



Amendments to the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions.

What are offshore króna assets?

The Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions entered into force in May 2016. The Act was an important element in the authorities' capital account liberalisation strategy. It provided for special treatment of specified króna assets, referred to as *offshore króna assets*, which it was considered necessary to subject to continued restrictions entailed in the capital controls, so as to make it possible to take the next steps towards lifting the capital controls on Icelandic households and businesses.

The Central Bank estimates the stock of offshore króna assets at about 84 b.kr. They fall into the asset classes listed in the following table.

| Offshore króna asset class | Market value (b.kr.) |
|--|-----------------------------|
| Treasury bonds and bills; other Government-guaranteed securities | 39.5 |
| Deposits and Central Bank certificates of deposit | 36.7 |
| Other securities and unit shares | 7.9 |
| Total | 84.0 |

What amendments are being proposed?

The amendments entail expanded authorisations for withdrawals from account subject to special restrictions, so that all offshore króna holders will be given the chance to release their offshore króna assets. The expanded authorisations are of three types and entail the following:

General authorisation: An authorisation for all holders of offshore krónur to release their offshore króna assets in order to purchase foreign currency and export it to an account abroad. The authorisation extends only to deposits and certificates of deposit; however, owners of other types of offshore króna assets, such as stocks or bonds, will have the option of selling them or, as applicable, holding them until maturity if they wish to exercise their authorisation.

Authorisation in connection with continuous ownership: An authorisation for offshore króna holders that have owned offshore króna assets continuously since before 28 November 2008 to release those offshore króna assets from the legal restrictions. It is not required that foreign currency be purchased, as with the general authorisation; instead, it will be permissible to allocate the assets in Iceland. This authorisation is subject to confirmation by the Central Bank of Iceland that the continuous ownership requirement has been satisfied.

Authorisation for individuals: An authorisation for individuals to withdraw up to 100 m.kr. from accounts subject to special restrictions. This authorisation extends to deposits and Central Bank of Iceland certificates of deposit. It is not required that foreign currency be purchased, as with the general authorisation; instead, it will be permissible to allocate the assets in Iceland. This authorisation is subject to confirmation by the Central Bank of Iceland that an individual is the beneficial owner of the funds.

Why is it timely to grant expanded authorisations for withdrawals?

When the Act entered into force, it was foreseen that the restrictions it provided for would be temporary measures and that the authorities would once again aim to lift the capital controls on offshore króna assets once resident entities' asset portfolios had been better rebalanced.

The authorities have worked systematically to solve the problem represented by offshore króna assets during the capital account liberalisation process. The Central Bank's June 2016 auction of foreign currency in exchange for offshore króna assets in cash, the temporary authorisation for offshore króna holders to conduct foreign exchange transactions with the Bank later that year, the Bank's transactions with the largest owners of offshore krónur under an agreement providing for the Bank's purchase of their offshore króna assets in H1/2017, and expanded authorisations for withdrawals from accounts subject to special restrictions have facilitated outflows of offshore krónur without adversely affecting the domestic foreign exchange market. With these measures, the stock of offshore króna assets has been reduced substantially. In accordance with the authorities' 2015 capital account liberalisation strategy, large steps were taken in 2016 towards liberalising capital controls on households and businesses, and in 2017 most of the capital controls were lifted. At the time the Act entered into force, offshore króna assets were estimated at 319 b.kr., or about 15% of GDP, but as a result of the aforementioned measures, they are now estimated at 84 b.kr., or 3.1% of GDP. Therefore, economic conditions now warrant lifting the capital controls on offshore króna assets. Care is being taken to ensure that the liberalisation does not undermine the

efficacy of the capital flow management measure (the special reserve requirement on capital inflows).

Why is this being done in this manner?

The aim of the changes is to lift the capital controls on offshore króna assets without undermining the efficacy of the special reserve requirement on capital inflows. The general authorisation requires that foreign currency be purchased and delivered abroad, thereby maintaining the separation of the onshore and offshore markets and ensuring that offshore króna holders wishing to invest in Iceland receive the same treatment as other investors with respect to the special reserve requirement.

The authorisation pertaining to continuous ownership does not require the purchase of foreign currency; instead, it allows for the allocation of offshore króna assets in Iceland. From the outset, individuals who satisfy the continuous ownership requirement have had such an authorisation, which is based on precedent concerning exemptions from the Foreign Exchange Act in order to transfer offshore krónur to Iceland. The main rationale for the exemptions and the authorisation was that owners of these krónur had not bought them at deep discounts in the offshore market after the capital controls were imposed. The amendment expands this authorisation to include legal entities and is not subject to any maximum amount.

Nor does the authorisation for individuals require the purchase of foreign currency; instead, it allows for the allocation of offshore króna assets in Iceland. It is not considered necessary to impose such a requirement, as individuals are already authorised to invest for up to 100 m.kr. without satisfying the special reserve requirement.

Will these amendments affect the exchange rate of the króna?

The Central Bank is well prepared to respond to short-term fluctuations in the foreign exchange market, as it holds large international reserve that are mostly financed domestically. Because the foreign currency outflows that could occur because of this liberalisation are connected to a legacy problem rather than to underlying economic conditions, there could be greater cause to mitigate the impact on the exchange rate than there would be otherwise. The extent to which the amendments affect the exchange rate of the króna in the absence of mitigating measures by the Bank will depend on how large a share of offshore króna holders choose to purchase foreign currency and how the transactions are spread over time.

Does the exercise of the authorisations require Central Bank confirmation?

The authorisation in connection with continuous ownership and the authorisation for individuals require confirmation by the Bank. It is assumed that applications will be submitted via e-mail. Applications for confirmation of continuous ownership must be accompanied by documentation demonstrating continuous ownership; i.e., an account statement dating from before 28 November 2008 and information on the assets when confirmation is requested. An individual's application for confirmation must be accompanied by documentation demonstrating that the individual concerned is the owner of the funds; i.e., a recent account statement. The Central Bank will set more detailed rules on implementation.