REVIEW OF THE FOREIGN DIRECT INVESTMENT (FDI) POLICY

BACKGROUND

The world economy is experiencing an unexpected recession on account of COVID -19. Many countries, including India, have declared COVID-19 crisis as a national emergency and have issued directions for partial or complete lockdown. During this crisis, lockdown is the only hope and solution for flattening the curve of COVID 19 though it adversely affects a country's economy. Business entities have reluctantly closed their operations, and few are running business operations under reduced capacities. Unprecedented lockdowns are adversely affecting business activities and have significantly reduced the value of shares on a short-term basis. Under this situation, some investors are grabbing this opportunity to takeover or acquire other entities in a hostile manner.

NECESSITY OF AMENDMENT OF FOREIGN DIRECT INVESTMENT (FDI) POLICY ON URGENT BASIS

It was noticed by the Authorities that a large part of shares of Housing Development Finance Corp. Ltd (17492909 shares representing 1.01% of total share capital) was acquired by People's Bank of China (PBOC) as per shareholding pattern for the period ending 31 March 2020 submitted with Stock Exchange as per the Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015. This open market purchase of shares by PBOC raised their stake in HDFC from 0.8% to 1.01% in the March quarter.

Considering the situation and the likelihood of more transactions like the above churning out in the near future, the Department of Promotion of Industry and Internal Trade (DPIIT), (Ministry of Commerce & Industry) has issued Press Note No. 3 (2020 series) dated 17th April 2020 to amend the Consolidated Foreign Direct Investment (FDI) Policy for the following reasons:

a. To curb opportunistic takeovers/acquisitions of Indian entities in a hostile manner.
b. To curb acquisition/takeover of Indian entities for non-fulfilment of contractual obligations due to COVID-19 and related uncertainties.

The following is a comparative analysis of the changes:

Present Position Para 3.1.1:	**Revised Position Para 3.1.1**	**Analysis / Remarks**
A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited.	A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited.	No Change
However, a citizen of Bangladesh or an entity incorporated in Bangladesh, can invest only under the Government route.	However, an entity of 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, can invest only under the Government route.	*Refer analysis below under Note 1**
Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.	Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.	No Change
Nil	In the event of the 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 the para 3.1.1(a), such subsequent change in beneficial ownership will also require Government approval.	- Contracts enabling transfer of ownership (beneficial ownership) in future, is also brought under Government Approval Route. - Both Direct and Indirect transfer of beneficial ownership will require Government approval.

Note 1 Analysis: Government Approval Route

The below mentioned investments were required to fall under Government Approval Route

Earlier Position	**Revised Position**
Investments from entity in Bangladesh	Investments from Entity of a country, which shares land border with India.
Investments from Citizen of Bangladesh	a. Investments from a *citizen* of any such country which shares land border with India. (or) b. Investments where *beneficial owner* of an investment into India is **situated** in any such country which shares land border with India

HIGHLIGHTS OF THE AMENDMENT:

- No ***non-resident entity or Citizen (s)*** of a country which shares a land border with India* is/are allowed to invest in Indian entities without obtaining prior approval from the Government of India.
- No ***non-resident entity is allowed to invest in Indian entity, who's beneficial owner*** is residing in a country which shares a land border with India without obtaining prior approval from the Government of India.
- No non-resident entity directly or indirectly owned by non-resident entity or Citizen (s) of a country which shares a land border with India is allowed to invest in an Indian entity without obtaining prior approval from the Government of India.

**The countries sharing land border with India are China, Pakistan, Bangladesh, Bhutan, Nepal and Myanmar.*

- The criteria of "Beneficial Ownership" has been added in addition to "Citizenship".
  For Example: A Taiwan Entity investing into India (under non-prohibited Sectors) whose beneficial ownership is held by persons who are situated in countries sharing land boarders with India or citizens of countries sharing land boarders with India - would require Government Approval before making investment in India.
- We need to analyse the terms
  a. Beneficial Ownership and
  b. Directly and indirectly transfer

  The term "**beneficial owner**" has been defined as the natural person who ultimately owns or controls a client and/or the person on whose behalf the transaction is being conducted, and includes a person who exercises ultimate effective control over a juridical person. Government of India has since examined the issue and has specified the procedure for determination of Beneficial Ownership. [RBI/2012-13/419 - A. P. (DIR Series) Circular No. 84 – DATED : February 22, 2013]
- Section 90 of the Companies Act, 2013 provides for **Test of Control**. "Control" means control as defined in clause (27) of section 2 of the Act which is as under: "control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.
- The words "indirectly transfer" shall have a wide connotation. Any possible structure of transfer not being direct transfer shall be construed as Indirect Transfer of ownership.

IMPACT OF THE AMENDMENT:

➢ In the event of transfer of ownership of any existing or future FDI in any entity in India, directly or indirectly resulting in the ownership falling within the restriction/ purview of above points, such subsequent change in beneficial ownership will also require approval from the Government.

- Further investment by existing investors of a country which shares a land border with India will require prior approval from the Government of India.
- All contractual obligations with respect to conversion of securities into equity shares shall require prior approval of the Government.
- There is no retrospective effect to this Press Note. It means shares of Indian entities acquired by non-resident entity (ies) or Citizen (s) of a country which shares a land border with India prior to date of this Press Note shall be valid and not require any further approval from the Government.

CONCLUSION:

This Press Note intends to lay curbs on the investments from specific target countries in the form of distress sale of Indian businesses. However, the investment made by countries which are not sharing land borders with India have not been brought under the Government Route. Investments made by citizens of such countries sharing land borders are prohibited irrespective of their country of residence. Further, investment by any persons situated in such countries sharing land borders are under approval route, if he/it holds beneficial interest.

It is important to note that the acquisition by an entity which does not share land border with India and where the beneficial ownership is not declared, more so in the case of indirect holding, shall be tracked by the Government of India. Any proxy / shadow holding shall defeat the very purpose of this restriction and would fail in curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic.

Important Note

Respected Prime Minister of India, Narendra Modi announced further extension of lockdown for 19 days from 12 a.m. 15th April 2020 on account of the coronavirus pandemic.

Since social distancing is the only solution to fight against corona virus, stay home, stay safe.

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