Impact of COVID-19 on FDI Regimes: One Year Later

More than a year ago, we summarized certain changes in foreign direct investment (FDI) regimes in response to the COVID-19 pandemic in countries other than India. We concluded that India could consider reviewing its FDI regime to ensure that appropriate checks were in place in respect of certain sectors.

In late-April 2020, the Indian Government issued an amendment to the Indian FDI policy to "*[curb] opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic*" (the ***2020 Amendment***), pursuant to which: (1) all investments by entities incorporated in a "*country which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country*" require prior regulatory approval; and (2) in the event of any transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview of item 1 above, such change in beneficial ownership also requires prior regulatory approval.

While seven countries share a land border with India, investments from Pakistan and Bangladesh were already regulated under Indian law. Of the remaining five, the target of the 2020 Amendment appeared to be China, given the Indo-China border skirmishes, exploration of investment opportunities by Chinese investors in India and scrutiny by the Indian securities regulator of Chinese ownership of portfolio investors that typically invest in listed securities.

Although triggered by COVID-19, the 2020 Amendment was neither restricted to essential or sensitive sectors nor specified to be applicable for a defined period. One of the key aspects of the 2020 Amendment is "*beneficial ownership*". The requirement for prior government approval could arguably be triggered even if a *single* share of an investing entity is beneficially held by an investor from one of the restricted bordering countries. The lack of clarity from the Government on this issue has resulted in uncertainty for more than a year, not only regarding inflow of new investments from China in the start-up sector but also regarding investments of private equity funds which may have investments from Chinese limited partnerships. Confusion has also reigned on whether investments from Taiwan are within the scope of the 2020 Amendment.

An OECD report issued in June 2020 classified changes to investment screening mechanisms directly associated with COVID-19 into two categories: (1) reforms that added assets to the scope of screening mechanisms that are crucial for the pandemic response (health-related industry sectors and associated supply chains) or that specifically strengthened controls in these areas; and (2) measures that introduced or enhanced FDI screening mechanisms across the board to prevent acquisitions in any sector where assets suffered from temporary financial stress and value distortions under the exceptional economic conditions associated with the pandemic. Certain countries that have contained the pandemic have now started easing restrictions. For example, in March 2020, Australia had introduced a zero-dollar monetary screening threshold in response to the coronavirus. With effect from January 1, 2021, these were removed except in respect of sensitive national security businesses, which continue to require mandatory clearance.

Given its focus and impact on investment from China, the 2020 Amendment does not appear to fall into either category described in the OECD report. In fact, China questioned the 2020 Amendment as well as India's ban on Chinese apps at World Trade Organisation meetings, including in January 2021. Media reports in February 2021 indicated that the Government had started processing China-related FDI applications after a nine-month hiatus and had constituted a coordination committee for this purpose, comprising officers from the ministries of home, external affairs, commerce and industry and Niti Aayog. The reports linked the move to the easing of tension at the Indo-China border rather than COVID-19. In March 2021, media reported that the Government may ease rules for investments from China, subject to security clearance. However, no amendment has been issued yet.

While FDI inflows ebbed elsewhere, India recorded 13% growth in FDI in 2020 despite the COVID-19 pandemic, led by investments in the digital sector. China was the only other country among those considered that showed FDI growth.

In our view, it may be time for the Government to consider whether the 2020 Amendment is justified any more in its current form on the basis of the COVID-19 pandemic. If not, it could be modified to reflect an investment screening mechanism that balances the requirements of corporate India with the Government's national security and economic concerns. Furthermore, key concepts such as "beneficial ownership" require clarity on an urgent basis. Lastly, the FDI approval process under the current regime (where the sectoral ministry is the relevant authority) has been more time-consuming than it was under the erstwhile Foreign Investment Promotion Board and hence, urgently requires to be streamlined to remove inefficiencies. The Government could consider setting up a pre-filing consultation mechanism, similar to the Competition Commission of India, to facilitate early determination of an approval requirement and reduce its administrative burden. It could also consider undertaking fast-track review of FDI applications in most sectors barring identified sectors of national importance such as critical infrastructure, banking, healthcare and telecom.

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