

Portfolio Investment by Foreign Nationals in the Tehran Stock Exchange

Introduction

The subject of portfolio investment by foreign nationals in the Tehran Stock Exchange (known also as TSE) was not officially permitted until the enactment of the relevant Regulations on 1 June 2005 in the form of a Government Decree (the "Regulations"). Prior to that date, foreign portfolio investment had been the subject of much debate and opposing views, although it was a relatively well-known fact that even prior to the enactment of the Regulations foreign investors were using different vehicles, such as trust arrangements and powers of attorney, to invest in the then booming TSE market. The enactment of the Regulations intended to put an end to the existing unregulated market and to bring it under a supervised order.

Definition of Foreign Investor

For the purposes of the Regulations and portfolio investment in the TSE, "foreign investor" is defined as a foreign individual (natural person) or legal entity who for the sole purpose of profiting (and not for participation in the management of Iranian companies) obtains a special Investment License from the Investment Board under the Foreign Investment Promotion and Protection Act (known as FIPPA) and engages in purchase and sale of securities listed in the TSE. This definition leads to the following conclusions:

- 1- in order to engage in portfolio investment in the TSE the foreign investor must obtain a special Investment License under FIPPA;
- 2- the portfolio investor may be a natural person or a legal entity validly incorporated under the laws of the jurisdiction of its incorporation; and
- 3- the portfolio investor, regardless of the ratio of his/its shares in a given company, cannot be involved in the management of the company in which he/it holds shares.

FIPPA and Coverage Provided

Neither FIPPA nor its Implementation Regulations specifically refer to portfolio investments and, it would appear, at the time of its enactment FIPPA was never intended to cover such investments through the TSE. However, the general provisions of FIPPA relating to foreign investment by purchasing of Iranian - company shares have been used, by analogy, to extend FIPPA coverage to foreign portfolio investments. Accordingly:

- 1- by obtaining an Investment License under FIPPA the foreign investor will be guaranteed (i) availability of foreign exchange for repatriation of the principal amount of its/his investment and dividends earned; and (ii) fair compensation in case of expropriation;

- 2- the definition of “foreign investor” under FIPPA also covers Iranian nationals who intend to invest in Iran by using foreign source funds. It is not clear whether this definition will also apply to portfolio investors; and
- 3- FIPPA coverage is limited to investments in certain fields of commercial operations (eg production, agriculture, mining, transportation and certain fields of services). It would appear, however, that such limitations will not apply to portfolio investments.

Permitted Investments and Ceiling

According to the Regulations the following limitations and ceilings apply to foreign portfolio investments in the TSE:

- 1- the foreign investor may only invest in the following types of financial assets:
 - (a) TSE listed shares;
 - (b) other types of TSE listed securities; and
 - (c) any TSE listed Participation Certificates (debentures).Accordingly, the holder of an Investment License under FIPPA for portfolio investment cannot use its/his said License to invest in unlisted shares (ie directly invest in unlisted Iranian companies) or securities;
- 2- the ratio of shares held by all foreign portfolio investors in any TSE listed company should not exceed 10% of the shares of that company;
- 3- the ceiling of the investment of each individual foreign portfolio investor in Participation Certificates (debentures) is 10% of the total amount of the investment of the relevant investor;
- 4- in case any of the above ceilings are exceeded, the relevant investor is required to sell the exceeding number of shares or securities, as the case may be, within one week; and
- 5- TSE shall, on a quarterly basis, advise the Investment Board of the ceiling of foreign portfolio investments in the TSE.

Importation of Funds

The foreign portfolio investor should, within one year from the date of the issuance of the Investment License, bring into Iran the total amount of the intended investment for which the Investment License is issued. According to the Regulations:

- 1- importation of funds into Iran can be gradual but should be completed within one year of the date of the Investment License;
- 2- within the same one year period the funds should be invested in the TSE listed shares or securities;
- 3- the regulations do not provide for the possibility of extension of the said one year period; and
- 4- the use of any portion of the funds that have not been brought into Iran or invested in the TSE within the above referred one year period is subject to obtaining of a fresh Investment License.

Investing in the TSE

For the purpose of investing in the TSE the foreign investor is required to open and maintain a dedicated bank account with an Iranian bank in Iran.

All funds brought into Iran by the foreign investor for purposes of portfolio investment should be deposited in the said dedicated bank account; all investments in the TSE should exclusively be made by using funds in the said account; and the proceeds of sale of any shares or securities as well as any dividend/profit received should exclusively be deposited in the said dedicated account.

The foreign investor is not permitted to use the funds in the said dedicated account for any purpose other than paying out or receiving funds exclusively in relation to his/its portfolio investments in the TSE.

Lock-in Period and Repatriation

There is a three year lock-in period. In other words, the foreign investor is permitted to repatriate the principal amount of his/its investment and the proceeds of his/its investments only after expiry of three years from the date that he/it has started to invest in the TSE. This lock-in period does not apply to dividends received for shares held in TSE listed companies, which can be repatriated annually.

Notwithstanding the above limitation, the foreign investor may apply for repatriation of the principal amount and accumulated profits of his/its investments in case he/it is unable to reinvest the same at the TES. Authorization for repatriation may be granted by the Investment Board upon recommendation by the TSE Board of Directors if foreign portfolio investment in shares and other TSE listed securities has reached two thirds of the total ratio of shares and securities allocated to foreign portfolio investment.

Direct Investment in Iranian Companies

The Regulations and the limitations provided thereunder apply only to foreign portfolio investments; direct (non-portfolio) investments by foreign nationals in Iran by purchase of shares in Iranian companies, whether or not listed in the TSE, are not subject to the limitations and other terms and conditions of the Regulations. Such investments and the Investment Licenses that may be issued to such investors under FIPPA, however, are subject to a set of other rules, terms and limitations.

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