Impact of COVID-19 on FDI Regimes

In the last few years, countries such as the United States have intervened in or blocked proposed FDI transactions to address national security concerns, with a particular focus on China. The COVID-19 pandemic has not only brought healthcare and critical infrastructure into focus from an FDI perspective, but has also weakened companies in other sectors and made them easy targets for creditors and opportunistic buyers.

In mid-March 2020, German media reported that the United States President had offered to take over CureVac, a German vaccine firm which was working on a vaccine for COVID-19, to secure the vaccine only for the United States – these reports were later denied. On March 25, 2020, the European Commission issued guidance concerning FDI stating *inter-alia* that in view of the pandemic, there could be an increased risk of attempts to acquire healthcare capacities (e.g., for production of medical or protective equipment) or related industries such as research establishments (e.g., vaccine developers) via FDI, the risks to the EU's broader strategic capacities may be exacerbated by the volatility or undervaluation of European stock markets and member states should remain vigilant to prevent the health crisis from causing a "*sell-off of Europe's business and industrial actors*". The European Commission has called upon member states to make "*full use*" of their existing FDI screening mechanisms to "*take fully into account*" the risks to critical health infrastructures, supply of critical inputs, and other critical sectors. For the first time, the European Commission has also called upon member states that do not yet have an FDI screening mechanism, or whose screening mechanisms do not cover all relevant transactions, to set up a full-fledged screening mechanism and in the meantime to use all other available options to address cases where a proposed acquisition of a particular business, infrastructure or technology would create a risk to security or public order in the EU.

In early April 2020, Germany approved legislation which will permit regulatory authorities to review whether an acquisition will lead to a probable impairment of public order or security (instead of an *actual* threat to public order or security). While this amendment had been proposed prior to the spread of COVID-19, Germany also proposes to expand the list of sectors in which FDI will require prior approval – a move that appears to be driven by the pandemic. Spain has also recently introduced a requirement for prior governmental authorization for: (1) non-EU investors to acquire 10% or more of, or acquire management rights in or control of, Spanish companies engaged in sectors such as utilities, data processing or storage, electoral or financial infrastructure and sensitive facilities, critical technologies and dual-use items (such as robotics and semiconductors, as well as biotechnology), supply of key inputs (such as raw materials and food security) and sectors with access to or ability to control sensitive information; and (2) FDI where the investor is directly or indirectly controlled by a government of another country. Italy – one of the worst affected by COVID-19 – has also expanded the list of sectors in which FDI will require prior governmental review to include those mentioned above.

With Europe having been declared as the epicenter of the COVID-19 pandemic in March, the above measures were perhaps expected. However, countries in other continents have also taken severe measures – for example, Australia temporarily amended its FDI regime with effect from March 29, 2020 in national interest to deal with the economic implications arising from the spread of COVID-19, following which all proposed foreign investments subject to the Foreign Acquisitions and Takeover Act 1975, where the other conditions for notification are met, will now require prior regulatory approval, regardless of value or the nature of the foreign investor.

India has since 1991 focused on liberalizing the FDI regime. FDI is permitted under the automatic route (i.e., without prior regulatory approval) in a majority of sectors, and remains controlled or prohibited only in limited sectors of strategic or national importance. In respect of healthcare in particular: (1) up to 100% FDI is permitted under the automatic route in hospitals (including construction); (2) up to 100% FDI is permitted under the automatic route for manufacturing of medical devices; and (3) up to 100% FDI is permitted under the automatic route in greenfield pharmaceuticals, whereas in brownfield pharmaceuticals, up to 74% FDI is permitted under the automatic route and beyond 74% up to 100% FDI is permitted with prior governmental approval – both categories are subject to additional conditions (for example, non-compete provisions are not allowed in *inter-se* contracts, and in respect of brownfield pharmaceuticals, disclosure is required of any proposed technology transfer after the induction of FDI). In addition, FDI in other critical infrastructure and technology – e.g., certain financial services, data processing and storage, artificial intelligence, robotics and semi-conductors – also remains unregulated to a certain extent.

FDI from Pakistan and Bangladesh, as well as FDI in specified sectors (comprising broadcasting, telecommunication, satellites (establishment and operation), private security agencies, defense, civil aviation and mining and mineral separation of titanium bearing minerals and ores, value addition and integrated activities) requires security clearance from the Indian Ministry of Home Affairs. However, Pakistani investors cannot invest in defense, space, atomic energy and sectors or activities prohibited for FDI even through the approval route. The security clearance form prescribed by the Government for the sectors specified above requires certain details of the investor and investee and specifically, whether the investor or its affiliates have presence or operations in Bangladesh, China or Pakistan.

Therefore, in India, terms such as “national security” and “sensitive” in the context of foreign investment have historically been relevant for FDI from Pakistan and Bangladesh and sectors such as defense, media and telecommunications. While the Indian FDI policy states that FDI in sectors that fall under the automatic route will be subject to applicable law, including security conditions, the Government has not explicitly used its discretion to block FDI in such sectors on grounds of security. As COVID-19 continues to spread, regulators worldwide are expanding the scope of their FDI screening mechanisms to include healthcare and critical infrastructure and technology to protect their national and economic interest. News reports indicate that Indian pharma companies are trading at their lowest valuations in the past 8-10 years, and the falling Rupee against the US dollar is expected to boost pharma exports. The recent hydroxychloroquine incident underscores the importance of India retaining control over indigenous critical infrastructure and technology. Given the unprecedented situation created by the COVID-19 pandemic and India’s heavy reliance on private healthcare, the Government will need to review the permissibility of, and security concerns relating to, FDI in healthcare. Further, it has been reported that the Chinese central bank now holds more than 1% shareholding in HDFC, and the Industrial and Commercial Bank of China and China Investment Corporation are reportedly exploring investment opportunities in the Indian financial services sector. Given that the pandemic has weakened (and may further weaken) companies in technology, infrastructure and other unregulated sectors, the Government may consider reviewing FDI regulations to ensure that appropriate checks are in place in relation to acquisition of such companies (including by governments or sovereign funds).

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