AMENDMENT TO FOREIGN DIRECT INVESTMENT REGIME IN INDIA

In order to curb "opportunistic takeovers or acquisitions of Indian companies due to the COVID-19 pandemic", the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("NDI Rules") have been amended with effect from April 22, 2020, to the effect that prior government approval is now required for investment by entities situated in countries which share a land border with India, i.e. Nepal, Pakistan, Bhutan, Bangladesh, Myanmar, Afghanistan but most significantly, China ("Bordering Countries") or where the beneficial owner of an investment into India is situated in or is a citizen of one of the Bordering Countries ("FDI Amendment").

This amendment also extends to transfer of beneficial ownership of any existing or future FDI (directly/indirectly) which falls within the purview of the restriction.

How this may impact You

» **Difficulty in raising funds:** Given the onset of a possible global money crisis, the FDI Amendment will likely be an unwelcome regulatory burden on investee companies (specially start-ups), banks and large overseas funds. In the short term, it may impact rescue funding and ongoing deals, and in the medium to long term it may detersome foreign investors from investing in India.

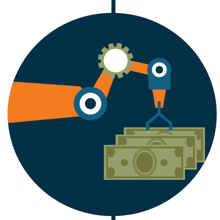
» **Urgent funding:** Regulatory approvals in India are time consuming and can take several months to come through. As urgent funding may be difficult to obtain from restricted foreign investors, banks may see a rise in requests for loans from Investee companies.

» **Increased due diligence:** Investee companies and authorized dealer banks will need to track beneficial ownership of investors. This will involve increased due diligence/know-your-customer efforts.

» **Pre-emptive rights:** Exercise of existing pre-emptive (including, put and call options) will also be covered under this FDI Amendment and be subject to approval. In transactions involving the Bordering Countries,this will impact future exercise of these options.

» **Conversion of External Commercial Borrowings ("ECBs"):** Structuring ECB-savailed from entities restricted under the FDI Amendment to equity by investee companies will be affected.

» **Ongoing transactions:** If Government approval is required for transactions that are already signed and are on the verge of closing, there could be a significant impact to timelines, closing accounting and post-closing pay-outs like, earn-outs etc.



» **Business and supply chain:** Several Indian businesses source their raw material from Bordering Countries (specially, China). Overall business relations with the Bordering Countries could be compromised (even if in the short term) and potentially, established supply chains may be impacted.

» **Opportunity for other investors:** Although aimed at all Bordering Countries, one of the largest impacts will be on investments from China. On the upside, this could lead to greater opportunity for other investors (mainly from the EU and US) if China is edged out in deals. On the flip side, this could negatively impact overseas funds with participants from the Bordering Countries.

Gray Areas Remain

- **Concept of 'beneficial ownership':** The scope of 'beneficial ownership' has not been clarified under the FDI Amendment. Extant legislations contain conflicting definitions of 'beneficial ownership'.

- **Existing investments:** Fresh infusion of funds by existing investors, irrespective of whether or not there is a change in shareholding (however miniscule) or change of control would still be subject to government approval.

- **Indirect acquisitions:** It is unclear if the amendment applied to global acquisitions by entities from Bordering Countries, resulting in Indian subsidiaries being indirectly acquired. If approval is indeed required, it is unclear who would be responsible for making this application. Given that penalties under Indian foreign exchange laws are usually levied on Indian entities, this could be construed to mean that the onus lies on the Indian entities.

- **Listed transactions:** The FDI Amendment does not appear to apply to investment by Foreign Portfolio Investments or Foreign Venture Capitalist Investments (which are regulated by the Securities and Exchange Board of India).

- **Investments in Limited Liability Partnerships ("LLPs") and other entity structures:** Current reading of the FDI Amendment excludes LLPs and other entity structures. This needs to be clarified.

- **Hong Kong:** It is unclear whether investments from Hong Kong or beneficial owners with roots in Hong Kong are covered within the purview of the FDI Amendment.

What Happens Next

- **Startup Ecosystem will change:** Chinese investors like Tencent, Alibaba, Fosun, and Foxconn own stakes in most Indian unicorns **(https://www.gatewayhouse.in/wp-content/uploads/2020/02/Table-1.pdf)**.These companies may now have to look elsewhere to continue their growth stories.

- **Trend towards Protectionism:** While FDI laws have been liberalized consistently over the past decades, there has been a trend towards localization and on-soil requirements in financial, privacy, and online intermediary regulations.Local Indian business interests usually lobby for and welcome such restrictions.

- **Ringfencing 'Essential Industries':**The nomenclature of 'essential industries' has become commonplace during this pandemic. The trigger for this new rule was the People's Bank of China increasing its shareholding in HDFC Bank, one of India's largest private sector banks.An outlier possibility of increasing protections on ownership of industries in health and pharma, etc., could be on the horizon.

- **CFIUS and FIRRMA:** The Committee on Foreign Investment in the United States ("CFIUS") reviews sensitive investments posing a threat to national security. The Foreign Investment Risk Review Modernization Act, 2018 ("FIRRMA"),broadens the purview of CIFUS to investments in any US businesses. India is some ways away from enacting such rules, but it's worth keeping a close watch on the impact COVID 19 has on foreign investment rules in the future.

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