Progress of the Plan for Removal of Capital Controls

This report is published by the Minister of Finance and Economic Affairs as provided for in Paragraph 2 of the Temporary Provision I in Act No. 87/1992 on Foreign Exchange, which reads as follows:

> The Minister shall make public a report on the progress of plans to remove restrictions on cross-border capital movements and foreign currency trading at six-month intervals until such restrictions are finally removed. The report referred to in the first sentence shall be published for the first time within six months of the entry into force of this act.

Former reports are available on the Ministry of Finance and Economic Affairs' website.[1]

A first draft of a bill for a new foreign exchange legislation has been published

A working group on the revision of the Foreign Exchange Act has submitted a preliminary draft of a comprehensive bill of legislation on foreign exchange. The bill reaffirms the principle that cross-border trade should be free. However, it is envisaged that measures may be taken which derogate from the principle in order to prevent economic or financial instability. First, it is proposed that under extraordinary circumstances, where there is significant risk that financial stability will be disrupted by capital flows and other measures are not available, it will be possible to resort to capital controls, similar to those that current laws and regulations authorise. Second, the Central Bank of Iceland (CBI) is authorised, subject to the approval of either the Minister of Finance and Economic Affairs or the Central Bank's Financial Stability Committee, to apply certain precautionary macroprudential tools. In particular, the CBI can set rules on:

1. Special reserve requirement (SRR), i.e. rules on new inflows of foreign currency;
2. Foreign currency-linked lending by credit institutions to non-hedged borrowers;
3. derivatives transactions involving domestic currency against foreign currency.

The above measures are based on the current Foreign Exchange Act and rules on Foreign Exchange. Amendments are proposed to the special reserve requirement, such that its conditions can solely be met through repurchase agreements with

[1] https://www.government.is/topics/economic-affairs-and-public-finances/progress-of-plans-to-remove-capital-controls/

the CBI. The arrangement e.g. entails that investors can be released from the SRR without changing its indended effect. It is also proposed that the CBI submit to the Minister of Finance and Economic Affairs and publish a report on the application of the SRR every six months, as long as it is in effect.

It is further proposed that the CBI will continue to be authorized to set rules on intermediation in foreign exchange transactions for parties that have statutory aurhorisation to act as intermediaries in foreign exchange transactions

According to the draft bill, the police authorities, the tax authorities, and Statistics Iceland will have access to information received by the Central Bank on foreign exchange transactions, cross-border movement of capital and cross-border payments. The proposal is in line with recommendations of the Minister of Justice‘s steering group, which were set out in an action plan on measures against money laundering and terrorist financing from August 2019.

The draft bill takes into account the changed institutional structure of financial market supervision. It is proposed that decisions concerning violations of the law will be made by the CBI‘s Financial Supervisory Committee.

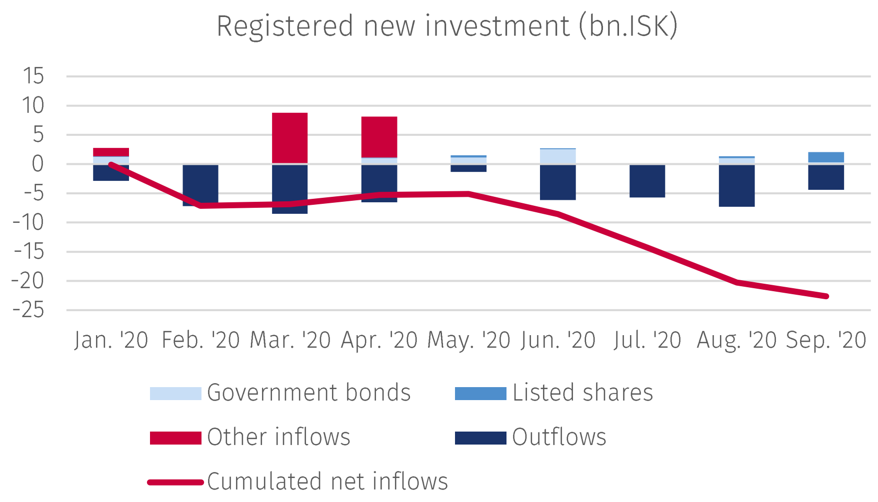
The draft bill further proposes that the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions be repealed. Thus, special obligations in trading with offshore króna assets will be eliminated and the offshore and onshore markets will merge. Holders of offshore króna assets can already fully dispose of their assets on the condition that the assets are exported to an account abroad. This arrangement was intended to safeguard the effectiveness of the SRR. However, as the SRR is currently not applied, the above conditions are no longer relevant and it is therefore considered appropriate to abolish them. The total offshore króna asset position amounts to 50 bn ISK and is almost unchanged from the publication of the last report on the progress of the plan for removal of capital controls in June this year.

Offshore króna assets	Market value (bn. ISK)
Treasury bonds and bills and other gov‘t guaranteed bonds	7.1
Deposits and Central Bank CDs	36.9
Other securities and unit shares	5.6
Total amount	**49.6**

Source: The Central Bank of Iceland

Non-resident investors sell Treasury bonds

Net inflow of foreign capital for registered new investment in Iceland has slowed. In the first nine months of the year, inflows amounted to 27 bn.ISK, compared with 68 bn. ISK in the same period last year. Outflows of new investment has also been stronger this year. Thus, net inflows of foreign capital into new investment amounted to 29 bn. ISK in the first nine months last year, compared to 23 bn.ISK net outflows this year. The outflows stem primarily from Treasury bond sales by non-resident investors. Significant other inflows in March and April this year relate to a non-resident investor's acquisition of a stake in a domestic real estate company. Foreign investors now hold 9% of outstanding treasury bonds issued in ISK, which is low both historically and internationally.



Source: The Central Bank of Iceland

Remaining restrictions

Restrictions on the following transactions remain in place:

1. Cross-border transfers of domestic currency due to transactions with offshore króna assets that are subject to special restrictions;

2. Foreign exchange transactions carried out between residents and non-residents without the intermediation of financial institution, if domestic currency is a constituent of the transaction;

3. Derivatives transactions involving domestic currency against foreign currency and undertaken for non-hedging purposes or for hedging purposes in relation to issuance of ISK debt abroad, sometimes referred to as glacier bonds.

The publication of the report on the progress of the plan for removal of capital controls will be stopped once a bill on a new comprehensive Foreign Exchange Act is passed in Parliament.