2016. If an owner of offshore króna assets exercises its authorisation, the offshore króna assets underlying those transactions shall be exempt from the restrictions provided for in the Act, upon receipt of confirmation by the Central Bank.
 - Unlimited authorisations for withdrawal:
 - For the purchase of special certificates of deposit issued by the Central Bank of Iceland.
 - For transfers between accounts subject to special restrictions.
 - For withdrawals of amounts not to exceed 6,000,000 kr. per calendar year, provided that it is demonstrated that the deposit is actually owned, and has continuously been owned, by an individual.
 - For accrued interest, indexation of interest, and dividend payments.
- The Central Bank is entrusted with the implementation of the Act; the Bank is granted broad authorisations to gather information and shall be empowered to adopt measures such as *per diem* fines and administrative fines.
- Furthermore, derived amendments to the Foreign Exchange Act and the Act on Electronic Registration of Title to Securities are recommended as regards points directly related to the substance of the bill of legislation.

Following the passage of this bill of legislation, the Central Bank of Iceland will publish information on the planned foreign currency auction in which all owners of offshore króna assets will be given the option of exchanging their offshore króna assets for euros, thereby avoiding the restrictions proposed in the bill.

4. Constitutionality and compliance with international obligations

4.1. Provisions of the Constitution and the European Human Rights Convention

The recommendations in the bill of legislation have been drafted with the aim of maintaining compliance with the Constitution and the European Human Rights Convention, particularly as regards protection of ownership rights and prohibition of discrimination. Failure to adhere to these principles could create liability for compensatory damages on the basis of Article 72, Paragraph 1 of the Constitution, cf. also the protection of ownership rights according to the European Human Rights Convention, or could constitute illegal discrimination, which would be in violation of the non-discrimination rule contained in Article 65 of the Constitution, cf. also the prohibition of discrimination on the basis of subjective considerations, according to the European Human Rights Convention and the EEA Agreement.

It is clear that the beneficial owners of offshore króna assets are residents and non-residents and that disposal of offshore króna assets has been subject to restrictions ever since the capital controls were imposed. The extraordinary circumstances currently prevailing are considered to justify the transfer of offshore króna assets in the form of electronically registered securities to administrative accounts with the Central Bank of Iceland and the transfer of deposit balances to accounts that will be subject to the special restrictions provided for in the bill of legislation. The same principles lie behind the recommendation that payments due to other offshore króna assets be subjected to comparable restrictions.

It is appropriate to emphasise that the bill of legislation does not represent a transfer of ownership rights. Furthermore, changes in the custody of króna-denominated assets are not conducive to eroding their value, with reference to the fact that the authorisations for disposal will be either unchanged or more liberal. Nevertheless, it can be said that, by stipulating changes in administration of custody, owners' right of disposal are being restricted as regards the selection of an administrator.

The Central Bank is authorised to charge administrative fees on offshore króna assets, but these fees shall not exceed the Bank's actual incurred expense. The restrictions in the bill of legislation centre mainly on owners' right to decide where their assets are held in custody.

The restrictions provided for in the bill are an element in the vital task of reducing the risk attached to the aforementioned offshore króna assets. The conditions prevailing at the time this bill of legislation is presented – i.e., the imposition of capital controls following the financial crisis in autumn 2008, the steps taken since then, and the damage that protracted capital controls do to the domestic economy – are discussed in detail in Section 2. Furthermore, reference is made to the discussion in that section concerning the necessary scope of the measures provided for in the bill of legislation.

The continued restrictions on the right to dispose of offshore króna assets are based on vital public interest considerations. These restrictions are a necessary element of measures to release the pressure that offshore króna assets could put on the exchange rate of the Icelandic króna, other things being equal, and they are also a way to give the owners of the assets the option of releasing them without jeopardising exchange rate stability. The objective of the bill is to enable the liberalisation of capital controls on households and businesses in Iceland, and also on owners of offshore króna assets.

The restrictions provided for in the bill – i.e., the continued restrictions in connection with certain króna-denominated assets and the segregation of such assets – are based on impartial, substantive, and generally applicable grounds. With the segregation of offshore króna assets set forth in the bill, an attempt is made to define the problem to be solved in a generally applicable, clear, and predictable manner, guided solely by the objectives of the bill.

It is vital that the measures provided for in the bill apply equally to all parties in comparable circumstances. As is described in Section 2, the króna-denominated assets under discussion create a particular problem in connection with liberalisation – more than other króna-denominated assets do. The restrictions on ownership rights in connection with specific assets, as provided for in the bill, are based on the assumption that parties in comparable circumstances will receive comparable treatment.

Nevertheless, it is important to observe the principle of proportionality. The króna-denominated assets covered by the bill are currently subjected to a variety of restrictions on treatment and disposal. The steps towards lifting the capital controls that are planned for the near future, concurrent with the presentation of this bill, centre on the Central Bank's facilitating the exit of offshore króna assets via a foreign currency auction. It is assumed that all owners of offshore króna assets who so choose will have a clear, realistic way to release their króna-denominated assets by exchanging them for foreign currency.

It is considered beyond doubt that the restrictions provided for in this bill fall within the scope provided to the legislature as regards restrictions on the treatment and disposal of ownership rights, with consideration given to Articles 65 and 72 of the Constitution. According to the above, the measures provided for in the bill are considered constitutionally sound and consistent with Iceland's obligations under the European Human Rights Convention.

4.2. The EEA Agreement

The steps towards capital account liberalisation that are outlined in this bill of legislation – which mainly entail the transfer of funds to special accounts – do not as such represent far-reaching restrictions on free movement of capital or other obligations under EEA law. Actually, the bill provides in many respects for broader authorisations to dispose of offshore króna assets than are currently in place.

As is mentioned above, the assets under consideration – whose beneficial owners are both residents and non-residents – are already restricted as regards movement of capital. In the current environment, transactions with offshore króna assets are permissible only internally (between owners of such assets), for investment in specified types of financial instruments, or in transactions with the Central Bank of Iceland via foreign currency auctions.

The bill of legislation is intended to facilitate further easing of restrictions on movement of capital, and transfer of custody and administration of the assets is a necessary part of this plan. If the measures outlined in the bill of legislation do not materialise, there is the risk that it will be more difficult to prevent owners of offshore króna assets from circumventing restrictions on movement of capital. Furthermore, the planned changes in custody and administration will make further liberalisation and supervision by the Central Bank of Iceland more effective and will ensure that the necessary oversight is in place.

As has been confirmed by the EFTA Court in Case no E-3/11 (*Pálmi Sigmarsson vs. Central Bank of Iceland*), rules that restrict free movement of capital must be conducive to achieving the set objectives and may not go further than is necessary. Although these measures are much less onerous than their predecessors – i.e., in connection with the imposition and easing of the capital controls – they represent, in part, continued restrictions on movement of capital. As a result, the conditions provided for in Article 43, Paragraphs 2 and 4 of the EEA Agreement must be satisfied, as before, in connection with protective measures such as the imposition and maintenance of capital controls and the measures that are necessary in connection with their removal. Iceland has some flexibility to determine whether these conditions are satisfied and which measures are appropriate – that is, necessary and conducive to achieving the desired objectives as regards national interests and domestic economic policy, but without going too far in comparison with other options that may be available. As regards the necessity of the measures and the observation of the principle of proportionality, reference is made to Sections 2, 4.1, and 6.4.

Particular attention has been given to ensuring that this bill of legislation does not conflict with the EEA Agreement. The steps taken towards liberalisation of capital controls with this bill do not in and of themselves entail restrictions on free movement of capital. The segregation of assets provided for in the bill is based on substantive considerations that are related solely to the objectives of the bill and do not, in terms of purpose or impact, represent discrimination between parties in comparable situations as regards residence or nationality, as this would be in contravention of Iceland's obligations under EEA law.

5. Consultation

During the preparation of this bill of legislation, extensive consultation took place with the Prime Minister's Office and the Central Bank of Iceland. In addition, meetings were held with the commercial banks, the Icelandic Banks' Data Centre, the Nasdaq Iceland exchange, and the Nasdaq CSD Iceland securities depository, so as to review identified technical issues. Furthermore, the Central Bank of Iceland acquired information and documentation from foreign financial institutions, in close collaboration with the Financial Supervisory Authority, as is described in Section 2.3.

6. Evaluation of impact

6.1. Impact on the Icelandic economy.

If the bill is passed into law, it can be expected that the impact on the Icelandic economy will be primarily of two types. First of all, the treatment of offshore króna assets stipulated in the bill is an important element in the capital account liberalisation strategy and will therefore contribute to unwinding the negative impact of protracted capital controls on the economy. Second, the segregation of offshore króna assets will prevent circumvention and will prevent owners of offshore krónur from exiting the

domestic economy unhindered when the next steps towards capital account liberalisation are taken, with the associated negative impact on Iceland's balance of payments.

The aim of the bill is to ensure that the liberalisation of capital controls does not have a significant negative impact on the exchange rate or the foreign exchange reserves. As a result, it can be expected that the impact on inflation will be limited and that, other things being equal, there will not be a negative effect on real disposable income and household debt service. The risk of a negative spiral of falling exchange rate and rising prices should therefore be limited, not least in view of the measures recommended with the bill of legislation.

In other countries, the capital controls are viewed negatively, even though they were necessary because of the financial crisis. If liberalisation proceeds successfully, it can be expected that the Republic of Iceland's credit ratings will improve further, as the capital controls are considered to have had a negative impact on the economy. Improved credit ratings will provide increased access to credit markets, and financing costs will decline. Other things being equal, this will increase the number of profitable investment opportunities available to residents and non-residents alike.

For little under eight years, the capital controls have placed restrictions on residents' ability to diversify risk in their asset portfolios. This is an important reason to lift the controls. Pension funds, third-pillar pension funds, and general investors have not received exemptions from the Foreign Exchange Act or the related rules, apart from the exemption granted in the past six months to pension funds, in the amount of 30 b.kr. These parties have therefore had limited opportunities to invest in foreign assets, except by reinvesting the foreign assets they held when the capital controls were imposed and by investing on the basis of agreements concluded before the controls were introduced. Because the capital controls have been in effect for such a long time, these funds have been unable to choose the most favourable risk-reward ratios. Over time, this exacerbates the risk of loss and could therefore cut into fund members' future income, and furthermore, the accumulated need to invest creates risks that could materialise upon removal of the controls. Iceland's pension fund system is one of the largest in the world relative to GDP. In such a large asset portfolio, risk diversification is of key importance to the economy and works against distortion of domestic asset prices.

If the bill passes, it will represent an important step towards the abolition of the capital controls. It will greatly increase the likelihood that controls on Icelandic households and businesses can be lifted entirely, thus enabling them to enjoy the benefits of free movement of capital.

6.2. Impact on the Central Bank and the foreign exchange reserves.

The capital account liberalisation strategy has the fundamental objective of ensuring that the foreign exchange reserves are sufficient and that the risk of substantial foreign currency outflows is minimised. The bill is an element in preventing the offshore króna assets from having undesirable negative effects on the exchange rate and the foreign exchange reserves. The Central Bank will determine how much scope it has to allocate a portion of its foreign exchange reserves towards releasing offshore króna assets through the foreign currency auction before offshore króna assets are segregated by custodians. This assessment will take into account, among other things, the Bank's need for foreign exchange reserves when the time comes to lift controls on Icelandic households and businesses. While liberalisation is underway, the size of the foreign exchange reserves will be determined through a cautious approach in accordance with guidelines issued by the International Monetary Fund (IMF).

The Central Bank of Iceland implements the capital controls and carries out supervision and monitoring of the controls. This bill creates the foundations for the next steps in liberalisation and minimises the risk of circumvention during the easing process, which would otherwise require extensive supervision and monitoring. The Central Bank should not be required to incur increased supervisory costs as a result of the passage of the bill, and over time, the cost of supervision should decline as liberalisation proceeds.

The Central Bank pays interest on the certificates of deposit that will be issued in connection with the bill. Because deposit money banks that hold offshore króna assets in the form of deposits will be required, by means of a special reserve requirement, to purchase these certificates of deposits, the balance on the banks' accounts with the Central Bank will decline, other things being equal. On the other hand, interest rates on seven-day term deposits and on current accounts with the Central Bank are higher than the proposed interest rate on the certificates of deposit, as interest on term deposits is determined by monetary policy at any given time, with the aim of affecting residents' spending and saving decisions. The Central Bank will therefore not be faced with increased interest expense on the issuance of the CDs. Interest rates

on certificates of deposit are determined annually by the Central Bank of Iceland, with reference to the Bank's legally mandated objectives and returns on its assets. The interest rate level also takes account of the effect that interest payments on certificates of deposit will have on the balance of payments, as interest on non-residents' assets can be converted to foreign currency in the domestic foreign exchange market. Furthermore, the rate of interest on certificates of deposit must not provide an incentive for carry trade.

6.3. *Impact on the Treasury.*

The removal of the capital controls will eliminate a major uncertainty concerning the Treasury's future credit options and debt service. In this context, it is appropriate to emphasise that international credit rating agencies have repeatedly pointed at the capital controls as one of the principal drags on Iceland's credit ratings and, therefore, on the terms offered to it in international credit markets. It is possible that the interest premium and interest expense faced by the Treasury could decline markedly, as other European countries with a similar position, economic framework, and public debt level enjoy much more favourable borrowing terms than the Republic of Iceland does.

In other respects, the measures proposed in the bill are not likely to have a palpable effect on Treasury expenditure, and it is not assumed that the substance of the bill will directly affect Treasury revenues.

6.4. *Impact on owners of offshore króna assets.*

The scope of the bill includes offshore króna assets in the amount of 319 b.kr. Table 2 gives a breakdown of offshore króna assets according to Article 1, Items 1(a)-1(g) of the bill.

<i>Item</i>	<i>Definition according to the bill</i>	<i>B.kr</i>
1.a	Deposits denominated in Icelandic krónur and held by the following parties with deposit-taking institutions in Iceland, irrespective of whether they are the actual property of the party in question or whether that party holds them in custody for another: 1. Foreign legal entities that have an operating licence or that carry out legally defined activities in the financial markets, their branches, and subsidiaries owned by them. 2. Other foreign institutional investors that invest in financial instruments, including parties that engage in securitisation or other financing activities.	74.3
1.b	Funds held in a custodial deposit account in the name of the payer, in an escrow account with a deposit money bank in the name of the owner or his representative, or in the form of specified assets of a creditor in the custody of the payer, provided that they have been paid for the benefit of a non-resident entity that has or has had a claim against a legal entity that has undergone winding-up proceedings or insolvency proceedings or has undergone restructuring via composition agreement.	19.5
1.c	Bonds and bills issued in Icelandic krónur by the Republic of Iceland or bearing a Treasury of Iceland guarantee, and owned or held in custody of a party falling under Items (a) of this numbered item.	176.5
1.d	Unit share certificates owned or held in custody by a party falling under Item (a) and issued in Icelandic krónur, in mutual, investment, and institutional investment funds that invest, directly or indirectly, in financial instruments issued by the Republic of Iceland or bearing a Treasury of Iceland guarantee.	0.9
1.e	Shares, bonds, and any type of debt instrument issued in Icelandic krónur by resident entities that underwent restructuring on the basis of a composition agreement according to the Act on Bankruptcy, Etc., after 28 November 2008, and owned by non-resident legal entities as a result of conversion of claims in which they invested after 28 November 2008. The same applies to reinvestment of the proceeds from such assets that have been sold, either partially or in full.	19.7
1.f	Shares, bonds, and any type of debt instrument issued in Icelandic krónur by resident entities, if the investment took place after 28 November 2008 and payment was remitted, directly or indirectly, by withdrawal from an account in Icelandic krónur with a foreign financial institution.	28.0
1.g	Unit share certificates owned or held in custody by a party falling under Item (a) and issued in Icelandic krónur, in mutual, investment, and institutional investment	0.3

	funds that, among other things, invest, directly or indirectly, in financial instruments issued in Icelandic krónur by entities other than the Republic of Iceland or those enjoying a Treasury of Iceland guarantee; deposits, cash, and derivatives.	
	Total	319. 1

The bill does not entail a requirement that owners of offshore krónur sell their assets, and their business relationships with domestic financial institutions and foreign securities depositories will remain unchanged. Owners of offshore króna assets held in accounts subject to special restrictions and administrative accounts with the Central Bank of Iceland will retain the right to dispose of their assets; they can make withdrawals, exchange interest and dividend payments in the foreign exchange market, and conduct trades with their offshore króna assets. According to the bill, securities depositories are required, upon request from the Central Bank of Iceland, to identify electronically registered offshore króna assets as restricted by allocating them provisional international ISIN identity codes, which will make it easier for owners of offshore krónur to hold mixed portfolios containing securities with and without encumbrances. Owners' authorisations to make withdrawals from their accounts are expanded, and owners are authorised to invest in special certificates of deposit issued by the Central Bank of Iceland. The Central Bank is an independent institution owned by the State, and the Treasury guarantees all of its obligations. It follows from this that the counterparty risk incurred by Central Bank depositors is vis-à-vis the Republic of Iceland. According to the Act on the Central Bank of Iceland, no. 36/2001, only specified parties are eligible to hold deposits with the Bank.

This bill gives owners of offshore krónur the lowest-risk investment option offered in Iceland, one that would otherwise not be available to them. In this sense, the authorisation to buy certificates of deposit is a concession granted to owners of offshore krónur, particularly those that do not want to participate in the voluntary exit options that will be offered and but choose instead to hold their Icelandic krónur for a longer period. Furthermore, individuals' withdrawal authorisations will be expanded to a maximum of 6,000,000 kr. per calendar year, if they can demonstrate that they have been continuous beneficial owners of the funds since 28 November 2008.

The Central Bank of Iceland will hold a foreign currency auction in which all owners of offshore krónur who choose to participate will be offered an exit path. Participation in the auction is voluntary, and the exit route will still be available to owners of offshore krónur for a period of time after the auction has taken place.

6.5. Impact on financial institutions and securities depositories

Domestic financial institutions' business relationships with owners of offshore krónur and with foreign securities depositories will remain intact if the bill is passed. This applies to custody and administration of securities and to deposits. There will be changes in the business relationship between domestic financial institutions and domestic securities depositories as regards custody of securities that fall within the scope of the bill, as the Central Bank will be the administrator of the securities vis-à-vis their custodians – i.e., financial institutions – and will act as intermediary vis-à-vis domestic securities depositories as regards registration of title. Transactions between domestic deposit money banks and the Central Bank will change as regards offshore krónur if the bill is passed.

Offshore króna assets held in deposit money bank accounts subject to special restrictions will be subject to special reserve requirements, according to the bill, and domestic deposit institutions will satisfy these reserve requirements by investing in Central Bank of Iceland certificates of deposit. This arrangement will make the Central Bank of Iceland's supervision of compliance with the Act more effective without requiring substantially increased supervisory expense and will ensure better oversight of offshore króna assets. Furthermore, the reserve requirements address the risk of circumvention, with the associated cost to the public, as this risk increases markedly as movement of capital is liberalised further. The certificates of deposit bear 0.5% interest at issuance. The interest rates are reviewed every 12 months by the Central Bank of Iceland, with reference to the Bank's legally mandated objectives and returns on its assets. The interest rate level also takes account of the effect that interest payments on certificates of deposit will have on the balance of payments, as interest on non-residents' assets can be converted to foreign currency in the domestic foreign exchange market. Furthermore, the rate of interest on certificates of deposit must not provide an incentive for carry trade.

The impact of this change on deposit money banks' liquidity should not be substantial because the banks have heretofore been required to hold liquid assets to offset a larger share of non-residents' deposits, according to Central Bank liquidity rules. However, the change can be expected to have a negative effect on the interest rate spreads of deposit money banks that are custodians of offshore krónur held in deposit accounts, but the strength of that effect will depend on the deposit rates offered by the banks on accounts subject to special restrictions.

Finally, it should be noted that balances on foreign financial institutions' settlement accounts with domestic financial institutions are classified as offshore króna assets; therefore, their disposal is subject to special restrictions. Such accounts play an important role in free cross-border trade with krónur, and for reasons related to circumvention, the balances on these accounts may not be combined with offshore krónur when the next steps towards liberalisation are taken. Transferring offshore krónur from these accounts to accounts subject to special restrictions makes the foreign financial institutions' settlement accounts available once again for free cross-border trade with krónur. Foreign securities depositories that operate in Iceland and have accounts with the Central Bank of Iceland can apply to have their offshore króna assets transferred to new accounts with the Central Bank that will be subject to the same restrictions as the special restricted accounts; therefore, their settlement accounts with the Bank will be available for free cross-border trade with krónur when the foundations for such trade develop.

Notes on individual Articles of the bill

On Article 1

This Article describes the objective of this Act, which is to promote the liberalisation of capital controls and create a foundation for unrestricted cross-border trade with Icelandic krónur, in the interest of economic stability and the public good. In order to achieve this objective, it is considered necessary to state more explicitly that króna-denominated assets falling within the scope of the bill shall be subjected to special treatment so as to minimise the risk of large-scale foreign currency outflows when the capital controls are lifted. These measures aim to address the negative impact of capital account liberalisation on the exchange rate of the Icelandic króna and thereby on the public interest. It is clear that unrestricted outflows, upon liberalisation of the capital controls, of foreign currency that could be bought using these króna-denominated assets could lead to a severe depreciation of the Icelandic króna, with strongly negative effects on private sector balance sheets. The authorities have an administrative duty to carry out liberalisation so as to protect the interests of households and businesses in Iceland.

On Article 2

Article 2 contains definitions of the principal terms appearing in the bill of legislation.

The definition of the term offshore króna assets is presented in eight items identified by the letters (a) through (h) and contained in Item 1 of the Article, where the assets are defined in terms of asset type and registered owner or custodian. Those assets that fall under the definition of offshore króna assets are have all been subject to special restrictions as regards foreign exchange transactions or movement of capital ever since the capital controls were introduced in 2008.

The term offshore króna assets refers, first of all, according to Item 1(a), to deposits denominated in Icelandic krónur and held in deposit accounts in Iceland, which are owned or held in custody by parties listed in points 1 and 2 of this Item. The definition of an owner of offshore króna assets in point (i) is based, among other things, on the definition of an institutional investor in Article 2, Paragraph 1, Item 9(a) of the Act on Securities Transactions, but it is emphasised in particular that this definition also extends to their subsidiaries and branches, irrespective of whether they are in Iceland or abroad. Falling under this definition, among other entities, are financial institutions and firms connected to the financial field, insurance companies, electronic money undertakings, payment institutions, UCITS funds and their management companies, pension funds and their management companies (as appropriate), sellers of commodities and commodity derivatives, and other institutional investors. Falling under point 2 of this Item are other foreign institutional investors that invest in financial instruments. In the sense of this provision, the term foreign institutional investors refers to legal entities such as pension funds and institutional investment funds.

It follows from this definition that in order for the funds in question to be classified as offshore króna assets in the sense of Item (a), the registered owner or custodian of the deposits must be a foreign legal entity that has an operating licence or carries out legal operations in the financial markets or is considered

an institutional investor that invests in financial instruments. The reason that the definition of offshore króna assets requires that the registered owner of custodian must be the aforementioned non-resident legal entities is that offshore króna assets in the form of deposits denominated in Icelandic krónur are held in deposit money banks in Iceland, in accounts owned by non-resident legal entities; such accounts are generally referred to as Vostro accounts. In the vast majority of instances, however, the beneficial owners of the funds in question are not the non-resident legal entities but their customers, which could be either residents or non-residents. For further clarification, it should be noted that Vostro accounts are accounts denominated in Icelandic krónur, where the non-residents hold in custody the balances owned by their customers, who are the beneficial owners of the funds. Therefore, the beneficial owners can trace their deposit balance in Icelandic krónur with a foreign financial institution to a deposit balance in a Vostro account with a financial institution in Iceland. According to the Act on Measures to Prevent Money Laundering and Terrorist Financing, no. 64/2006, a beneficial owner is defined as one or more individuals who actually own the operations or controls the customer, individual, or legal entity that is registered for or carries out the transactions. According to this Item, beneficial ownership of offshore króna assets is therefore always in the hands of individuals, which in this case are both residents and non-residents. The restrictions provided for in the bill of legislation therefore do not discriminate between parties as regards nationality or domicile.

Second of all, according to Item 1(b), offshore króna assets include funds that have been paid to foreign creditors and deposited to a custodial deposit account in the name of the payer or to an escrow account with a deposit money bank in the name of the owner, or that take the form of the creditor's segregated assets in the custody of the payer. These are escrow payments made to priority creditors and general creditors by resident entities that have undergone winding-up or insolvency proceedings or have undergone restructuring via a composition agreement according to the Act on Bankruptcy or the Act on Financial Undertakings, and the provision extends to all foreign creditors, including non-resident legal entities, non-resident individuals, and non-resident public entities. The term foreign creditors refers to creditors that are considered non-residents in the sense of the Foreign Exchange Act, no. 87/1992. The provision is intended to extend to funds that have been paid in escrow and have therefore not been paid directly to these foreign creditors because of the restrictions on cross-border movement of capital provided for in the Foreign Exchange Act. These include assets owned that are by foreign creditors and whose distribution has been restricted more than the assets of domestic creditors, as they are more volatile because of a lack of home bias and are likelier to seek an exit if they are distributed to the creditors concerned.

Third, according to Item 1(c), offshore króna assets includes Icelandic Treasury bonds and bills issued in Icelandic krónur or by entities bearing a State guarantee, such as the Housing Financing Fund, and which are owned or held in custody by the entities listed in point (a). These include bonds and bills in which investments have been made using withdrawals from Vostro accounts and, when they are settled or otherwise redeemed, the funds will be deposited to the same accounts. As is applicable to Item (a), beneficial owners of such funds are both residents and non-residents.

Fourth, cf. Item 1(d), offshore króna assets include unit share certificates, issued in Icelandic krónur, in mutual funds, investment funds, and institutional investment funds that invest directly or indirectly in financial instruments issued by the Icelandic Treasury or entities with a State guarantee, such as the Housing Financing Fund, and owned or held in custody by the parties listed in Items (a)(i) and (a)(ii). Indirect investment refers, for instance, to a fund that invests in other funds, which in turn invest in the specified financial instruments.

Icelandic funds have been granted special exemptions by the Central Bank of Iceland to receive offshore króna assets from Vostro accounts versus issuance of unit share certificates, and the funds have invested in accordance with the investment authorisations granted by the Central Bank at any given time. The proceeds of settlement and redemption of such unit share certificates are then re-deposited to the Vostro account. As is applicable to Items (a) and (b), beneficial owners of such funds are both residents and non-residents.

Fifth, cf. Item 1(e), offshore króna assets include holdings in private limited companies, equity securities, bonds, and any type of debt instrument owned by non-resident legal entities and issued in Icelandic krónur by a resident entity in connection with its restructuring on the basis of a composition agreement pursuant to the Act on Bankruptcy, Etc., no. 21/1991, after 28 November 2008. This also includes reinvestment of the proceeds from such assets that have been sold, either partially or in full. The provision extends to the assets of non-residents that had claims against resident entities that have undergone restructuring via composition agreement or have converted them into share capital and/or have received

bonds and/or other debt instruments that the resident entity has issued in connection with the composition agreement.

Sixth, cf. Item 1(f), offshore króna assets include holdings in private limited companies, equity securities, bonds, and any type of debt instrument issued in Icelandic krónur by resident entities, in which the investment was made after 28 November 2008 by means of a direct or indirect payment from an account denominated in Icelandic krónur with a foreign financial institution. This refers to investments that were made using offshore krónur where the investor has benefited from the difference between the onshore and offshore exchange rates. Given the profit that investors in these assets can expect to realise upon the removal of capital controls in the domestic market, it is clear that such assets will seek an immediate exit. It is emphasised in particular that payment have taken place with direct or indirect payment from a króna-denominated account with a foreign financial institution. The word indirect refers, for instance, to cases where offshore krónur have been used for investment in Iceland, such as in bonds, and their proceeds have been allocated to investment in holdings in companies, bonds or, as applicable, other debt instruments issued in Icelandic krónur by resident entities. This item also covers investments in companies that invest in such assets.

Seventh, cf. Item 1(g), offshore króna assets include unit share certificates, issued in Icelandic krónur, in mutual funds, investment funds, and institutional investment funds that invest directly or indirectly in financial instruments issued in Icelandic krónur by resident entities other than the Icelandic Treasury or entities with a State guarantee, such as the Housing Financing Fund, and/or deposits, cash, and derivatives, and owned or held in custody by the parties listed in Item 1(a). This is not an exhaustive list of the assets in which these funds could invest. Indirect investment refers, among other things, to funds that invest in shares in other funds that invest in the aforementioned financial instruments. In instances involving unit share certificates in funds that invest in a mixed portfolio of securities, such as both Treasury bonds and bonds issued by firms and financial institutions, unit share certificates are included under this Item.

Eighth, cf. Item 1(h), offshore króna assets include sales proceeds or other payments due to assets according to Items (c)-(g) that accrue during the period from the entry into force of this Act until 1 September 2016. These are assets that could provide an incentive to dispose of them so as to avoid transferring them to accounts subject to special restrictions.

Item 2 defines the term non-resident legal entity in negative terms; i.e., those that are not considered residents according to the definition set forth in the Foreign Exchange Act, no. 87/1992. The term applies to any legal entity whose registered legal address is not in Iceland, whose Articles of Association do not list Iceland as its address, or whose actual directorship is not in Iceland.

Item 3 defines the term Central Bank of Iceland foreign currency auction. These are auctions conducted on the basis of Article 18, cf. Temporary Provision III, of the Act on the Central Bank of Iceland. no. 36/2001.

In Item 4, deposit money banks are defined as commercial banks, savings banks, and deposit divisions of co-operative societies. Commercial banks and savings banks are authorised, on the basis of an operating licence pursuant to the Act on Financial Undertakings, no. 161/2002, to receive deposits. Deposit divisions are also authorised to do so, on the basis of the Act on Co-operative Societies, no. 22/1991.

Item 5 defines the term resident entity and makes reference to the definition in the Foreign Exchange Act, no. 87/1992.

Item 6 defines Central Bank of Iceland certificates of deposit mainly as debt instruments issued by the Central Bank of Iceland to registered owners or deposit money banks that hold offshore króna assets in accounts subject to special restrictions.

Item 7 defines electronically registered securities as securities that have been registered in electronic (de-materialised) form in accordance with the provision of the Act Electronic Registration of Title to Securities, no 131/1997.

Item 8 defines an account subject to special restrictions as an account denominated in Icelandic krónur, in the name of the owner or custodian of offshore króna assets according to Items 1(a) and 1(b), and held with a deposit money bank in Iceland, which shall be identified with ledger code 21 in Icelandic Banks' Data Centre hf. systems and is subject to special restrictions according to this Act.

Item 9 defines an administrative account as a Central Bank of Iceland account where financial instruments are registered in the name of the custodian of offshore króna assets in the form of electronically registered securities. Administrative accounts are custodial accounts for securities that are established with the Central Bank of Iceland in accordance with Article 5, Paragraph 2 of the bill of legislation.

Item 10 defines the reference exchange rate as a rate of exchange of the króna versus the euro that is set at ISK 220 per euro. This is the same exchange rate as the weighted average in the 20 foreign currency auctions that the Central Bank of Iceland has held for owners of offshore krónur since 2012.

Item 11 defines a customer as an entity that authorises a custodian to act on its behalf and to be registered for financial instruments or funds. The term customer refers to registered owners or custodians of electronically registered offshore króna assets in the form of securities that hold their securities with financial institutions.

Item 12 defines a custodian as a financial institution authorised to hold financial instruments owned by its customers. The definition is the same as the definition of a custodian in the Regulation on Nominee Registration and the Custody of Financial Instruments in Nominee Accounts, no. 706/2008.

Item 13 defines a custodial account as an account where offshore króna assets in the form of electronically registered securities are held. Custodial accounts may be held with commercial banks, savings banks, and securities undertakings.

On Article 3

This provision applies to assets that fall under the definition of the term offshore króna assets in the bill of legislation but are, with this Article, explicitly exempted from the special restrictions provided for in the bill.

On Item 1. It is recommended that assets owned by governments, central banks, and international institutions of which Iceland is a member be excluded from the scope of the Act. Examples of international institutions that carry out legally mandated activities in the financial markets are the International Monetary Fund, the Nordic Investment Bank and the European Investment Bank.

On Item 2. It is recommended that assets deriving from premiums paid in accordance with contractual agreements in domestic currency providing for supplemental insurance protection for the accumulation of third-pillar pension savings with a non-resident custodian of pension rights that is authorised to conduct operations in Iceland pursuant to Chapter II of the Act on Mandatory Insurance of Pension Rights and on Activities of Pension Funds, no. 129/1997, and in accordance with contractual agreements for investment plan insurance, single-premium life insurance, and regular savings plans with foreign insurance companies, on the basis of an exemption from the restrictions set forth in Article 13(b), Paragraph 3 of the Foreign Exchange Act, no. 87/1992, be excluded from the scope of the Act. These are premiums that are paid in Icelandic krónur to honour contracts that resident individuals have entered into with foreign insurance companies and foreign custodians of pension rights. The provision is included in the interest of consistency with these parties' exemptions pursuant to Articles 4 and 5 of the rules on Foreign Exchange, no. 565/2014, for cross-border transfers of domestic currency. These assets may take the form of both deposits and financial instruments, but with the aforementioned provisions of Rules no. 565/2014, foreign insurance companies and foreign custodians of pension rights were granted investment authorisations comparable to those enjoyed by resident entities, for the domestic currency they receive from payment of premiums.

On Item 3. It is recommended that funds owned by foreign electronic money institutions and utilised in accordance with these institutions' exemptions from the restrictions set forth in Article 13(b), Paragraphs 1 and 2 and Article 13(c), Paragraph 3 of the Foreign Exchange Act, no. 87/1992, for the purpose of engaging in payment intermediation in Iceland, be excluded from the scope of the Act.

On Item 4. It is recommended that funds deriving from investments made after 28 November In the provision, it is stipulated that domestic new investment using new inflows of foreign currency shall be unrestricted. The term new investment implies that resident and non-resident investors may import foreign currency to Iceland and invest in the country without having the proceeds of the sale of their investment locked in by restrictions on foreign exchange transactions and cross-border movement of capital. According to the Foreign Exchange Act, new investment is investment commencing after 31 October 2009 and based on new inflows of foreign currency that is converted to domestic currency at a financial undertaking in Iceland. In undertaking new investment, investors are taking a position in the Icelandic

króna for the term of their investment. Foreign currency account balances dating from before 31 October 2009 and held in domestic financial institutions, export revenues, and other foreign currency subject to repatriation requirements are not classified as new inflows of foreign currency; therefore, the new investment authorisation cannot be used in connection with such capital. Furthermore, there are restrictions on what type of investment is permissible, as direct and indirect investments in derivative contracts and claims against entities subjected to winding-up or insolvency proceedings with composition agreements entailing distribution of assets to creditors are not classified as new investment. On the basis of the aforementioned views – i.e., of promoting foreign investment in the Icelandic economy – it is considered appropriate to exclude from the scope of the Act those investments that satisfy the conditions for new inflows of foreign currency even if they do not fulfil other conditions in the provision.

On Item 5. It is recommended that funds deriving from participation in Central Bank of Iceland auctions be excluded from the scope of the Act. Over the period from 28 June 2011 through 10 February 2015, the Central Bank offered to purchase euros in exchange for Icelandic krónur for long-term investment in the Icelandic economy, or in exchange for payment in Treasury bonds. Furthermore, the Central Bank of Iceland has advertised for bids on the sale of Icelandic krónur for cash payment in foreign currency. Such auctions, through the so-called Investment Programme and Treasury Bond Programme, have been an element in the Central Bank's capital account liberalisation strategy of 25 March 2011.

On Item 6. It is recommended that the assets of those entities that fell within the scope of the Act on a Stability Tax, no. 60/2015, when that Act entered into force be excluded from the scope of this Act. This refers to the fulfilment of a composition agreement that has been confirmed by the District Court, upon prior approval by the Central Bank of Iceland. In view of the measures that were taken with the Act on a Stability Tax, no. 60/2015, and the exemptions that were granted to taxable entities pursuant to that Act on the basis of the authorities' stability conditions, it is not considered necessary that the assets according to Item 6 be included with the segregation of offshore króna assets, as the negative effects that these assets could have had on monetary and exchange rate stability have already been mitigated.

On Item 7. It is recommended that specified offshore króna assets, which would otherwise fall under Article 2, Item 1(e) of the bill of legislation, be excluded from the scope of the Act; that is, share capital, bonds, and other debt instruments issued in Icelandic krónur by a resident entity that has undergone restructuring on the basis of a composition agreement pursuant to the Act on Bankruptcy, Etc., no. 21/1991, after 28 November 2008, and owned by a non-resident legal entity if the investment took place after 28 November 2008. More specifically, the provision applies to those offshore króna assets that derive from the foregoing if the Central Bank has granted an exemption from the restrictions contained in the Foreign Exchange Act, no. 87/1992, for distributions in foreign currency from the resident entity. Cross-border movement of foreign currency is restricted according to Article 13(b) of the Foreign Exchange Act, no. 87/1992, and the Central Bank is authorised to grant exemptions from those restrictions in Article 7 of the same Act. It is considered appropriate to grant the Central Bank flexibility in assessing which parties are granted exemptions for distributions in foreign currency, and according to Article 7, Paragraph 2 of the Act, the Central Bank shall consider the consequences of the capital controls for the applicant, the objective of the capital controls, and the impact that an exemption will have on monetary and exchange rate stability.

On Items 8 and 9. It is recommended that offshore króna assets that were the basis for foreign exchange transactions with the Central Bank of Iceland according to Article 9, Paragraph 2 be exempted from the restrictions in the Act. In view of the transactions that owners of offshore krónur have with the Central Bank of Iceland, cf. Article 9, Paragraph 2, it is not considered necessary that those assets that are the basis of the transactions be subjected to the restrictions in this Act, as the negative effects that these assets have on monetary and exchange rate stability have been mitigated to a degree comparable to other offshore króna assets. The same views apply to offshore króna assets that are the basis of foreign exchange transactions in the Central Bank of Iceland's 2016 foreign currency auction at the auction exchange rate. In such transactions, it is assumed that the owner of the offshore króna assets will deliver to the Central Bank an amount equal to the market value of the offshore króna assets, so that the settlement of the transaction takes place with delivery of an amount equal to the market value of the offshore króna assets less the product of the market value of the offshore króna assets and a percentage of the Central Bank of Iceland's official central exchange rate of the Icelandic króna against the euro on 20 May 2016 and the auction exchange rate. This enables owners of offshore króna assets to release their offshore króna assets from the restrictions without needing to sell the assets.

On Article 4

In Paragraph 1, it is recommended that deposit money banks be obliged to transfer offshore króna assets according to Article 2, Items 1(a) and 1(b) that are in their custody to accounts subject to special restrictions no later than 1 September 2016. It is stipulated in particular that the amount of the offshore króna assets shall not be lower than the combined amount according to Article 2, Items 1(a) and 1(b) upon the entry into force of the Act, adjusted for returns and conventional and appropriate administrative costs in instances involving such costs. In this way, consideration is given to the fact that the amount could increase or even decrease between the entry into force of the Act and the date of transfer, which may not be later than 1 September 2016. As regards administrative costs, it is emphasised that it is only permissible to deduct an amount that can be considered normal administrative expense that has verifiably been incurred. This represents an attempt to prevent owners of offshore króna assets from circumventing the transfer recommended in the bill.

In Paragraph 2, it is recommended that foreign securities depositories that operate in Iceland and hold in custody offshore króna assets according to Paragraph 1 in deposit accounts with the Central Bank of Iceland be permitted, until 1 August 2016, to apply to have their offshore króna assets transferred to new accounts with the Central Bank of Iceland that are subject to the same restrictions as the accounts subject to special restrictions.

Paragraph 3 sets for the general rule that withdrawals from accounts subject to special restrictions are prohibited. Furthermore, exceptions from the general prohibition on withdrawals from accounts subject to special restrictions can be found in Chapter IV of the bill.

On Article 5

In this Article, it is recommended that offshore króna assets according to Article 2, Items 1(c)-1(g) of the bill, which were registered electronically in accordance with the Act on Electronic Registration of Title to Securities, no. 131/1997, on the date the bill was approved if it is passed into law, be transferred to an administrative account with the Central Bank of Iceland, in the name of the custodian that holds the offshore króna assets concerned on the date of transfer, no later than 1 September 2016. In the provision, the obligation to transfer offshore króna assets is placed on their custodians on the date of transfer; i.e., as applicable, deposit money banks and securities undertakings, all of which are considered financial institutions in the sense of the Act on Financial Undertakings, no. 161/2002. It is important that the parties have ample time to carry out the transfer, and it is assumed that the transfer will have taken place no later than 1 September 2016.

Furthermore, Paragraph 2 states that it is permissible to transfer offshore króna assets according to Paragraph 1 between custodians' administrative accounts with the Central Bank of Iceland, provided that such transfer does not involve a change in registration of title at the securities depository. This means that owners can transfer custody of their offshore króna assets according to Paragraph 1 from one custodian to another without restrictions according to the Act on such transfer of custody, insofar as it does not result in a change in the ownership of the offshore króna assets.

An administrative account with the Central Bank of Iceland is an account owned by the Central Bank of Iceland where the financial instruments are registered in the name of the custodian. The transfer of electronically registered offshore króna assets to administrative accounts does not entail any change in the obligations of current custodians vis-à-vis their customers, except that the Central Bank will henceforth act as an intermediary for the registration of title to those securities in the securities depository. This means that the custodian continues to ensure that the requirement to disclose information to supervisory bodies, including the Financial Supervisory Authority, is met in accordance with the rules and laws governing the financial markets. The Central Bank will establish an administrative account for each counterparty within the Nasdaq CSD Iceland hf. securities depository and the Central Bank securities system, as the Central Bank's counterparties in this instance are the custodians of the securities on the date of transfer.

This provision stipulates that the Central Bank shall take over the rights and responsibilities entrusted to account operators according to the Act on Electronic Registration of Securities, no. 131/1997, in connection with these offshore króna assets. The term account operator refers to a company or institution that acts as an intermediary for the registration of title to electronic securities in a securities depository, and the entities that can undertake registration of title in the depository are listed in Article 10 of the same Act, among them the Central Bank of Iceland. Account operators notify the securities depository of purchases and sales of electronic securities in the register, and the authorisation in connection with these specified offshore

króna assets will only apply to the Central Bank of Iceland. The securities depository will list the Central Bank of Iceland in its system as an account operator in accordance with Article 24 of the Act on Electronic Registration of Title to Securities, no. 131/1997. Furthermore, an owner of electronic securities may not request that his offshore króna assets with a securities depository be transferred from the administrative account with the Central Bank of Iceland to his account administered by another account operator; cf. Article 8, Paragraph 2 of the Rules on Electronic Registration of Title to Securities, no. 397/2000.

In Paragraph 3, it is stipulated that settlement and redemption of offshore króna assets in the form of securities shall take place in Icelandic krónur that shall be deposited to accounts subject to special restrictions; balances on such accounts are subject to the restrictions set forth in Article 4 of the bill. Therefore, all payments of principal and interest and other payments shall be deposited to accounts subject to special restrictions. This ensures that parties cannot release their offshore króna assets from the restrictions in the Act by transferring them. It is also recommended that, if a foreign securities depository has requested that offshore króna assets in the form of deposits be transferred to accounts with the Central Bank of Iceland that are subject to the same restrictions as the specially restricted accounts, cf. Article 4, Paragraph 2 of the bill of legislation, settlement and redemption of offshore króna assets according to Article 5, Paragraph 2 shall take place with payment to such accounts with the Central Bank of Iceland. Because foreign securities depositories can request that their offshore króna assets in the form of deposits be held in such accounts with the Central Bank, it is considered appropriate that [funds deriving from] settlement and redemption, according to Article 5, Paragraph 3, of their offshore króna assets in the form of electronically registered securities be deposited to the same accounts with the Central Bank.

In addition, it is emphasised, according to Paragraph 4, that if the offshore króna assets according to Paragraph 1 are held in a nominee account with a financial institution pursuant to Article 12 of the Act on Securities Transactions, no. 108/2007, it is assumed that their custody will be transferred from the nominee account with the financial institution concerned to an administrative account with the Central Bank, in the name of the financial institution. The term nominee account refers to nominee accounts in the sense of Article 12 of the Act on Securities Transactions, no. 108/2007, and the Regulation on Nominee Registration and the Custody of Financial Instruments in Nominee Accounts, no. 706/2008.

Furthermore, it is recommended in Paragraph 5 that, upon transfer according to Paragraph 1, the securities depository shall, upon request by the Central Bank of Iceland, provide information on required encumbrances according to Paragraph 3 of that provision by assigning the electronic issue of the offshore króna assets a provisional international ISIN identity code for securities. The acronym ISIN refers to International Securities Identification Number, which is usually called the ISIN or ISIN number of an issued security. The allocation of a provisional ISIN identity code shall take place as soon as possible, but no later than three business days after the Central Bank of Iceland's request has been received by the securities depository.

Paragraph 6 states that, upon settlement relating to securities according to Paragraph 3, where payment takes place with Icelandic krónur not subject to the restrictions provided for in the Act, the securities depository shall lift the encumbrance described in Paragraph 5, upon prior confirmation by the Central Bank of Iceland. The Central Bank will therefore need to confirm that the requirements for removal of the encumbrance according to the provision have been fulfilled, and thereafter, the securities depository will delete the provisional ISIN identity code allocated according to Paragraph 5 from the electronic issue of the offshore króna assets.

On Article 6

In Paragraph 1 it is recommended that sale proceeds, payments of principal, prepayments, final payments, interest and indexation of interest, dividends, and other payments due to offshore króna assets according to Article 2, Items 1(d)-1(g) of the bill that are not electronically registered be transferred to accounts subject to special restrictions, and it is assumed that this will be done within three business days of the date the funds were put at the disposal of or could have been put at the disposal of the owner or his agent. The transfer is a simple action, and it is therefore considered sufficient to grant a three-day deadline to execute it.

In Paragraph 2, it is recommended that owners of offshore króna assets guarantee the endorsement of the encumbrance so that the assets explicitly indicate the existence of the encumbrance. For example, the endorsement shall appear on equity securities, unit share certificates, or registers of shares, as applicable, or in the instance of a loan agreement, with a notification to the borrower announcing a change in payment

instructions, making reference to accounts subject to special restrictions. If such offshore króna assets are transferred without settlement, the encumbrance according to Paragraph 2 shall apply to the purchaser. It is also stipulated that the owner of the offshore króna assets shall notify the Central Bank of Iceland, within three months of the entry into force of the Act, of his or her offshore króna assets and shall specify how the requirements concerning the endorsement of the encumbrance on the offshore króna assets have been satisfied. This obliges owners of offshore króna assets falling under Paragraph 1 to notify the Central Bank of the assets on their own initiative, so as to make it possible to supervise them and to ensure compliance with the provision concerning the transfer of settlement and payment flows on the assets to accounts subject to special restrictions.

Paragraph 3 of the Article recommends that deposit money banks notify the Central Bank of Iceland, on the date of payment, of all payments made to accounts subject to special restrictions according to Paragraph 1.

On Article 7

It is recommended that the Central Bank of Iceland resolve disputes and have decision-making power in other respects concerning the implementation of this Act, and that case handling be governed by the Administrative Procedures Act. Decisions taken by the Central Bank are final at the administrative level but may be appealed to the courts. The provision stipulates that appeal to the courts shall not postpone the legal effect of a decision as provided for in the first sentence. Furthermore, Article 24 of the bill contains a special rule stating that such proceedings shall be initiated within three months of the date the parties were notified of the decision.

On Article 8

The provision stipulates that offshore króna assets held in accounts subject to special restrictions shall be subject to reserve requirements. This means that an amount equal to the total balance of the deposit money bank's accounts subject to special restrictions must be invested in Central Bank of Iceland certificates of deposit. It is required that deposit money banks fulfil the reserve requirements within the same business day. If this is not done, the Central Bank is authorised to direct-debit the amount of the shortfall from the deposit money bank's current account with the Bank on the following business day. Furthermore, it is assumed that certificates of deposit will be held in the customer's custodial account with a financial institution, which in turn will hold the securities in its administrative account with the Central Bank of Iceland.

In Paragraph 5, it is recommended that it be prohibited to hypothecate any type of offshore króna assets and Central Bank of Iceland certificates of deposit. This restriction is considered necessary because of the danger of circumvention, which could materialise as the capital controls are eased further.

On Article 9

This Article gives owners of offshore króna assets temporary permission to withdraw, on a voluntary basis, part or all of the funds from accounts subject to special restrictions in order to use the funds for foreign exchange transactions with the Central Bank of Iceland at a special reference exchange rate. It is considered appropriate to give owners of offshore krónur the flexibility to exit for a limited period of time after the Act enters into force; the time limit for this authorisation is set at 1 November 2016. The reference exchange rate is defined as a rate of exchange of the króna versus the euro that is set at ISK 220 per euro; cf. Article 2, Item 10.

In Paragraph 2 of the Article, owners of offshore króna assets falling under Article 2, Items 1(e)-1(g) are granted a special authorisation to carry out foreign exchange transactions with the Central Bank of Iceland at the reference exchange rate, without prior sale of the offshore króna assets. This gives owners of these offshore króna assets an opportunity to reduce the potential negative impact on the market value of the offshore króna assets, as it is clear that the majority of the offshore króna assets according to Article 2, Items 1(e)-1(g) are not as liquid as those falling under Items 1(c) and 1(d). It is assumed that settlement of the transactions will take place with delivery, by the owner of the offshore króna assets to the Central Bank, of an amount equal to the market value of the offshore króna assets less the product of the market value of the offshore króna assets and a percentage of the Central Bank's official central exchange rate of the króna versus the euro on 20 May 2016 and the reference exchange rate, which can be expressed as follows:

$$\left(1 - \frac{\text{Opinbert miðgengi Seðlabanka Íslands (EUR)}}{\text{Viðmiðunargengi}}\right) * \text{Markaðsvirði aflandskrónueignar}$$

Translation of formula:

$\left(1 - \frac{\text{official Central Bank EURISK exchange rate}}{\text{reference exchange rate}}\right) * \text{market value of offshore króna assets}$

Paragraph 3 discusses how the market value of the offshore króna assets in the sense of Paragraph 2 shall be determined.

Paragraph 4 reiterates that the offshore króna assets used as a basis for transactions according to the provision shall be exempt from the restrictions contained in the bill of legislation, upon prior confirmation by the Central Bank of Iceland.

On Article 10

In this provision, it is recommended that owners of offshore krónur according to Article 2, Item 1(a) be authorised to make withdrawals from accounts subject to special restrictions or accounts with the Central Bank of Iceland that are subject to the same restrictions, in order to invest in Central Bank of Iceland certificates of deposit. The certificates of deposit will bear 0.5% interest for the first 12 months from the date of issue. At that point, the interest rate will be reviewed by the Central Bank of Iceland, and further reviews will take place every 12 months. It is assumed that such certificates of deposit will be held in the deposit money bank's administrative account with the Central Bank of Iceland. In the provision, it is assumed that the sales proceeds, redemption value, and interest on certificates of deposit will be paid to accounts subject to special restrictions.

On Article 11

In Paragraph 1 of the Article, it is recommended that it be permissible to transfer funds between accounts subject to special restrictions. This enables account owners to transfer funds among themselves. It is not considered necessary to restrict such movement of capital if it takes place within this set of owners, but it is clear that this could lead to increased concentration of ownership of offshore króna assets.

Paragraph 2 of this Article recommends that parties be able to withdraw accrued interest, indexation of interest, and dividend payments, upon prior confirmation from the Central Bank of Iceland. Movement of capital due to payments of interest, indexation, and dividend payments are classified under the current account balance and therefore are governed by the same principles as trade in goods and services, according to the Foreign Exchange Act, no. 87/1992. As a result, it is considered most appropriate that parties be authorised to withdraw funds deriving from such payments from their specially restricted accounts. This arrangement has a precedent in Article 13(j), Paragraph 1 of the Foreign Exchange Act, no. 87/1992, which states that cross-border movement of capital and related foreign exchange transactions, including payments of interest, indexation, and dividends, are exempt from the restrictions contained in the Act. It is recommended that withdrawals of interest be limited to interest payments on deposits held in accounts subject to special restrictions, bonds and bills according to Article 2, Items 1(c), 1(e), and 1(f), and Central Bank of Iceland certificates of deposit. Indexation in the sense of this provision refers to indexation of interest and not indexation of principal. Furthermore, it is recommended that withdrawals of dividends be limited to dividend payments deriving from profits on a company's regular operations. The capital controls introduced on 28 November 2008 take account of the international obligations to which Iceland is a party and are based on the division of the balance of payments into the current account balance and the capital and financial account balance. Payments falling under the capital and financial account are generally restricted by the Foreign Exchange Act, but payments falling under the current account balance are generally permitted unless explicitly prohibited. Dividend payments, including in the sense of the Act on Public Limited Companies, no. 2/1995, can entail transfers falling under the capital and financial account balance; therefore, it is not a given that such payments will be unrestricted. For example, reinvested earnings are classified under the capital and financial account. If dividend payments are made that are based on the sales proceeds of an investment, such dividend payments fall under the capital and financial account. Profits from a company's regular operations therefore refer to profit from the actual operation of the company, and not revenues deriving from the sale of assets in excess of sales gains, profits due to debt write-offs, asset valuation increases, share capital reductions, or other comparable factors. On

the other hand, distribution of dividends not restricted by the Foreign Exchange Act is based on profits from regular operations and the carry-over of profits from regular operations in previous years, assuming that the profits have not been used for reinvestment; for instance, in company infrastructure. It is recommended that the Central Bank be authorised to refuse confirmation if the purpose of the distribution underlying the dividend payments appears to be to circumvent the restrictions contained in the Act. This entails that the Central Bank is authorised to determine whether the payment derives from the company's operating revenues at any given time, with reference to its regular operations.

On Article 12

In Paragraph 1, it is recommended that individuals who are beneficial owners of offshore króna assets – that is, owners of króna-denominated deposits with parties falling under Article 2, Item 1(a) – be authorised, without expiry, to make withdrawals from accounts subject to special restrictions, upon prior confirmation from the Central Bank of Iceland. It is required, however, that the individual in question have been the beneficial owner of the offshore króna assets and have been the owner continuously since 28 November 2008. The aforementioned requirements can be met by presenting a confirmed bank statement showing the individual's uninterrupted ownership of the funds in question since 28 November 2008. This requirement is deemed necessary to limit the possibility of circumvention.

In Paragraph 2, it is recommended that an individual who is the owner of offshore króna assets according to Article 2, Item 1(b) at the time this Act enters into force be authorised to withdraw funds from accounts subject to special restrictions upon obtaining prior confirmation by the Central Bank of Iceland.

Paragraph 3 sets the maximum withdrawal per calendar year at 6,000,000 kr. per individual, which is in line with the authorisation for living expenses for non-resident individuals provided for in Article 13(b), Paragraph 2 and Article 13(c), Paragraph 3 of the Foreign Exchange Act, no. 87/1992. It is not assumed, however, that the parties in question must demonstrate that the funds will be used for living expenses abroad.

On Article 13

This provision assumes that the Central Bank of Iceland is authorised to charge fees for services in connection with the custody of securities held in administrative accounts with the Bank. It is also assumed that fees according to this provision may not exceed the Central Bank's actual cost incurred in connection with custody and administration of the securities.

On Article 14

This Article assumes that the Central Bank of Iceland will carry out supervision to ensure compliance with the Act. To this end, it is recommended that it be required to provide the Bank with all information and documentation that it considers necessary in order to carry out this supervision satisfactorily, irrespective of obligations to observe confidentiality. It is also recommended that the Central Bank be authorised to take the necessary measures to ensure that the parties obligated by this bill of legislation comply with it and ensure that the offshore króna assets are segregated and placed securely in accounts subject to special restrictions. In this context, it is recommended that the Central Bank be authorised to conduct on-site inspections.

On Article 15

This Article lays down the confidentiality requirements applying to employees involved in implementing the Act. The provision is comparable to that in Article 15 of the Foreign Exchange Act.

On Article 16

In this provision, it is recommended that in supervising the implementation of this Act, the Bank be authorised to gather information and documentation from other authorities, irrespective of their obligation to observe confidentiality. This Paragraph is modelled on Article 14, Paragraph 4 of the Act on Official Supervision of Financial Activities, no. 87/1998. According to the provision, other authorities' duty to observe confidentiality should not stand in the way of the Central Bank's investigations, and the bank has, among other things, the right to gather documents and other data that the other authorities may possess. It is clear that other institutions carry out tasks similar in nature to those of the Central Bank and could be in possession of information on, for instance, connections between parties and other factors that could be useful in Central Bank investigations. It is emphasised that any such information that the Central Bank may

acquire from other authorities falls under the confidentiality provisions contained in Article 15 of the bill of legislation. Accordingly, the information is covered by the same confidentiality with respect to the Central Bank as it is with respect to the other authorities.

In monitoring compliance with the Foreign Exchange Act, the Central Bank may need to gather information from abroad in order to carry out its tasks. As a result, it is considered appropriate to emphasise, in Paragraph 2, that the Central Bank may request the assistance of the Financial Supervisory Authority in gathering such information in cases where the Financial Supervisory Authority is authorised to gather it and the Central Bank is not. For the same reason, it is considered appropriate to reiterate the authorisation to engage in reciprocal exchange of information with public entities abroad, as is provided for in the Act on the Central Bank of Iceland.

On Article 17

In this Article, it is recommended that the Central Bank be authorised to impose coercive measures in the form of per diem fines if parties do not comply with the Bank's requests for information and documentation, deliberately provide the Bank with incorrect information, or do not act on demands for remedial action within a suitable time frame. This authorisation applies to both residents and non-residents, irrespective of whether they are individuals or legal entities. The provision is based on a similar provision contained in Article 11 of the Act on Official Supervision of Financial Activities, no. 87/1998, and Article 15(h) of the Foreign Exchange Act, no. 87/1992. It is recommended that the amount of the per diem fines range from 50,000 kr. to 50,000,000 kr. per day. Furthermore, it is recommended that the per diem fines collected according to this provision revert to the Treasury, less the costs incurred in collecting them.

On Article 18

This Article provides for measures that the Central Bank can adopt in response to illegal conduct. It is recommended that the Bank be authorised that conduct considered to be in violation of this Act be discontinued immediately. The provision is intended to enable the Bank to halt or prevent violations and to specify remedial action. It is directed at any type of actions or measures that are considered in contravention of the Act, including contracts, terms and conditions, and other instruments. If the parties concerned do not comply with the Bank's demands, the Bank is authorised to impose per diem fines. The provision applies both to resident and non-resident legal entities and to resident and non-resident individuals.

On Article 19

This provision stipulates that specified violations of the provision of the bill will be punishable by fines. More specifically, it authorises the Central Bank of Iceland to impose administrative fines on individuals or legal entities that violate specified provisions of the bill of legislation or, as applicable, any rules that may be adopted on the basis of the Act, if the bill is passed. The fine framework in this provision differs according to whether the party concerned is an individual or a legal entity. It is necessary to stipulate penalties for violations against these provisions; otherwise, there is the risk that the parties in question will ignore their obligation to transfer their offshore króna assets to accounts subject to special restrictions or will circumvent restrictions on withdrawals from such accounts, and that the provisions will therefore not have the intended effect.

Furthermore, violations against Articles 4-6 of the bill, which focus on the transfer of offshore króna assets and the authorisation for withdrawal, are considered particularly serious, and penalties for such violations could be subject to fines ranging up to five times the amount of the unauthorised transaction. This is considered necessary in order to have the necessary preventive effect, so as to avoid jeopardising the interests the bill is designed to protect.

On Article 20

This Articles recommends that the Central Bank of Iceland be authorised to conclude cases by settlement. Settlement entail admission by the party that he has violated the law and payment of a fine determined by the Central Bank, or compliance with other requirements set by the Bank. The amount of the fine in cases concluded by settlement could be considerably lower than the amount of an administrative fine, and the reduction is determined, in part, by whether the party has attempted to remedy the violation or has taken appropriate remedial action, and by the stage of the case at which the settlement is reached. It is assumed that the consent of the parties is required in order to conclude a case by settlement. It is also

recommended that settlement be binding for the party to a case once it has been accepted and its substance confirmed by the party's signature. It is assumed that the Central Bank of Iceland can lay down more detailed rules on the implementation of this provision.

On Article 21

In this Article, it is recommended that provisions on an individual's right not to incriminate himself during an administrative investigation be enshrined in law. While such a general provision is not contained in the Administrative Procedures Act, it is considered desirable that the substance of it be legalised, as administrative sanctions, which can be considered penalties for a "criminal charge" in the sense of Article 6, Paragraph 1 of the European Human Rights Convention, may be imposed for violations of the Act. The provision only applies if there is a "reasonable suspicion" that the party in question has committed a criminal act. It is considered appropriate to assume that the authorities' suspicion must be strong enough that there is reason to assign the party in question the legal position of a suspect in accordance with the Code of Criminal Procedure. Therefore, there must exist circumstances or evidence that indicates the guilt of the party in question and that the investigation will be direct at the party in particular and not a larger group of individuals. If there is a reasonable suspicion that the party in question has committed a criminal act, he is only required to provide information if the possibility can be excluded that the information could have significance for a decision on his guilt. For example, he could be required to provide information on his name and address. The provision is comparable to those in Article 112 of the Act on Financial Undertakings and Article 15(c) of the Foreign Exchange Act.

On Article 22

This Article discusses expiry and recommends that the Central Bank of Iceland's authorisation to impose administrative fines shall expire when five years have passed from the conclusion of the conduct concerned. It is also stipulated that this expiry shall be interrupted when the party is notified that his case is under investigation by the Central Bank. Moreover, it is stipulated that the Central Bank of Iceland shall notify the party of an investigation of an alleged violation unless it is clear that the party has already become aware of it. The interruption of the deadline has legal effect vis-à-vis all parties that have participated in the violation. This provision is in line with the requirement in the Administrative Procedures Act concerning the authorities' obligation to provide notification.

On Article 23

This provision guarantees the Central Bank the investigative measures that are deemed necessary, including the right to request information and the authorisation for the Bank to conduct special investigations and confiscate documents in accordance with the provisions of the Code of Criminal Procedure. The wording of the provision is based on a similar provision contained in the Act on Official Supervision of Financial Activities, no. 87/1998, and the Foreign Exchange Act, no. 87/1992.

On Article 24

According to this provision, a party that does not wish to abide by the Central Bank's decision may initiate legal proceedings before the courts within three months of the date the decision was made known to him. Such initiation of legal proceedings does not postpone the legal effect of the decision or the authorisation for enforcement, except in instances according to Article 17, Paragraph 2, which states that it is prohibited to collect per diem fines before a court judgment has been handed down if suit has been filed to demand invalidation of a decision by the Central Bank on per diem fines and the plaintiff has requested expedited handling. A comparable provision can be found in Article 18 of the Act on Official Supervision of Financial Activities and in Article 15(h) of the Foreign Exchange Act. This provision is based on the conviction that it is important for a party not willing to abide by the Central Bank's decision to be able to file suit to demand its invalidation in court. The Article also provides for a three-month filing deadline, in the same manner as in the Act on Official Supervision of Financial Activities and the Foreign Exchange Act, as it is considered that cases involving disputes about Central Bank decisions be adjudicated by the courts as soon as possible.

On Article 25

The Article requires no explanation.

On Article 26

The Act on the Law and Ministerial Gazette and the Official Gazette stipulates that statutes shall be binding on all parties beginning on the day after the date of their publication in the Law and Ministerial Gazette, where the instructions were published. Due to the nature of the provisions of this bill of legislation, it is necessary that the Act be binding upon all parties immediately upon publication.

On Article 27

Upon the entry into force of this Act, the following amendments shall be made to other Acts.

Item 1 recommends amendments to the Foreign Exchange Act, no. 87/1992, with subsequent amendments. First is an amendment to Article 13(e) of the Act. It is recommended that a new sentence be added to Paragraph 2 of this provision. According to Article 13(e), Paragraph 2, sales proceeds from transactions with financial instruments issued in domestic currency, according to Paragraph 1 of the provision, which take place between residents and non-residents and are settled in Iceland, must be deposited to the seller's account with a financial undertaking in Iceland. It is recommended that there be an explicit provision requiring that the sales proceeds of financial instruments falling under the definition of offshore króna assets according to the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions be deposited to an account subject to special restrictions or an account with the Central Bank that is subject to the same restrictions according to the same Act.

Second of all, an amendment is recommended to Article 13(g), Paragraph 1 of the Foreign Exchange Act, no. 87/1992, which states that borrowing and lending between residents and non-residents for purposes other than cross-border trading in goods and services are prohibited unless such borrowing and lending take place between undertakings in the same conglomerate. It is recommended that the exemption be limited to borrowing and lending between companies in the same group in foreign currency. Therefore, intragroup lending in domestic currency will not be permissible unless it fulfils the general requirements contained in Article 13(g) of the Act concerning cross-border borrowing and lending.

Third, it is recommended that Article 13(j), Paragraph 6 of the Act be amended so as to state explicitly what is considered a dividend payment in the sense of the provision, so that the term dividend applies only to dividends deriving from profits on the company's regular operations. It is also explained that the term profits on regular operations refers to profits on the company's operations and not profits on sales of assets in excess of sales gains, profits from debt write-offs, profits due to valuation increases, or those due to comparable factors such as share capital reductions, etc. It is also recommended that the Central Bank be authorised to refuse confirmation if the purpose of the distribution underlying the dividend payments appears to be to circumvent the restrictions contained in the Foreign Exchange Act, no. 87/1992. This entails that the Central Bank is authorised to determine whether the payment derives from the company's operating revenues at any given time, with reference to its regular operations.

Fourth, it is recommended that five new paragraphs be added after Article 13(n), Paragraph 9, and that these be Paragraphs 10-14 of the provision, which shall provide for exemptions from the restrictions contained in the Foreign Exchange Act for those capital transfers and, as applicable, those foreign exchange transactions with offshore króna assets that are provided for in the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions.

Fifth, it is recommended that two new sentences be added after Article 13(p), Paragraph 1, Item 3 of the Act, stating that in connection with its supervision according to the Foreign Exchange Act, no. 87/1992, the Central Bank may conduct on-site inspections or request information in this matter as often as it deems necessary. It is also stated that a decision to conduct an on-site inspection may be implemented via enforcement proceedings.

Item 2 recommends an amendment to the Act on Electronic Registration of Title to Securities, no 131/1997, with subsequent amendments. It is recommended that a Temporary Provision be added to the Act, stipulating that the Central Bank of Iceland has sole authority to act as an intermediary for the registration of title to securities according to Article 2, Items 1(c)-1((g) of the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions whose custody is transferred to the Bank. This ensures that custody of the securities will not be transferred to another account operator, as is otherwise assumed to be permissible under the Act.