

## The Eurozone Crisis Du Jour: Cyprus

Banks in Cyprus opened today at 10 am GMT, 10 days after they closed, as Cyprus became the first country in the Eurozone to implement capital and exchange controls in an attempt to prevent a run on the nation's banks and a collapse of its financial system.

These protective controls have been justified by many of the key players as an urgent "one-off" solution to the latest Eurozone crisis but others have raised concern that they may be used as a precedent for the future. This note examines the exchange controls that have been imposed and publicised by Cyprus to date, and provides some insights as to their nature and status under European and international law.

### Background

The legislation imposing the capital controls in Cyprus has been implemented very quickly and the restrictions are expected to be in force for seven days. Capital controls are generally prohibited under EU and international law, as further discussed below. If the capital controls remain in force for longer than the initial seven-day period, it is highly likely that the law will be revised to counter any evasion techniques that develop and to address any legal challenges that are made to the law.

This is the first capital and exchange control regime to be implemented in the Eurozone and there is likely to be a period of uncertainty in the commercial sphere outside Cyprus as corporations digest the likely impact on their operations in or in relation to Cyprus, and assess how the capital controls are enforced by the Central Bank of Cyprus.

The capital controls will initially be in force for seven days from 28 March 2013. The capital controls are subject to certain exemptions, and will not apply to:

- any new money deposited from abroad after 27 March 2013;
- cash withdrawals via debit or credit card from extra-territorial accounts; or
- diplomatic missions.

### Summary of Capital Control Provisions

- Individuals will not be permitted to withdraw more than €300 per day from any one bank, unless they have withdrawn less than €300 on the previous day.
- There is a prohibition on cashing cheques, although depositing cheques is permitted.
- There is a prohibition on non-cash transactions, or any extra-territorial transfer of money, subject to certain exceptions, including the following:
  - Payments for commercial imports in the ordinary course are permitted, providing that evidentiary documents are presented. Payments from €5,001 to €200,000 must be approved by the Central Bank of Cyprus.
  - Subsistence and tuition expenses of up to €10,000 per quarter are permitted for (i) Cypriot residents studying abroad and (ii) for the immediate family of Cypriot residents, again with

the presentation of relevant evidence, and provided that all payments are made to the beneficiary.

- Persons travelling abroad are permitted to use credit or debit cards up to the amount of €5,000 per month per person.
- Payment of salaries for employees working outside the Republic of Cyprus is permitted.
- There is a prohibition on the premature termination of maturing fixed term deposits.
- There is a prohibition on transporting banknotes abroad in euros or any other currency, above the amount of €3,000 per person, per trip. The Head of Customs Operations is responsible for the implementation of this measure.
- Financial transactions, payments or transfers that have not been completed prior to the issue of the decree are also subject to these restrictions.
- There is a prohibition on the execution of payments without cash or money transfers by credit institutions that aim to circumvent the restrictions.
- The restrictions apply to all accounts, payments and money transfers, regardless of currency.
- The decree is in effect for seven days, starting with the date of its publication at the Official Newspaper of the Republic (i.e. seven days from 28 March 2013).
- According to newspaper reports in Greece, all those who have their ordinary residency, and all legal persons who have their registered office, in Cyprus will be obliged to transfer to Cyprus all the monies acquired from exports or sales of property in the country, within two weeks of the relevant transaction. This is effectively a repatriation provision intended to draw cash back to Cyprus. This additional provision is as yet unconfirmed by other sources but is a plausible inclusion within a regime of capital and exchange controls.

## Exchange Controls and EU and International Law

### *EU Treaty*

One of the fundamental principles of the European Union is the support for the free movement of capital between member states. An imposition of capital controls that restricts this free movement of capital has the potential to undermine any remaining confidence in the currency union of the Eurozone member states.

Article 63 of the Treaty on the Functioning of the European Union (the “EU Treaty”) states that “all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited”. “Restrictions” has been widely defined by the European Court of Justice, and would be likely to catch the Cypriot capital controls.

The Cypriot government has been permitted by the European Commission to introduce the capital controls in apparent violation of Article 63 as it is arguable the capital controls are “justified on grounds of public policy or public security” under Article 65 (1)(b) and are required in the public interest. Nevertheless, relying

on this exception is not entirely fool proof, since EU case law establishes that restricting the free movement of capital cannot be undertaken for purely economic reasons or for the general financial interests of a Member State.

### *IMF Agreement*

The IMF Articles of Agreement state at Article VIII section 2 that “no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions”. Iceland was permitted by the IMF to impose capital controls in 2008, which still remain in force, and IMF support for the Cypriot capital control regime is important given that IMF-approved measures are far more likely to be recognised and enforced outside the EU.

### *Bilateral Investment Treaties*

The Cypriot capital control regime may be in breach of one or more of the Bilateral Investment Treaties (“BITs”) entered into by Cyprus. BITs frequently contain protective provisions for the benefit of foreign investors, for example, holders of bonds or other types of sovereign debt. These provisions grant foreign investors rights relating to the repatriation of profits and the right to withdraw money from the counterparty state. BITs also often oblige states to fully compensate investors for any expropriation. These protections are tougher than under public international law. The more recent BITs frequently include provisions that permit investors to commence arbitration proceedings directly against states to enforce their rights in respect of their foreign investments. Such disputes are typically referred to the International Centre for the Settlement of Investment Disputes, which is affiliated with the World Bank.

The types of investments that are protected by the BITs typically include bonds and claims to money. In the mass claim brought by Italian holders of Argentinian sovereign bonds in August 2011, it was held by a majority of the tribunal that bonds constituted an “investment” for the purpose of protection under the BIT between Argentina and Italy. The protection was also extended by the BIT to the security entitlements held by the claimants in the bonds.

As of 1 June 2012, Cyprus had entered into 27 BITs. The operation of the capital controls imposed by Cyprus may contravene clauses in any applicable BITs and if so, foreign investors may have rights to claim directly against the Cypriot state. The existence and extent of any potential BIT claims has not yet been assessed and these are only likely to emerge once we have had an opportunity to observe how the Cypriot capital controls work in practice and confirm the length of time for which they are in force. Nevertheless, investors have sought to rely on the protective provisions in BITs in order to enforce their rights against defaulting states. Actions have already been threatened on the basis of breach of BITs against Spain, the Czech Republic and Italy.