Protection of Foreign Direct Investment in Cyprus

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The Cyprus bail-in and the new legal landscape on failing banks in the EU

Despite the Eurozone currently reported to be out of recession, developments in the spiraling Eurozone crisis during 2013, involving Cyprus and particularly the Eurogroup consensus imposing a haircut on bank deposits in Cypriot banks, have caused renewed interest and discussion over how foreign investments are protected under Cyprus law and European Union (EU) law. The means in which the 2013 banking crisis was dealt with in Cyprus, is of tantamount importance, as it has shed light on the practical aspects of how failing banks will be rescued across the EU.

In fact, the European Commission had as of 2102 made public plans to use the bail-in approach in the rescue of failing banks. Seeking to distance Member States from dependency on the European Stability Mechanism (ESM), EU policy is shifting towards dealing with failing banks in a manner that preserves financial stability and protects taxpayers. This should occur through financial support from resolution funds sourced from the banking sector itself and not a Member State's taxpayers.

It is now evident that in the EU, depositors and shareholders of banking institutions that are failing should not expect a State bail-out (whether directly or through IMF/EU-sponsored funds). On the contrary, depositors with over EUR100.000 in a single account in a failing bank should expect to bail-in to save such bank.

This new reality shall soon be transformed into EU legislation and national transposing legislation soon thereafter. The proposed EU directive on failing banks is aimed at providing national authorities with common powers and instruments to pre-empt bank crises and to resolve any financial institution in an orderly manner in the event of failure, whilst preserving essential bank operations and minimizing taxpayers' exposure to losses. The directive is envisaged establish a range of instruments to tackle potential bank crises at three stages: preparatory

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and preventative, early intervention, and resolution.

Institutions would be required to draw up recovery plans, and update them annually, setting out the measures they would take to restore their financial position in the event of significant deterioration. Resolution authorities would have to prepare resolution plans for each institution, setting out the actions they might take if an institution were to meet the conditions for resolution. Such resolution authorities would also have the power to appoint special managers to an institution if its financial situation were to deteriorate significantly or if there were serious violations of the law.

This approach, imminently constituting part of the legal order of the EU, was put into effect in the case of Cyprus, causing considerable losses to depositors (Laiki Bank collapsing and its secured deposits absorbed into the Bank of Cyprus and the latter's depositors suffering a 47.5% haircut on their deposits).

Depositors filed and pursued administrative recourses before the Supreme Court of Cyprus against the primary and secondary legislation giving rise to the bail-in, arguing these were unconstitutional and infringing their constitutional rights. In its Judgment of 17/6/2013, the Supreme Court declined jurisdiction in these cases and held the bail-in to evade administrative judicial review, as it had been a development falling in the sphere of private law.

Does Cyprus protect foreign direct investments?

Foreign direct investments should be distinguished from bank deposits. As soon as such distinction is clear, it is inevitable that foreign direct investment in Cyprus is not only not at risk but is in fact highly protected through sophisticated legal instruments and mechanisms. Distinguishing foreign direct investments from any other amounts injected into Cyprus, or across the EU for that matter (e.g. in the form of bank deposits) has a catalytical role towards the analysis of protection of foreign

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investments.

The 4th Edition of the *OECD Benchmark Definition of Foreign Direct Investment* defines 'foreign direct investment' as a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise.

Cyprus is a jurisdiction actively protecting foreign direct investment. Cyprus, being an established business center and an aspiring financial hub, has ensured that adequate legal protection for foreign investors is afforded. Direct investment protection in Cyprus stems from international law, EU law and Cyprus law itself. Cyprus' accession to the EU has catalytically elevated the efficiency with which foreign investment must be treated.

Broadly speaking, Cyprus adheres to and its legal order has seamlessly transposed all four established types of mechanisms offered by states to foreign investors towards investment protection:

- Multilateral investment treaties
- Bilateral investment treaties
- Investment contracts
- Domestic investment legislation

Which international investment protection rules does Cyprus adopt?

At an EU level, a comprehensive EU investment policy is implemented, allowing the EU to negotiate investment protection agreements itself. Article 207(1) of the TFEU explicitly mentions foreign direct investment as forming part of the common commercial policy, while the TFEU itself establishes the EU's exclusive competence on foreign direct investment.

International investment law aims to protect the owner of

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tangible or intangible assets who transfers them from one country to another to generate wealth from their use in that country. The safeguards relating to the protection for foreign investment and proprietary rights afforded by international investment law comprise the requirement of non-discrimination, the prohibition of confiscatory taxation, the standard treatment of foreign investors, and the doctrine of abuse of rights. Cyprus, a renowned international business center, is a signatory to a significant number of the major international conventions and treaties and has incorporated a plethora of acknowledged concepts and practices of international investment rules into its national legal order.

How do investment treaties protect parties directly investing in Cyprus?

BITs and MITs generally contain similar investor protections. The most common protections found in these instruments are:

- Protection from expropriation without compensation;
- Most favoured nation provisions;
- National treatment provisions;
- Fair and equitable treatment;
- Full protection and security; and
- Free transfer of investment and returns.

How does the Constitution of Cyprus afford protection to investors?

Part II of the Constitution of Cyprus (Fundamental Rights and Liberties) establishes equality amongst all persons, irrespective of their nationality, and safeguards fundamental rights to the same extent as such rights are protected under the European Convention of Human Rights. Both foreign and national investors are offered continuous protection and security in Cyprus and enjoy the same rights and civil liberties, a main aspect of which is the right to access to justice.

Of particular importance in the above context are the right

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to petition and the right to property. The right to petition is guaranteed under Article 29 of the Constitution. Any violation by an administrative authority of a person's fundamental rights entitles such person to request this authority to remedy the situation. Moreover, any administrative act or omission that harms the legitimate interests of any person could be subject to administrative recourse pursuant to Article 146 of the Constitution.

The right of ownership of property is considered as one of the fundamental rights under the Constitution of Cyprus and as such it is clearly and absolutely protected by article 23 of the Constitution.

Is Cyprus a signatory to any international instruments relating to foreign investment?

Cyprus is a signatory to the most important multilateral treaties (MIT) relating to foreign investment, which are briefly described herebelow.

The ***Energy Charter Treaty*** (ECT), signed and ratified by Cyprus, is an international agreement which establishes a multilateral framework for cross-border co-operation. The treaty covers all aspects of commercial energy activities including trade, transit, investments and energy efficiency and is responsible for protection of direct foreign investments. Its provisions protect investors and their investments from political risks involved in investing into a foreign country such as discrimination, expropriation, nationalization, breach of contract, damages due to war, etc.

The ***Multilateral Investment Guarantee Agency*** (MIGA) is an autonomous international organization (under the World Bank), to which Cyprus is a member state. MIGA offers insurance to cover five types of non-commercial risks: currency inconvertibility and transfer restriction; government expropriation; war, terrorism, and civil disturbance; breaches of contract; and the non-honoring of sovereign financial obligations.

The ***International Center for Settlement of Investment***

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Disputes (ICSID), established under the ICSID Convention of 1966, which Cyprus has signed and ratified, is an impartial international forum providing facilities for the resolution of legal disputes between eligible parties, through conciliation or arbitration procedures. ICSID can be utilized for the resolution of any investment dispute arising from an investment made by a national of a contracting state in the territory of another contracting state.

As evidenced by its large membership, dramatically increasing caseload, and by the numerous references to its arbitration facilities in investment treaties and laws, ICSID has come to play an important role in the field of international investment and economic development.

The principal requirements for ICSID arbitration are:

- party consent in writing; and
- the existence of a legal dispute arising from an investment between an ICSID Contracting State and a national of another Contracting State.

Consent to ICSID arbitration by a host state may be contained in national investment legislation, an investment contract or an investment treaty. ICSID is a self-contained system which provides for enforcement in Contracting States. It derives its authority from its status as an institution of the World Bank. Investment disputes may also be heard in other fora.

Of the total investment disputes to have been referred to arbitration, the overwhelming majority were filed with ICSID or under the ICSID Additional Facility (which provides for ICSID arbitration in circumstances where the requirements of the ICSID Convention are not met). However, the Stockholm Chamber of Commerce, the Permanent Court of Arbitration in the Hague and the International Chamber of Commerce (ICC) have also been widely chosen by parties for the settlement of investment disputes.

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Does Cyprus have any Bilateral Investment Treaties with other states?

Cyprus is a party to a number of Bilateral Investment Treaties (BIT) with a plethora of states, amongst others with Armenia, Belarus, Belgium and Luxembourg, Bulgaria, China, Czech Republic, Egypt, Greece, Hungary, India, Iran, Israel, Italy, Jordan, Lebanon, Malta, Montenegro, Poland, Qatar, Romania, Serbia and Seychelles.

BITs govern issues relating to investments carried out by nationals of one contracting state in another contracting state. They guarantee protection for such investments and provide regulations for settling any disputes which may arise therefrom. Nevertheless, despite the dispute resolution advantages that BITs afford, it should be stressed that within the context of its constitutionally enshrined safeguards, an investment-friendly domestic legal regime and its ratification of international legal instruments, the treatment provided for investors from states that are parties to BITs is essentially the same treatment which would be offered by Cyprus to investors from any country.

Is there an authority responsible for promoting foreign investment in Cyprus?

On a strategic level, a measure that undoubtedly reflects the importance of the development of Cyprus as an attractive investment destination has been the establishment of the Cyprus Investment Promotion Agency ('CIPA'), as of January 2008. CIPA is a registered non-profit company limited by guarantee and fully funded by the Government of Cyprus. CIPA has a threefold mandate:

- to promote Cyprus as an attractive international investment center in key priority growth sectors
- to advocate reform in Cyprus required to improve the regulatory and business environment and infrastructure
- to provide investor support with after care and further development services.

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CIPA, in conjunction and partnership with the private sector and related government organizations and agencies, plays a significant role in promoting Cyprus as an appealing investment location, providing vital aftercare services to new and existing investors, and acting as an advocate for reforms that further improve the business operating environment.

Are there any specifically regulated sectors or 'restricted investments'?

In line with the freedom of establishment there are no restrictions on investment by citizens of EU member states other than those applying to specifically regulated sectors, such as banking and finance sectors, where approvals may be required for customer protection purposes, but these apply equally to Cypriots, nationals of other EU member states and third-country nationals. For both EU and third country investors, restrictions remain on acquisitions in the areas of real estate, tertiary education, public utilities, radio and television stations, newspapers and magazines and airlines.

It is characteristic that free movement of capital legislation is in place ensuring that no restrictions in relation to the movement of capital shall exist, including profits and dividends, from Cyprus to any person in either a Member State of the EU or a third country. Furthermore, there is no exchange control legislation in Cyprus and residents and non-residents alike may hold and manage assets and liabilities in any foreign currency in any jurisdiction, including freely convertible and transferable balances on the island. In all but a very few strategic sectors of the economy, namely those perceived to relate to national and public security, foreign investors may now participate with no limits on equity holdings and without any prescribed minimum level of capital investment.

In general, foreign investors no longer need approval from the Central Bank of Cyprus and may invest and do business in most sectors in Cyprus on equal terms with local investors.

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Is there a mandatory screening of foreign investment?

There is no mandatory screening of foreign investment. Foreign investors can incorporate a company directly at the Registrar of Companies through regulated lawyers (advocates), a procedure identical to that for national residents. Similarly, foreign investors may acquire shares in an existing Cypriot company directly, without prior permission by the Central Bank (which had been the previous regime).

Are Cyprus' foreign investors protected in respect of taxation issues?

Cyprus has developed a wide network of Double Tax Treaties (DTT) with more than 45 states, ensuring that the same income is not taxed in more than one country. Most of these DTT follow the OECD Model Convention, while the US-Cyprus tax treaty follows the most recent model of United States Agreements. Amongst a plethora of states that have concluded DTT with Cyprus, are the following countries:

Azerbaijan	Austria
Belarus	Belgium
Bulgaria	Canada
China	Czech Republic
Denmark	France
Germany	Greece
Hungary	India
Ireland	Italy
Kuwait	Norway
Poland	Qatar
Romania	Russia
Slovakia	Slovenia
Ukraine	United Kingdom
United States of America	Sweden

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Moreover, Cyprus has laid particular attention to elevating both the competitiveness and the investment protection approach with respect to its shipping sector. It is considered as one of the most competitive shipping centers in the world in terms of registration fees and taxes. No tax is imposed on profits from the operation of Cypriot registered vessels, or on dividends received from a ship-owning company.

Is Cyprus a safe destination for direct foreign investment?

The EU's legislative landscape on failing banks has undergone a fundamental shift. Cyprus was indeed the first Member State to experience and implement the resolution and bail-in approach with respect to failing banks, thus relieving taxpayers and direct investors from suffering the burden of rescuing failing banks. Protection of foreign direct investment in Cyprus, as a distinct matter from failing banks, remains at the highest possible levels.

Being an established business center and a maritime champion, Cyprus has ensured that adequate legal protection for foreign investors is afforded. Direct investment protection in Cyprus stems from international law, EU law and Cyprus law itself.

Cyprus has implemented significant economic and structural reforms that transformed the economic and business landscape of the country, as a result of the country's EU accession. Tariffs and quantitative restrictions have been eliminated for all manufactured goods and agricultural products originating in Cyprus and other EU countries, liberalizing trade. Within the EU, the Common Customs tariff and all relevant EU legislative frameworks for the facilitation of the free movement of goods, capital and services have been transposed into the Cypriot legal order.

Cyprus' hydrocarbons reserves currently at the exploration phase have attracted eminent oil & gas operators and are a stellar indication of how secure Cyprus has become for foreign direct investment. Both

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during the procurement of the offshore sea blocks in Cyprus' Exclusive Economic Zone and at present, investors and multinational corporations, such as Total, ENI, Noble Energy and KOGAS are actively engaging in Cyprus-based activities.

There can be no doubt that Cyprus is a jurisdiction actively protecting foreign direct investment, enabling investors to safely harness all possibilities the country offers as a gateway to the EU. Cyprus adheres to and its legal order has seamlessly transposed all four established types of mechanisms offered by states to foreign investors towards investment protection.

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