THE CHINESE THREAT: ANALYSING INDIA'S CHANGE IN FDI POLICY

*-Arundhati Diljit**

ABSTRACT

Foreign Direct Investment (hereinafter FDI) imbues the economy with opportunities for growth and development and hence, is crucial for any country. However, there is an increasing fear that there are some malign investments, particularly from China, which can take advantage of the pandemic induced fall in valuation, to acquire a stake in many strategic sectors. Many countries have made changes to their investment policy so as to safeguard themselves against this threat. India has introduced 'Press Note No. 3' which changed the FDI policy to protect domestic interests. The amendment mentions that the objective of such change is to 'curb opportunistic takeovers'. However, the implications and efficacy of such a move are questionable considering the uncertainties associated with it. The notification fails to provide a clear definition of the term 'beneficial owner' which has given rise to a varied application within the country. There is also a concern that the change reflects anti-Chinese sentiments growing within the country and not the interests of the economy. This paper will try to ascertain the problems associated with this policy change. It will delve into the ambiguities of the term 'beneficial owner' and try to identify the most appropriate definition for the same. The paper will also compare India's approach with that of other countries and will try to draw out the differences to determine if they are for better or worse. By virtue of this analysis, the author will also attempt to make certain suggestions to remedy the issues identified.

Keywords- Foreign Direct Investment, Beneficial Owner, China, Strategic Sector, National Security

INTRODUCTION

FDI is essential for any country and this is especially the case for developing countries. FDI adds to the investible resources and capital formation and is a means of transferring production technology, skills, innovative capacity, and organizational and managerial practices between locations.[1] However, in recent times, there is an increasing fear among countries that certain individuals and corporations are taking advantage of the situation brought about by the pandemic to buy companies at a low rate. This fear is heightened especially in the case of Chinese investments.

In order to deal with this problem, various countries have taken measures that provide closer scrutiny of incoming funds. India, too, has made some changes in its FDI policy which are particularly aimed against Chinese investors. This may suit the

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*Student, National Law Institute University, Bhopal.

[1] Padma Mallampally and Karl P Sauvant, 'Foreign Direct Investment in Developing Countries' (1999) 36(1) IMF <www.imf.org/external/pubs/ft/fandd/1999/03/pdf/mallampa.pdf> accessed 8 September 2020.

anti-Chinese feeling prevailing in the country; however, the impact on the economy, especially with the raging COVID-19 pandemic, is concerning as Chinese investments form a major chunk of all the funds that start-ups and MSMEs receive.[2] The new policy could mean that these funds would decrease.[3] It is also likely that a close inspection of all Chinese investments would result in delay, which would be damaging, as in the business world, quick action and access to funds are essential.[4] Apart from concerns regarding the implications of the policy change, certain problems arise while trying to implement it. The notification introducing the new policy is shrouded with ambiguities- the term beneficial owner, despite being crucial for applying the new policy, is left unclarified.

Since the amendment comes at a time when anti-Chinese sentiments are growing within the country, the amendment has not been scrutinised or criticised wide level. This paper attempts to understand the effectiveness of this policy, its shortcomings and with the backdrop of such analysis, will try to find solutions to the problems identified. Part I of the paper will look at the regulatory framework for FDI in India and the changes swept in by Press Note No. 3 (*hereinafter* PN3).[5] Part II delves into the problems raised by the term 'beneficial owner'. Part III is dedicated to a comparative analysis of the FDI policy changes in other countries, and in Part IV, the author makes certain suggestions to deal with the problems which have been identified.

THE REGULATORY FRAMEWORK AND CHANGE IN POLICY

FDI in India is primarily regulated through the Foreign Exchange Management Act, 1999. The Central Government has the right to notify rules[6] and the Reserve Bank of India (*hereinafter* the RBI), can introduce regulations[7] to administer and control foreign transactions. Within the Central Government, the Department for Promotion of Industry and Internal Trade (*hereinafter* the DPIIT) is the primary authority involved in the formulation of policy regarding FDI.[8]

[2] Vinayak Burman and Hardik Thakker, 'FDI Policy Tweak May Squeeze Chinese Investments into MSMEs, Startups' *Financial Express* (22 April 2020) <www.financialexpress.com/ industry/ sme/cafe-sme/msme-fin-2-fdi-policy-tweak-may-squeeze-chinese-investments-into-msmes-startups/1936201/> accessed 8 September 2020.

[3] Peerzada Abrar and Neha Alawadhi, 'FDI Policy Changes to Impact Investments from China Amid Covid-19 Lockdown' (*Business Standard*, 21 April 2020) <www.business-standard.com/ article/ economy-policy/fdi-policy-changes-to-impact-investments-from-china-amid-covid-19-lockdown-120042001335_1.html> accessed 8 September 2020.

[4] ibid.

[5] Government of India, *Press Note No 3 (2020 Series)* (Ministry of Commerce & Industry, 7 April 2020) (Press Note No 3).

[6] Foreign Exchange Management Act 1999 (FEMA 1999), s 46.

[7] ibid s 47.

[8] Department for the Promotion of Industry and Internal Trade, 'Role and Functions of the Department for Promotion of Industry and Internal Trade' (Department for the Promotion of Industry and Internal Trade) <https://dipp.gov.in/about-us/role-and-functions-department-promotion-industry-and-internal-trade> accessed 8 September 2020.

Foreign investment can flow into the country either through the automatic route, where no approval is necessary or through the Government approval route. Proposals for foreign investment through the Government route are studied by the respective Ministry/Department. An exception to this general rule were the investments coming in from Bangladesh or China, which required Government approval regardless of the sector to which the investment is directed.[9]

This was the policy that existed in India prior to the onslaught of the pandemic. In April 2020, the Indian government brought about a change in the policy which has many far-reaching implications. The impetus for imposing further restrictions came when the People's Bank of China raised its stake in HDFC from 0.8 per cent in March 2019 to 1.01 per cent in March 2020. The Bank had bought 1.75 crore shares of HDFC Bank between January and March.[10] This rang warning bells, prompting the government to hastily introduce certain changes in the existing foreign policy.

The notification increased the range of countries from which investments require mandatory government approval. Now, government approval is necessary for investments from any country 'which shares land border' with India.[11] Considering that Bangladesh and Pakistan were already on that list, coupled with the fact that India does not receive much investment from other neighbouring countries, it is clear that the amendment is directed against China. According to PN3, the changes were brought about for curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic.[12]

This change is in consonance with the global trend. Reports suggest that Beijing is on a buying spree owing to the coronavirus pandemic-induced economic downturn that many countries are facing.[13] In this scenario, various countries[14] have tightened their investment policies and have started scrutinising financial inflows more stringently.

With this background, the paper will now proceed to analyse an ambiguity that exists in PN3 that hampers its efficient application.

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[9] Department for the Promotion of Industry and Internal Trade, 'Consolidated FDI Policy Circular of 2017' (Department for the Promotion of Industry and Internal Trade 2017) para 3.1.1.

[10] 'HDFC Stake Impact: Centre Tweaks FDI Norms with an Eye on China' The Week (New Delhi, 18 April 2020) <www.theweek.in/news/biz-tech/2020/04/18/hdfc-stake-impact-centre-tweaks-fdi-norms-with-an-eye-on-china.html> accessed 8 September 2020.

[11] Press Note No 3 (n 5).

[12] Press Note No 3 (n 5).

[13] Geeta Mohan, 'As Global Economies Dwindle, World Wakes up to China's Hostile Takeovers Amid Pandemic' (*India Today*, 21 April 2020) <www.indiatoday.in/ business/story/world-wakes-up-to-china-hostile-takeovers-of-companies-amid-covid-19-pandemic-1669240-2020-04-21> accessed 19 September 2020.

[14] Prabha Raghavan, 'Explained: Why India Tightened FDI Rules, and Why it's China That's Upset' *Indian Express* (New Delhi, 23 April 2020) <https://indianexpress.com/ article/explained/why-india-tightened-fdi-rules-and-why-its-china-thats-upset-6374693/> accessed 12 September 2020.

CONCEPT OF BENEFICIAL OWNER

A term that is of particular importance within the amendment is 'beneficial owner'. Even if the investments do not come directly from a country that shares land borders with India, if the beneficial owner of the investment is a citizen of any such country, the investment is prohibited.[15]

The government, however, has not released any clarification regarding the scope of the same. Even though from an FDI policy perspective, beneficial ownership has not been discussed, the term has been used in other contexts. The paper will now move on to analyse whether it is possible to attribute any of these understandings to the term used in the PN3, to achieve the purpose of the amendment.

INDIAN COMPANIES ACT

The term beneficial owner has been defined in the Indian Companies Act, 2013, by virtue of the Companies (Amendment) Act, 2017. But it is particular to the concept of a 'significant beneficial owner'. It defines a beneficial owner as-

> "*Every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than twenty-five per cent. or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control over the company.*"[16]

India introduced the concept of beneficial ownership in pursuance of the recommendations given by the Financial Action Task Force (*hereinafter* FATF). The FATF definition focuses on the natural (not legal) persons who actually own and take advantage of capital or assets of the legal person; as well as on those who really exert effective control over it.[17] The concept of a beneficial owner under the Companies Act too is ultimately a natural person.

It can be concluded that, from the perspective of the Companies Act, there could be an actual owner and an ostensible owner. Hence, it would require the authorities to look at the structure of a company to see who the actual beneficiaries are. For example, consider a Company A based in Canada, 50% of whose shares are held by Company B. 90% of Company B's shares are held by a Chinese national. An investment coming from Company A prima facie does not seem to be hit by the amended rule, considering it comes from a Canadian country. But, by virtue of the term 'beneficial owner', the said investment would be hit by the rule.

[15] Press Note No 3 (n 5).
[16] Indian Companies Act 2013, s 90(1).
[17] Financial Action Task Force, *Best Practices on Beneficial Ownership for Legal Persons* (October 2019) <www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf> accessed 10 September 2020.

The Companies (Significant Beneficial Owners) Amendment Rules, 2019, further strengthened the provision by providing more definitive criteria and introducing a lesser threshold for determining beneficial ownership. The rules prescribe a limit of 10%, beyond which the investor would be considered a significant beneficial owner.[18]

Despite the promising focus on the individual and the clear grounds laid down for determination, the Companies Act perspective of the 'beneficial owner' has certain shortcomings. The definition under the Companies Act, read with the Significant Beneficial Owner Rules, deals specifically with a significant beneficial owner. Hence, there would still be ambiguity if this definition is adopted, as there is no clarity on whether a 'beneficial owner' would be synonymous with a 'significant beneficial owner' or if the threshold would be lesser for the former.

RBI MASTER DIRECTION, 2016

Another definition that offers a means of determining beneficial ownership is the RBI Master Direction of 2016. In the definition provided within the Direction, the beneficial owner is- 'natural person(s), who, whether acting alone or together or through one or more juridical persons, has/have a controlling ownership interest or who exercise control through other means.'[19]

It goes on to lay down the threshold of interest which a person must have in a company to be deemed a beneficial owner. It focuses on 'controlling ownership interest', which involves a "*25% ownership of the shares or capital or profits*" of the juridical person when it is a company.[20] Other entities, such as trusts and partnership firms have a different threshold.[21] Here, the focus is again on the natural person who is behind the legal entity, but there is a departure from the Companies Act provisions as the definition particularly pertains to who a 'beneficial owner' is. This would help overcome the shortcoming of the latter to bring clarity to PN3.

JUDICIAL INTERPRETATIONS

The judicial interpretations of 'beneficial ownership' are mostly related to cases that involve taxation. These interpretations would mostly be untenable as they often do not pierce the corporate veil and are not very concerned about the natural person behind the company.

To take an example, there is the case of *M/s Golden Bella Holdings Ltd v Deputy Commissioner of Income Tax.*[22] Here, the taxpayer had invested in the debentures of an Indian company. Before such an investment, the company had received a loan from

[18] Companies (Significant Beneficial Owners) Amendment Rules 2019, r 2(h).

[19] Reserve Bank of India, *Master Direction - Know Your Customer (KYC) Direction, 2016* (RBI Master Direction).

[20] ibid.

[21] ibid.

[22] *M/s Golden Bella Holdings Ltd v Deputy Commissioner of Income Tax* ITA No 6958/MUM/2017.

its parent company. When the taxpayer attempted to get the benefit under the existing taxation law by virtue of the interest it received from such debentures, the tax authorities refused such a claim. They were of the opinion that the ultimate beneficiary of the interest received is the parent company and not the taxpayer itself and hence the parent company is the beneficial owner.

However, the court rejected the argument of the authorities. The court held that there was not enough evidence showing that the taxpayer was not the one who utilized the funds received from such interest payment or that it did not have enough control over the funds.[23] Therefore, the focus of the court was on who received the interest payment as opposed to who was the ultimate owner of such a company.

Likewise, in *YUM! Restaurants (India) Pvt Ltd v Commissioner of Income Tax*[24] the question was whether the holding company of the taxpayer changed. Here, the ultimate parent company remained the same; however, there was a transfer of shares between the intermediary companies of the parent company which held the shares of the taxpayer. The question was whether the taxpayer could then claim the losses of previous years to offset the business income of the current year. The tribunal held that there was no evidence showing that there was an arrangement that made the ultimate parent company the beneficial owner and so a transfer of shares between the intermediary companies would amount to a change in the beneficial owners of the taxpayer. The tribunal did not allow the claim of the taxpayer. Hence, the court once again did not pierce the corporate veil to determine who the beneficial owner is.

Adopting the judicial approach in the abovementioned cases would be opposed to the purpose of changing the FDI policy as this would allow Chinese investors to surpass the scrutiny by creating legal entities such as companies. The definition in the Companies Act, as mentioned earlier, does not completely address all the concerns which PN3 poses. It deals particularly with the specifications of a 'significant beneficial owner' and therefore, fails to shed light on what would encompass a beneficial owner. Hence, it can be concluded that the RBI definition would be the most appropriate. It provides an exact understanding of what a beneficial owner is. It is also in consonance with the aim of the amendment, which is to focus on the ultimate natural owner behind the investment.

However, adopting this definition, in theory, will not suffice. A further perusal regarding this issue will be undertaken in Part IV.

FOREIGN INVESTMENT POLICY IN OTHER COUNTRIES

As mentioned earlier, India is not the only country that has tweaked its foreign policy in pursuance of the threat that emanates from Chinese investments. Many other countries in Europe and America have undertaken certain changes in their policy.

[23] ibid.

[24] *YUM! Restaurants (India) Pvt Ltd v Commissioner of Income Tax* 122 (2005) DLT 370.

This section of the paper will look into the changes adopted by the three countries. These countries have been chosen in a way that represents the trend across continents.

USA

In 2018, the Foreign Investment Risk Review Modernization Act (*hereinafter* FIRRMA)[25] was introduced.

It grants the President the authority to block or suspend proposed or pending foreign 'mergers, acquisitions, or takeovers' by or with any foreign person that could result in foreign control of any United States business, including such a merger, acquisition, or takeover carried out through a joint venture that threatens to impair the national security.[26]

FIRRMA further broadens the purview of review by the Committee on Foreign Investment in the United States, hereinafter referred to as the CFIUS, by adding four new types of covered transactions including a non-exhaustive provision which includes any other transaction, transfer, agreement, or arrangement designed to circumvent CFIUS jurisdiction.[27]

This amendment ensures that any sort of transaction which was previously not scrutinised will now be susceptible to an inspection and even a possible blockade if it is found to threaten national security. It does not limit the scrutiny to certain sectors or particular investors.

GERMANY

The German government has introduced many changes to its foreign investment regulations. The most recent addition is a draft bill to reform the Foreign Trade and Payments Act which was approved by the German government in April 2020. The amendment introduces a new threshold for foreign investments which can be reviewed by the German Federal Ministry for Economic Affairs and Energy. The threshold has been changed from investments that are an endangerment of public order and security to investments that are likely to affect public order or security in Germany.[28]

Till the amendment, an 'actual threat' had been the applicable standard. As a result of the change, critical infrastructure acquisitions could be examined in a more 'forward-

[25] Foreign Investment Risk Review Modernization Act HR 5841 of 2018 (US).

[26] ibid §403.

[27] US Treasury, *Summary of the Foreign Investment Risk Review Modernization Act of 2018* (US Treasury) <www.treasury.gov/resource-center/international/Documents/Summary-of-FIRRMA.pdf> accessed 8 September 2020.

[28] Außenwirtschaftsverordnung [AWV] [Foreign Trade and Payments Ordinance] BGBl I at 1637 (10 July 2020).

looking' manner in the future.[29] This grants the government an opportunity to further scrutinise the investments without being bound to a higher threshold, and as the USA amendment, there is no exhaustive list of sectors to which the scrutiny must be limited to.

AUSTRALIA

In Australia, the Foreign Acquisitions and Takeovers Amendment (Strategic Assets) Bill 2020, will amend the Foreign Acquisitions and Takeovers Act 1975. The object of this bill is to keep under the ownership and control of the people of Australia assets that are vital for the functioning of the economy. This is done by preventing foreign persons or entities from acquiring a 10 per cent or greater interest in Australian land, water, or other assets that are either of 'strategic economic importance' or 'strategic defensive importance' to Australia.[30]

To determine whether an asset is of strategic economic or defensive importance, a new body will be established, called the Foreign Ownership Assessment Board (FOAB).[31] This will result in closer scrutiny on all investments.

ANALYSING THE DIFFERENCES IN FOREIGN INVESTMENT POLICY

On a perusal of the aforementioned policy changes adopted by the 3 countries, certain differences are very apparent when comparing it with India's approach. The major difference which can be noted is that India has only brought in restrictions with respect to neighbouring countries; in practical terms, the restrictions have only been imposed against China. The other three have imposed restrictions on all countries which cross a particular threshold.

This particular focus on Chinese investments is puzzling when we take into consideration the rationale behind the policy change. The reason why the government decided to bring in the change was to curb opportunistic takeovers during the pandemic.[32] However, investments from China do not amount to much of India's FDI. Even when the pandemic induced effects on the markets were at their peak, the maximum amount of FDI, as DPIIT data shows[33], did not come from China. Therefore, the changes brought in by the PN3 can hardly be seen to remedy the reason for which it was introduced.

[29] Stefan Kirwitzke and Dr Falk Schöning, 'Next Steps Towards Tighter German Foreign Investment Control Rules Passed' (*JD Supra*, 20 June 2020) <www.jdsupra.com/legalnews/next-steps-towards-tighter-german-61849/> accessed 15 September 2020.

[30] Foreign Acquisitions and Takeovers Amendment (Strategic Assets) Bill 2020, Explanatory Memorandum .

[31] Foreign Acquisitions and Takeovers Amendment (Strategic Assets) Bill 2020, sch 1.

[32] Press Note No 3 (n 5).

[33] Department for Promotion of Industry and Internal Trade, *Fact Sheet on Foreign Direct Investment from April, 2000 To March, 2020* (Department for Promotion of Industry and Internal Trade, 28 May 2020) <https://dipp.gov.in/sites/default/files/FDI_Factsheet_ March20_28May_ 2020.pdf> accessed 8 September 2020 (Fact Sheet on FDI).

As mentioned earlier, the increase in the stake held by Chinese investors in HDFC was the major impetus for bringing about this change. However, what was largely lost in the smoke was that, along with China's increase in stake, Saudi Arabia, too, has been gradually increasing its stake-holding over the years.[34] Singapore has more stake in the bank than both Saudi Arabia and China and is one of the biggest sources of FDI in India.[35] Therefore, the question which looms large is whether the Indian policy change is actually able to do away with the threat of opportunistic takeovers. The Chinese fear is well-founded, but the complacence shown towards the intention of other countries is unwarranted.

The second difference is that other countries have not made it mandatory to obtain approval for all sectors. The countries which have been analysed focus on investments that flow into sectors that are important economically or due to their significance to the security of the country. In other words, strategically important investments.

India has chosen to introduce these restrictions in all sectors. This is immoderate, especially while considering the type of investments which India receives from China. The sectors which received maximum inflows from China include the automobile industry, electrical equipment, and services sector.[36] Also, most of the investment from China comes in the form of greenfield investments (out of 43 deals, 23 are greenfield investments[37]) where the investor brings in the capital and sets up new industries. This does not amount to takeovers; in fact, it helps in the development of infrastructure and employment. The restrictions imposed on investments and the likely delays associated with them will definitely affect these investments. Therefore, a blanket imposition of the restrictions across sectors does not help and to the contrary, would end up reducing the opportunities that investments offer.

On account of these observations, it would seem that the government introduced these changes hastily. It reflects the sentiments of the people as opposed to a rational consideration of the effects and effectiveness of such an action. Though this notification was introduced only for the pandemic times, it does seem like it will continue to operate till relations with China normalise. In the following segment, the author will attempt to make certain suggestions that could correct some of the

[34] 'HDFC Shares Fall 3.3% as People's Bank of China Raises Stake to 1.1%' (*News 18 Business*, 13 April 2020) <https://news18.com/news/business/hdfc-shares-fall-3-3-as-peoples-bank-of-china-raises-stake-to-1-1-2575421.html> accessed 8 September 2020.

[35] Fact Sheet on Foreign Direct Investment (n 33).

[36] 'India Received $1.81 bn FDI From China During Apr'14- Mar'19: Piyush Goyal' *Economic Times* (28 June 2019) <https://economictimes.indiatimes.com/news/economy/finance/india-received-1-81-bn-fdi-from-china-during-apr14-mar19-piyush-goyal/articleshow/69989734.cms?utm_ source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed 5 September 2020.

[37] Steven Raj Padakandla and Niranjan Sahoo, 'India's China FDI Gamble' (*Diplomat*, 1 May 2020) <https://thediplomat.com/2020/05/indias-china-fdi-gamble/> accessed 08 September 2020.

problems which have been identified.

SUGGESTIONS

A SEPARATE BODY FOR DETERMINING THREAT

Currently, all the FDI which comes from China requires approval and this goes to the respective ministry or the DPIIT. This is likely to be a very time-consuming process. Therefore, it would be beneficial to introduce a body that particularly focuses upon accepting or rejecting applications, like the CFIUS in the USA. CFIUS is an inter-agency committee, whose powers include the right to review and act against any national security concerns arising from non-controlling investments and real estate transactions involving foreign persons.[38] The review process under CFIUS mainly involves voluntary filing (except in some cases) by parties to the transaction. However, it can initiate the review of a transaction even where a filing has not been made.[39] This would ensure that there is a centralised agency which constantly reviews all the investment which comes into the country. As discussed earlier, Australia has also followed this suit and will establish an independent body- FOAB- to look at the investments which flow into the country.

This can also be justified by looking at the Chinese investment in HDFC. HDFC is the largest private sector bank in India.[40] The investment flowed into a very crucial sector of the Indian economy and that too by a foreign government-controlled bank. The investment was able to pass the scrutiny of the government. Therefore, it is possible to make strategic investments without pressing the alarm button.

Hence, there is a need to have a central agency that would scrutinise the investments like the erstwhile Foreign Investment Promotion Board (*hereinafter* FIPB), but one which is less restrictive in nature. FIPB scrutinised almost all investments and its approval were essential for the investments to flow in. The FIPB was later abolished to create a more conducive investment atmosphere.[41] In the USA, investments do not require the prior approval of the CFIUS. Instead, the body only monitors all investments and intervenes in the event that there is some threat.

In India, there never existed a statutory body like the CFIUS for comprehensively screening the FDI. Whatever limited examination the FIPB did, it did not extend to the post-approval stage.[42] Therefore, India should consider establishing a body like

[38] Defense Production Act 1950, 50 USC App 2170, s 721.

[39] Defense Production Act 1950, 50 USC App 2170.

[40] Prabhjote Gill, 'SBI, India's Largest Bank, is Only Worth a Third of HDFC Bank — and the COVID-19 Lockdown is Making it Bleed Even More' (*Business Insider*, 5 May 2020) <www.businessinsider. in/ finance/news/sbi-share-price-and-hdfc-bank-share-value-comparison/articleshow /75535265.cms> accessed 2 September 2020.

[41] Abolition of the Foreign Investment Promotion Board (FIPB) 2017, F No 01/01/FC12017 -FIPB.

[42] Biswajit Dhar and KS Chalapati Rao, 'What India Could Learn from US When it Comes to Examining FDI Inflows' (*The Wire*, 23 August 2018) <https://thewire.in/macro/what-india-could-learn-from-us-when-it-comes-to-examining-fdi-inflows> accessed 8 September 2020.

CFIUS. Like the FIPB, this body too could come under the aegis of the Ministry of Finance. This body can look into all investments which flow into the country and get involved in the event that there is some threat to the country.

Even if PN3 ends up being a temporary measure, it would still be beneficial to have a body that is entirely dedicated to reviewing foreign investments. This specialised body would be more equipped to undertake scrutiny of the investments. Further, FDI approval is often received later than other approvals and does not stick to the prescribed timelines. One of the reasons for this is the time taken by the various ministries/departments to provide their comments to the Competent Authority.[43] A specialised body would remove the need for approval from individual ministries and would help speed up the entire process.

NON-DISCRIMINATORY APPLICATION

The changes listed in PN3 have implications only on Chinese beneficial owners' investments. However, it would be prudent to widen the ambit of scrutiny to other countries as well, in order to ensure that strategic sectors and those crucial for national security do not fall into the hands of foreign powers, regardless of the latter's intentions.

Chinese FDI in India does not even fall in the top ten investments that flow into India.[44] India has received the most amount of FDI from Mauritius, Singapore, the Netherlands, and the USA.[45] Most of the Chinese capital raised this year came via a few deals by existing investors, and prior to the coronavirus pandemic and the FDI policy change.[46] This shows that Chinese investors have not focused on acquiring business cheaply due to their undervaluation and were only adding to their existing investments.

Further, as discussed earlier, the increase in the stake held by Chinese investors in HDFC prodded the introduction of PN3. But other countries, too, hold a stake in the bank. Also, China's central bank has sold some or all of its stake in HDFC. According to the latest data disclosed by the lender to the stock exchanges, People's Bank of China was not among HDFC's key shareholders, which identifies only those investors holding over 1% stake.[47]

[43] Rajat Sethi and Tanya Aggarwal, 'A Review of the Foreign Investment Approval Process in India' (*SNR*, 9 April 2020) <www.snrlaw.in/a-review-of-the-foreign-investment-approval-process-in-india/> accessed 16 September 2020.

[44] Fact Sheet on Foreign Direct Investment (n 33).

[45] ibid

[46] Mugdha Variyar, 'Chinese Funding in Indian Startups Slows Amid Pandemic, FDI Rule Change; Border Tensions a Concern' (*CNBC*, 18 June 2020) <www.cnbctv18.com/startup/chinese-funding-in-indian-startups-slows-amid-pandemic-fdi-rule-change-border-tensions-a-concern-6156161.htm> accessed 10 September 2020.

[47] Ashwin Ramarathinam and Swaraj Singh Dhanjal, 'China's PBoC Sells HDFC Stake' (Mint, 10 July 2020) <www.livemint.com/companies/news/china-s-central-bank-sells-hdfc-shares-11594385680034.html> accessed 8 September 2020.

Considering that Chinese investments have been overwhelmingly surpassed by the investments received from other countries, it can hardly be said that the government's aim to prevent opportunistic takeovers has been achieved. It is imperative to ensure that no country takes undue advantage of the ongoing crisis to make acquisitions.

Hence, there is a need to scrutinise investments from all countries and see if they are unduly taking advantage of the fall in prices. This would also ensure that strategic companies do not fall into the hands of foreign powers. This is the approach followed by other countries, as discussed earlier, and in India as well, it would be a more comprehensive and effective approach to achieve the objective mentioned in PN3.

SCRUTINY IN STRATEGIC SECTORS

As a corollary to the previous suggestion- apart from widening the ambit of scrutiny, there is also a need to limit it in other ways so that it is not an overly restrictive approach. The time taken to scrutinise all investments from Chinese beneficial owners, regardless of how strategically important it is for the country's security or economy, is not fruitful. Each investment now flowing from China must obtain clearance. As per the Standard Operating Procedure released by the DPIIT, a particular ministry must signify its approval or rejection of an application within 8 to 10 weeks.[48] This is not a short duration as investor sentiments can change in a lesser time period. And as mentioned earlier, these timelines are often not adhered to. Also, considering how the number of applications will increase in light of PN3, there is bound to be a backlog.

Further, the subject of national security is mostly opaque, and the ministry is not obliged to provide the reason for delaying an application or even revoking a proposed investment.[49] This would affect India's attractiveness as an investment destination deleteriously. This should be avoided at a time when India is trying to better its position in the World Bank's ease of doing business ratings.[50]

A recollection of the policy adopted by other countries discussed earlier reveals that they have only targeted investment that flows into the strategic sectors. This would be a more beneficial approach as after all FDI is a very important aspect for a developing economy such as India.

[48] Standard Operating Procedure (SOP) for Processing FDI Proposals 2017, No 1/8/2016-FC-1.

[49] Shrimi Choudhary, 'Border Backlash: India May put on Hold FDI Proposals of 6 Chinese Firms' *Business Standard* (New Delhi, 22 June 2020) <www.business-standard.com/article/economy-policy/watching-the-dragon-half-a-dozen-chinese-fdi-proposals-may-be-on-hold-120062100822_1.html> accessed 8 September 2020.

[50] 'World Bank's Ease of Doing Biz: DPIIT Focusing on 6 Parameters to Push India's Ranking' *Economic Times* (20 January 2020) <https://economictimes.indiatimes.com/ news/economy/policy/world-banks-ease-of-doing-biz-dpiit-focusing-on-6-parameters-to-push-indias-ranking/articleshow/73106380.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed 20 September 2020.

Chinese portfolio investment in start-ups like Ola, Swiggy, Paytm, OYO, and Snapdeal is now valued at more than $6 billion. Around 18 of the 23 unicorns in India are backed by Chinese investors.[51] This investment is likely to come under scrutiny and would affect the funding of such start-ups. A developing country like India requires sufficient and timely funds. Further, Chinese investments are mostly greenfield investments, which are highly beneficial to the country. There is already evidence that the FDI from China has slowed down due to the twin effects of Covid-19 and the amended FDI policy.[52]

There is a need to ensure that the steps taken to forward national security are not overly restrictive. The economic health of a country and its long-term security depends on maintaining a welcoming environment for the vast majority of foreign investments.[53] Therefore, the policy should be modified so that only those investments which fall into the strategic sectors, such as defence, banking, health, etc., come under this additional scrutiny. The government must identify sectors that have a greater bearing on the national security and economic stability of the country and probe only into investments flowing into the same.

THRESHOLD FOR BENEFICIAL OWNERSHIP

As discussed earlier, another concern that exists is the amount of interest a Chinese entity must have in the investing vehicle. Even if the government chooses to retain the existing policy, there should be clarity with respect to its applicability. Authorised dealer banks are applying different thresholds for determining beneficial ownership for FDI coming into India, adding to the uncertainty surrounding the amended PN3 guidelines.[54] Legal certainty plays a huge role in determining the kind of global investment which can be attracted. Countries with high legal uncertainty degree tend to hold back more conservative investment. [55]

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[51] Burman (n 2).

[52] Variyar (n 46).

[53] Alan P Larson and David M Marchick, *Foreign Investment and National Security* (Council on Foreign Relations Press, July 2006) <https://cdn.cfr.org/sites/ default/files/pdf/2006/07/CFIUSreport.pdf> accessed 17 September 2020.

[54] Ashley Coutinho, 'Varying Beneficial Ownership Caps Muddy Waters for FDI Investments' (*Business Standard*, 8 June 2020) <www.business-standard.com/article/economy-policy/varying-beneficial-ownership-caps-muddy-waters-for-fdi-investments-120060700997_1.html> accessed 08 September 2020.

[55] Fabio Ulhoa Coelho, 'Legal Certainty and Protection of the Investments: A Comparative Perspective (Common law & Civil law)' (2017) 1 International Journal of Insolvency Law <https://ojs.imodev.org/index.php/IJIL/article/view/154/265/> accessed 8 September 2020.

[56] RBI Master Direction (n 19).

[57] Shrimi Choudhary and Subhayan Chakraborty, 'India May Set 10% Beneficial Ownership Cap for FDI Flowing from Countries' *Business Standard* (11 May 2020) <www.business-standard.com/article/economy-policy/india-may-set-10-beneficial-ownership-cap-for-fdi-flowing-from-7-countries-120051100016_1.html.> accessed 08 September 2020.

Therefore, it is imperative to bring in some clarity with respect to the applicable threshold. A large number of banks have been using the RBI Circular to determine a beneficial owner. It prescribes a threshold of 25% for a company and 15% for non-corporate, such as partnerships and trusts.[56] There are speculations that the government may instead propose that the cap should be 10%.[57]

Without an official notification, it is fruitless to contemplate on which of the existing definitions of beneficial ownership is to be applied. Even though the RBI Master Direction is an appropriate definition, after the notification of Foreign Exchange Management (Non-debt Instruments) Rules, 2019, the finance ministry has become the notifying authority for changes to FDI policies, instead of the RBI.[58] Therefore, it is not binding on any of the stakeholders. Hence, there is a need for the DPIIT to officially come out with a statement regarding which standard to apply or introduce its own criteria for the same.

CONCLUSION

The Indian economy is going through tumultuous times and there is a shortage of funds due to the ensuing pandemic. In such a scenario, it is exigent that changes in policy do not further hamper the investment which flows into the country. The changes brought in by PN3, apart from dampening investor sentiment, is also plagued with ambiguity when it comes to application. This lack of clarity is an additional complication which future investments will face. A non-uniform application of the rules by authorised dealers would again give rise to arbitrariness which would hold back India's attempt to be an attractive place for investment.

By taking a cue from other countries, it can be seen that a blanket application of restrictions on all investments is not the appropriate path to choose. It is of course uncontended that the security of the nation should be at the forefront when it comes to deciding the FDI policy. However, when investments are not likely to affect the security of the country, it would be ideal to not impose restrictions on the same.

The anti-Chinese sentiments in India are growing and the amendment spelt the beginning of a slew of actions against China. However, it is of utmost importance that we do not lose sight of the fact that Chinese investments in India fund a lot of start-ups and it also creates many work-opportunities for the people. With the new policy in place, there will be a delay in receiving investments which are likely to affect the attractiveness of India for investment. Therefore, the government should consider changing the restrictions in such a manner that investments in non-strategic sectors are left unscathed and only those which have the potential to affect national security should be scrutinised. This is particularly essential during the pandemic, as it would be the time when companies and start-ups would require funding the most.

To ensure a more holistic approach the government, while bringing about a policy change, must try to balance the security interests of the country with the essential interests of the economy.

[58] Finance Act 2015.