

New Foreign Investment Restrictions Imposed by India

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Like several other major economies, the Indian economy has been adversely affected by the lockdowns and market disruptions caused by the COVID-19 pandemic. In these circumstances, valuations and stock prices of Indian companies have witnessed precipitous declines.^[1] The government of India (the “**Government**”) has revised Indian investment laws to check “opportunistic takeovers/acquisitions” of Indian companies. These revisions are discussed below.

Evolution of the Foreign Direct Investment Regime

There are two routes through which foreign investors may invest in India. One is the “automatic route”, where no government approval is required under Indian foreign exchange laws to make an investment as long as it is within prescribed thresholds for the relevant sector. The other route is the “government route”, where an approval is required under foreign exchange laws from the relevant industry regulator, prior to the investment.

Over the last several years, the rules relating to foreign direct investment (“**FDI**”) in India have been progressively liberalised. Companies and entities in most sectors can be 100% foreign owned and investments in several sectors can be made through the “automatic route”. Historically, investors from only two of India’s neighbouring countries – Pakistan and Bangladesh – have been subject to stricter investment rules (requiring all investments to be approved by the Government).^[2] Notably, investors from the People’s Republic of China (“**PRC**”) have not been subject to such strict scrutiny other than in sensitive sectors such as telecom, defence and railway infrastructure. Based on Government data for the period between April 2000 and December 2019, PRC originated investments account for more than 99% of all foreign direct investments made by investors from countries sharing a land border with India.^[3] This does not include investments by PRC-based investors that are routed through investment gateways such as Mauritius and Singapore.

Given the generally liberal investment regime in India, widespread concerns have arisen that investors from countries sharing a land border with India (especially the PRC) could acquire stakes in Indian companies at significantly low valuations, in the current economic downturn, becoming a significant player in India’s economy.

Recent Restrictions Imposed under India’s Investment Regime

In order to curb such ‘opportunistic’ investments, the Government has issued a notification amending the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (“**Revised Rules**”).^[4] Based on the Revised Rules, any investing entity:

- (i) that belongs to/is incorporated in; or
- (ii) that is beneficially owned by a citizen of or a person situated in,

a country sharing a land border with India (an “**Affected Investor**”),^[5] must obtain the Government’s approval prior to making its investment. The Revised Rules came into effect on April 22, 2020.

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Under the Revised Rules, the following transactions will require prior Government approval (even if the sector is an “automatic route” sector):

1. Direct Acquisitions: any acquisition of a stake in an Indian entity by an Affected Investor, or
2. Indirect Acquisitions: any transaction that will result in an Affected Investor becoming a beneficial owner of an Indian entity.

Prior Government approval must also be obtained for any transfers of existing foreign investment, which would result in an Affected Investor securing beneficial ownership of an Indian company.

The Revised Rules will impact cross-border/multi-jurisdictional acquisitions by an Affected Investor that has an India component, even where the transaction does not result in a transfer of shares of an Indian entity. For example, an Affected Investor will need prior Government approval for any acquisition outside India, if such acquisition leads to a change in beneficial ownership of the Indian entity.

Uncertainties Regarding the Restrictions

The Revised Rules contain language that is not entirely clear. The following are some of the key issues that are yet to be clarified by the Government:

- Will prior Government approval need to be obtained for all transactions resulting in any beneficial ownership of an Indian entity being held by an Affected Investor (an extreme interpretation)? In practice, would the Government utilise *de minimis* thresholds regarding the significance or quantum of the beneficial ownership?
- The status of investors from the Special Administrative Regions of Hong Kong and Macau is unclear, given that these regions form a part of the PRC. Given that Hong Kong is a significant investor into India (and is accounted for separately by the Government in investment statistics), will investors from Hong Kong be subject to the same scrutiny as those entities from the PRC?
- The Revised Rules currently apply to additional investments made by Affected Investors already holding interests in Indian entities. For example, a PRC entity that has a wholly-owned subsidiary in India will need to seek the prior approval of the Government in order to make additional investment into its wholly-owned subsidiary. It is unclear as to why such an approval is required given that the PRC entity already owns all of the shares of its wholly owned Indian subsidiary.

Further, the timelines for processing approval applications from Affected Investors is unclear. This could introduce significant uncertainties for indirect acquisitions and cross-border/multi-jurisdictional transactions in which India is only one component of a larger transaction.^[6]

The Government is expected to provide more clarity regarding the Revised Rules over the next few weeks. This is necessary in order to ensure that Indian businesses continue to be able to access foreign investment sources expeditiously, both to tide over the recent economic downturn and for long-term growth.

[1] For example, more than sixty percent of stocks on the benchmark Sensex of the BSE fell by more than 30% since the start of the pandemic. See “*Tightened FDI norms: No love for thy neighbor*”, Financial Express dated April 21, 2020, available at <https://www.financialexpress.com/opinion/tightened-fdi-norms-no-love-for-thy-neighbor/1934683/>.

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[2] Rule 6, Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and Paragraph 3.1.1 of India's Foreign Direct Investment (FDI) policy.

[3] Department for Promotion of Industry and Internal Trade, "Fact Sheet on Foreign Direct Investment (FDI) From April, 2000 To December, 2019", https://dipp.gov.in/sites/default/files/FDI_Factsheet_December-19_5March2020.pdf.

[4] Department of Economic Affairs Notification No. S.O. 1278 (E) dated April 22, 2020, available at <http://egazette.nic.in/WriteReadData/2020/219107.pdf>.

[5] The following are countries that share a land border with India: (1) Afghanistan, (2) Bangladesh, (3) Bhutan, (4) China, (5) Myanmar, (6) Nepal and (7) Pakistan.

[6] There are some unconfirmed news reports that the Government will expedite the vetting process for foreign investment by PRC investors in non-sensitive sectors. See "Fast vet option for China FDI", The Telegraph dated April 25, 2020, available at <https://www.telegraphindia.com/business/coronavirus-concerns-fast-vet-option-for-china-fdi/cid/1768042>.

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