PORTFOLIO INVESTMENT SCHEME FOR NRIS

Portfolio Investment Scheme for NRIs

Schedule 2 and 3 of the Notification No. FEMA 20/2000 RB contains provisions relating to Portfolio investment by NRIs. OCBs are not allowed to make fresh investments in India under the Portfolio Investment Scheme vide Notification No. FEMA 46 dated 29th November 2001. Further, in September 2003, RBI has banned OCBs from investing in any manner in India. In fact, the category of OCB has been abolished. However, they can continue to hold and sell shares purchased before 29th November 2001.

Portfolio investment is covered by general permission subject to following condition/provisions.

(i) Investment is permitted on repatriation as well as non-repatriation basis.

(ii) Purchases, sale of shares (Preference and Equity) and/or convertible debentures are covered.

(iii) Purchase/sale is done through registered broker of a registered broker of a recognised stock exchange.

(iv) One bank branch must be designated by NRIs and all purchase/sale must be routed through that designated bank branch only.

(v) All transactions of sales and purchase must be delivery based. Speculative transactions are not allowed.

(vi) Mode of investment may be in any of the following ways:

(a) For investment on Repatriation basis
- inward remittances through normal banking channels
- out of FCNR/NRE account.

(b) For investment on non-repatriation basis Besides the above two, investment can be made out of NRO account.

(vii) Ceiling on Investment

(a) Per investor (Each NRI)

- 5% of the paid-up value of shares of an Indian Company on both repatriation and non-repatriation basis.

- 5% of the value of each issue of convertible debenture of an Indian Company on both repatriation and non-repatriation basis.

(b) Per investee Company

(Total holding by all NRIs put together on both repatriable as well as non-repatriable basis.)

10% of paid-up value of shares of an Indian Company.

10% of paid-up value each series of convertible debenture.

This ceiling of 10% could be increased to 24%, if the General Body of concerned
Indian Company passes a special resolution to that effect.

It is interesting to note that FIIs are allowed to increase their investments under portfolio investments scheme up to the sectoral cap. Whereas NRIs are allowed to increase the limit only up to 24%.

(viii) Repatriation of Sale/Maturity Proceeds

(a) Sales proceeds of Investment held on repatriation basis can be credited to NRE/FCNR/NRO account after payment of applicable taxes.

(b) If investment is on non-repatriation basis, credit of sale/maturity proceeds is permitted in NRO account.

(ix) Existing OCBs (i.e. prior to Sep 16, 2003) must intimate the designated bank branch immediately on the holding/interest of NRIs in the OCB becoming less than 60%.

(x) NRIs are allowed to enter into forward contracts to hedge their investment made in India.

(xi) NRI is also permitted to invest in exchange traded derivatives contracts approved by SEBI from time to time out of his Rupee funds held in India on Non-Repatriable basis subject to the limits described by SEBI.

(xii) NRIs can also invest without limit on repatriable basis in Government dated securities, treasury bills, units of domestic mutual funds, bonds issued by PSUs, shares in public sector enterprises which are being disinvested by Government. They can also invest without limit on non-repatriable basis. In Government dated securities, treasury bills, units of Domestic mutual funds, units of Money market mutual funds. However, NRIs are not permitted to make Investments in Small Savings Schemes including PPF.

Practical Issues

(i) Can NRIs take their securities outside India?

There is no express prohibition in FEMA. As such "demat" being in vogue, physical transfer of security assumes little or no significance. Under FERA, general permission was granted for taking securities outside India.

(ii) Can NRIs invest under portfolio investment scheme out of funds borrowed in India?

No NRIs cannot invest out of borrowed funds in India.

(iii) Can power of attorney holder manage portfolio on behalf of NRIs?

Yes. A power of attorney holder can manage portfolio on behalf of NRIs. However, he cannot effect remittance outside India. With internet trading, life of NRIs has become easy for portfolio investments.

(iv) Can NRIs avail of loan against such securities?

Yes. NRIs can borrow against shares or other securities. However, the loan should be utilized for meeting the borrower's personal requirements or for his own business purposes.

(v) Is any approval required from anyone to begin Portfolio Investment?

NRIs do not need any approval to undertake Portfolio Investment. They have to comply with the guidelines. FIIs need approval of SEBI and RBI. An application has to be filed with SEBI as the relevant rules. The application is forwarded to RBI. Both approvals are available simultaneously. One does not have to approach SEBI and RBI independently. In fact for FIIs, SEBI is the monitoring authority. Detailed rules are laid down under the SEBI law.

(vi) How can NRI begin portfolio Investment?

NRIs should comply with the following conditions:

- The NRI designates a bank branch for routing all his purchase and sale transactions through that Bank branch only.

- Purchase and sale is carried out through a registered broker on a recognized stock exchange.

- All transactions of purchase and sale must be delivery based. Speculative transactions are not allowed.

(vii) Can income earned on Portfolio Investment be remitted abroad?

Income such as interest and dividend earned by NRI from portfolio investments acquired whether on repatriation basis or on Non-repatriation basis, can be remitted abroad provided applicable taxes have been deducted/paid.

However capital gains can be repatriated only if investment is on repatriable basis.

(viii) Are NRIs required to file any reports to RBI?

The NRI investor is not required to file any Return or Report with the RBI with regard to acquisition or sale of shares and/ or debentures in an Indian Company. Only the link office of the designated bank branch is required to furnish a report on daily basis on Portfolio Investment Scheme Transactions to RBI.

Portfolio Investment Scheme for Foreign Institutional Investors (FIIs)

Schedule 2 of the Regulation 5(2) of Notification No. 20/RB-2000 dated 3rd May, 2003 deals with the provisions relating to Portfolio Investment by FIIs. FIIs such as Pension Funds, Investment Trusts, Assets Management Companies, etc., who have obtained registration from SEBI, are permitted to invest on full repatriation basis in the Indian Primary and Secondary Stock Markets (including OTCEI) as well as in unlisted, dated Government securities, Treasuries Bills and Units of Domestic Mutual Funds without any lock-in-period.

Brief provisions of the schemes are as follows:

(i) FII must be registered with SEBI.

(ii) FII shall not obtain prior permission of RBI for purchase the share/convertible debentures of an Indian Company.

(iii) Purchase is allowed through registered brokers on recognised stock exchange in India.

(iv) Manner of Investments

FIIs are permitted to open a foreign currency account and/or a non-resident rupee accountin India with a designated branch of an authorized dealer. The purchase and sale of permitted securities must be routed through this account only.

(v) Forex cover to hedge investment in India

FIIs are permitted to hedge the market value of their entire investment in equity as on a particular date without any reference to a cut off date.

(vi) Limit on Investment

(a) Individual holding

Holding by each FII (including SEBI approval sub-account of FII) shall not exceed ten percent (10%) of the total paid-up equity capital or (10%) of the paid-up value of each series of convertible debentures issued by an Indian Company.

(b) Total holding

The total holding of all FIIs/sub-accounts of FIIs put together shall not exceeds 24% of paid-up equity capital or paid up value of each series of convertible debentures.

(c) Holding in Government Securities

In case of Investment in Government Securities (para (ix) given below); the ratio of investment between equity and debt should be atleast 70:30 (i.e. (i.e. minimum 70% for equity). There is no limit on the amount of investment. If the FII wants to invest 100% in the debt fund, then it can form a debt fund and get the same registered with SEBI

(vii) Remittance of sale proceeds
FII will be allowed to remit sale proceeds of shares/convertible debentures after payment of applicable taxes.

(viii) FIIs are also permitted to invest in exchange traded derivatives contracts approved by SEBI subject to the limit prescribed by SEBI.

(ix) FIIs can also invest in dated Government securities, treasure bills, non-convertible debenture/ bonds, and units of Domestic mutual funds.

(x) Procedure for FIIs to make portfolio Investment in India

FIIs should comply with the following conditions:

- The FII should designate a bank branch for routing all purchase and sale transactions through that bank branch only.

- Purchase and sale should be carried out through a registered broker on a recognised stock exchange. Of course, in case of private placement investment, there will be no broker.

- All transaction of purchase and sale must be delivery based. Speculative transactions are not allowed.

- FIIs can open a bank account in foreign currency and rupee (known as Special Non-resident Rupee Account). Free transfer of funds between the two accounts is permitted. All transactions should be routed through these accounts. The transaction can be done through Special Rupee Account.

- For derivative trading, a separate sub-account in Rupee should be opened. The funds can be freely transferred between the special rupee account and the sub-account. However, repatriation of funds abroad can be done only through the main Special Rupee Account.

(xi) FIIs are required to submit a daily report of the transactions in a soft copy format to Chief General Manager, Exchange General Manager, Exchange Control Department, Reserve Bank of India, Foreign Investment Division, Central Office, Central Office Building, Mumbai 400 001. Details of exchange-traded derivatives are, however, not required to be submitted. This will facilitate RBI to keep tabs on limits of investment.

Investments by NRIs on Non-Repatriation Basis

Schedule –IV of notification No. 20/2000-RB deals with provisions relating to such type of investments. Briefly the provisions are as follows: -

(i) General Prohibition

Investments in shares or convertible debentures of an Indian Company engaged in following type of activities are not permitted.

- Chit Fund or Nidhi Company
- Agricultural or Plantation activities
- Real Estate Business
- Construction of farm houses or
- Dealing in Transfer of Development Rights (TDRs).

(ii) General Permission

Subject to above, NRIs are free to invest without any limit on non-repatriation basis in shares or convertible debentures of an Indian Company. However, only direct investment in the form of public issue, private placement or right issue is covered here. It follows that secondary investment, on private arrangement basis, would require prior RBI approval.

NRI can also, without any limit, purchase on non-repatriation basis dated Government Securities, treasury bills, units of domestic mutual funds, units of Money Market Mutual Funds.

However, NRIs are not permitted to make Investments in Small Savings Schemes including PPF.