Demystifying Protectionist Regimes in the Age of Globalisation: A Brief Comparative Analysis of the Indian and Other FDI Screening Regimes

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When one embarks on the journey to find a precise definition of the term 'protectionism', it can be guaranteed that the term at best provides a general description of a societal or economic ill that must be avoided by a modern society. The risk attached to such a generic term is the subjective nature in

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which the term is used in specific instances. However, protectionism is here to stay, as nations are increasingly becoming more nationalistic.

The world is experiencing the effects of increased globalisation at a transcendental speed. One of the key factors behind such globalisation is foreign direct investment (FDI). FDIs often outperform government aids and portfolio investments, as one of the largest sources of non-debt external financing. In addition to the direct benefit of capital inflows that FDIs bring, certain indirect benefits follow suit.[1] Access to diversified international markets, an increase in domestic supply chains, reforms in domestic laws and regulation to keep pace with modernisation are key indirect benefits, which have made FDIs an attractive option for domestic markets.[2]

However, while modern governments are well informed about the lucrativeness of FDIs coming from resource-rich destinations, many countries have begun to implement rigid screening mechanisms before permitting FDI inflows. The rise of opportunistic takeovers[3] and foreign investments made with undesirable motives has propelled an increase in FDI screening mechanisms across countries.[4]

The first part of this article aims to understand the general rise of protectionism in the formulation of FDI policies and the impact of the Covid-19 pandemic on the same. The second part involves an analysis of Indian FDI regimes with a protectionist character. Finally, in the third part, the authors compare the Indian FDI regime with other FDI regimes around the world, to identify protectionism in FDI laws.

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1 Federico Carril-Caccia and Elena Pavlova, 'Foreign Direct Investment and its drivers: a global and EU perspective' (June 2018) 4 ECB Economic Bulletin https://www.ecb.europa.eu/pub/economic-bulletin/articles/2018/html/ecb.ebart201804_01.en.html accessed 14 June 2023.

2 UNCTAD, 'World Investment Report 2021' (United Nations 2021) https://unctad.org/system/files/official-document/wir2021_en.pdf accessed 10 June 2023.

3 'National Security-Related Screening Mechanisms for Foreign Investment' UNCTAD Investment Policy Monitor https://unctad.org/system/files/official-document/diaepcbinf2019d7_en.pdf accessed 11 June 2023.

4 Prakash Loungani and Assaf Razin, 'How Beneficial Is Foreign Direct Investment for Developing Countries?' (June 2001) 38(2) Finance & Development Magazine, International Monetary Fund https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/the-impact-of-covid-19-on-capital-markets-one-year-in accessed 14 July 2023.

The rise of protectionism in FDI policies

Covid-19 and its aftermath

A key element of economic globalisation has been the interdependence of supply and demand of essential goods and services experienced by countries on a global scale.[5] However, with the onset of the Covid-19 pandemic early in 2020, supply and demand witnessed simultaneous shocks due to lockdown restrictions and containment measures imposed by several countries, in an effort to curb the spread of the virus. Trade restrictions, restricted supply of critical goods, shortage of medical supplies and the corresponding demand for the goods across the world highlighted the interconnected nature of today's globalised world.[6] While this may be true, countries began to take greater precautions to reduce their dependence on other countries in regards to sources considered 'risky' from a domestic perspective.

The market meltdown caused by the pandemic led to a lack of liquidity in companies, which in turn made them vulnerable to opportunistic takeovers. Several countries, including India, introduced policies to curb instances of such takeovers of domestic entities. The deficiency in global supply of critical goods, along with the possibility of hostile takeovers, strengthened the nationalistic tendencies of countries. Since 2020, the world has witnessed the growth of increasingly protectionist FDI policies.

More recently, rising geopolitical tensions in the European Union flowing from the Russian invasion of Ukraine have resulted in several Member States

5 Ivo Mossing and Michael Lischka, 'Globalisation, Economic Interdependencies and Economic Crises' in *International Impacts on Social Policy* (Palgrave Macmillan 2022), 289–304.

6 Tarek Sultan, '5 ways the COVID-19 pandemic has changed the supply chain', *World Economic Forum* (14 January 2022) https://www.weforum.org/agenda/2022/01/5-ways-the-covid-19-pandemic-has-changed-the-supply-chain accessed 10 June 2023; Chad P Bown, 'How COVID-19 Medical Supply Shortages Led to Extraordinary Trade and Industrial Policy' (2022) 17(1) https://www.ncbi.nlm.nih.gov/pmc/articles/PMC8441910 accessed 9 June 2023; Devanshu Jain, 'Shortage of everything: How Covid-19 exposed the vulnerability in modern global supply chains' *Economic Times* (14 August 2021) https://economictimes.indiatimes.com/small-biz/trade/exports/logistics/shortage-of-everything-how-covid-19-exposed-the-vulnerability-in-modern-global-supply-chains/articleshow/85320950.cms accessed 10 June 2023.

notifying stringent FDI screening laws.[7] Concerned authorities have been granted extensive powers such as the power to 'call in' FDI transactions for review post-closing, if there is a possible threat to national security interests.[8]

The tale of protectionism and geopolitics

A quest to understand the precise meaning of protectionism would be futile. The word 'protectionism' has been used in a very generic manner, often with a subtext, condemning a societal or economic ill that a particular section of society denounces.

No democratically elected government explicitly espouses protectionism, as the underlying objective of such governments is economic growth and increased capital inflows into domestic economies. Trade restrictions would obstruct this objective. Therefore, the abstract concept of protectionism is to be evaluated against specific criteria indicated by governments, such as 'national or security interest' or 'public interest'. However, such phrases are vague and can, once again, lead one into the loop of uncertainty behind an understanding of the subtext of protectionist policies issued by authorities. It is at this juncture that an understanding of the geopolitics of countries becomes important in ascertaining the motive and objective behind state-issued policies.

In a recent ruling, the Court of Justice of the European Union has clarified that the EU FDI Screening Regulation 2019/452 does not apply to acquisitions by EU-based investors (except in prescribed circumstances) (Case C-106/22). Further, measures that restrict fundamental freedoms (ie, free movement of capital/freedom of establishment) can be justified only on the ground that the acquisition harms, or risks harming, the national interest.[9]

7 European Commission, 'Guidance to the Member States concerning foreign direct investment from Russia and Belarus in view of the military aggression against Ukraine and the restrictive measures laid down in recent Council Regulations on sanctions' (2022/C 151 I/01) https://eur-lex.europa.eu/EN/legal-content/summary/screening-framework-for-foreign-direct-investments.html#:~:text=In%20response%20to%20Russia%27s%20unprovoked%20and%20unjustified%20military,and%20public%20order%20from%20Russian%20and%20Belarusian%20investments accessed 12 June 2023.

8 International Monetary Fund 'Trade Disrupted' (June 2023) 60(2) Finance & Development Magazine https://www.elibrary.imf.org/view/journals/022/0060/002/article-A007-en.xml accessed 13 June 2023.

9 Case-106/22, *Xella Magyarország Építőanyagipari Kft v Innovációs és Technológiai Miniszter*, Judgment of the Court (Second Chamber), available at https://curia.europa.eu/juris/document/document.jsf;jsessionid=017AC12693F29897C9361833CD208357?text=&docid=275390&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=2271465.

When marrying protectionism and geopolitics in the context of FDIs, an important question that arises is whether a company that has received foreign funding through FDI, can act independently of any control exercised by their home state. Another important concern flowing from this question is whether the company operating in the host jurisdiction is pursuing strategic objectives of their home state, especially in sensitive sectors. Therefore, whether geopolitical tensions are real or imagined, they play a significant role in influencing the regulatory policies of different countries.

Protectionism in FDI regimes

As discussed above, FDI acts as one of the key modes of capital financing for domestic growth and the proliferation of FDI regimes across countries stands as testimony to this. However, the lasting impact left by the Covid-19 pandemic and other geopolitical tensions between countries has increased awareness among countries that protecting certain vital industries and strategic enterprises plays a significant role in safeguarding national interests, whether economic or political.

On a preliminary review of the FDI screening regimes adopted by countries such as India, the United States and (some of) the Member States of the European Union, it is clear that there is a combination of sector-specific and jurisdiction-specific reviews. Investments are subject to enhanced review depending on the criticality of the sector of investment and nature of control that may be strategically exercised by investors, in terms of their voting rights, shareholding, material influence or effective participation in the management decisions of the target entity.

The following part provides an overview of the legislative and policy developments that have taken place in India in the FDI landscape along with a brief comparison of the Indian regime against FDI screening mechanisms adopted by different jurisdictions in the recent past.

India

Foreign exchange control laws

Foreign Exchange Management Act and accompanying Rules

The Indian FDI regime has experienced a vast transformative change since the 1990s. When the erstwhile Foreign Exchange Regulation Act 1973 (FERA) was in place, no foreign investment, whether for the purpose of setting up a branch office in India or acquiring a whole or part of any

Indian company, was permitted without obtaining prior approval. During this regime, the rule-making power was exercised by the Reserve Bank of India (RBI). Under the FERA regime, all FDIs were de facto subjected to an approval regime, which increased the complexity in the Indian FDI regime and made the process cumbersome to investors. However, the introduction of the Foreign Exchange Management Act 1999 (FEMA) and the various rules and regulations issued thereunder have eased the FDI process by clearly bifurcating foreign investments that require government approval and those that are permitted to be made without any approval requirement.

The Foreign Exchange Management (Non-Debt Instruments) Rules 2019 (the 'NDI Rules') have been instrumental in removing bottlenecks with respect to foreign investments. Under the NDI Rules, FDIs are permitted to be made under two routes: the automatic route and the approval route. Under the automatic route, foreign investment up to 100 per cent can be made in specified sectors such as mining, petroleum and natural gas, manufacturing, airports, greenfield pharmaceuticals, financial services and industrial parks, without obtaining any prior approval. However, under the approval route, foreign investments in certain sectors such as satellites, private security and agencies, print media and public sector banking are permitted, subject to obtaining prior approval from the relevant ministry of the central government.[10] Further, India has a hybrid model for certain sectors such as defence, air transport services, telecom services and single brand product retail trading where FDIs up to 49 per cent are permitted under an automatic route subject to prescribed conditions and any investment exceeding the 49 per cent threshold will be subject to the approval route. In addition to the NDI Rules, India's Foreign Direct Investment Policy 2020 (the 'FDI Policy') prescribes certain FDI-linked conditions that must be satisfied for the purpose of making the FDI.[11] For instance, in the multi-brand retail trading sector, FDI up to 51 per cent is permitted under the approval route subject to satisfying certain conditions such as the condition that requires that at least 30 per cent of the value of procurement of manufactured/processed products purchased should be sourced from Indian micro, small and medium-sized enterprises, which have a total investment not exceeding US$2m.[12] The law captures the specific conditions that must be satisfied by investors for any proposed FDI. Clear indications and compliance of investment conditions significantly reduce the risk of the transaction being questioned at a later point.

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10 Foreign Exchange Management (Non-Debt Instruments) Rules 2019, rule 3(b) ('NDI Rules').

11 Consolidated FDI Policy, DPIIT Government of India (15 October 2020).

12 *Ibid* 9.

Press Note 3 (Series 2020)

While the overall regime under the NDI Rules and FDI Policy capture a sector-specific review of foreign investments, protectionist layers can be found in prohibited investments by certain countries. For instance, a citizen of Pakistan or an entity incorporated in Pakistan is not permitted to invest in defence, space or atomic energy, even under the government route. India's longstanding geopolitical tensions at the India–Pakistan border and differences at a policy level have seeped their way into the FDI regime. This being the exception to the rule, Press Note 3 (Series 2020) ('PN 3'), issued by the Department for the Promotion of Industry and Internal Trade (DPIIT') on 23 March 2022, is intended to 'curb the opportunistic takeovers/acquisitions of stressed and strategic assets of Indian companies due to the current pandemic'.[13]

Under PN 3, all FDIs from countries sharing a land border with India (ie, Afghanistan, Bangladesh, Bhutan, China, Myanmar, Nepal, Taiwan and Pakistan) are required to obtain a security clearance from the Central Ministry of Home Affairs (MHA) and approval from the relevant central department, prior to making any investment into India. The government has clarified that even in the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in beneficial ownership falling within the purview of PN 3, such subsequent change in beneficial ownership will be subject to government approval.

With the notification of PN 3, certain key amendments have been made to FEMA and the FDI Policy. Accordingly, all investments, direct or indirect, by entities incorporated in a 'country which shares [a] 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',[14] now require prior approval of the Indian government. Prior to the introduction of PN 3, only FDI from entities that were either based out of Pakistan or Bangladesh required prior government approval. The primary trigger behind the notification of PN 3 appears to be rising geopolitical tensions, catalysed by the Covid-19 pandemic.

The main concern surrounding PN 3 from the date of its notification has been the sheer ambiguity surrounding the term 'beneficial owner' and the lack of guidance afforded by the government in clarifying what

13 Ministry of Commerce & Industry, 'Government amends the extant FDI policy for curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic' (18 April 2020) https://www.pib.gov.in/PressReleasePage.aspx?PRID=1615711 accessed 14 June 2023.

14 Ministry of Commerce & Industry, 'Investment from Land Border Sharing Countries' (23 March 2022) https://pib.gov.in/PressReleasePage.aspx?PRID=1808806 accessed 14 June 2023.

beneficial ownership means in the context of FDI approvals. Under Indian laws, there is no uniform and consistent definition of a 'beneficial owner'. As per the Companies (Significant Beneficial Owners) Rules 2018, read with the Companies Act 2013, an entity holding not less than ten per cent shareholding in an entity would be considered as a beneficial owner.[15] However, under the Prevention of Money Laundering (Maintenance of Records) Rules 2005, a 'beneficial owner' is an individual who either has a controlling ownership interest, that is, more than 25 per cent ownership of the entity, or can exercise control on the policy decisions or management of the entity.[16] Considering that investors often have multi-layered structures, spread across various jurisdictions, the ambiguity has led to significant difficulties in the computation of beneficial ownership. As a result, even minority investments involving less than ten per cent investment by land-bordering nations have been subject to government approval and MHA clearance.

It is to be noted that FDIs made into Indian limited partnerships are also covered under the ambit of the NDI Rules.[17] Further, investments made by investment funds such as pooled investment vehicles, which are owned and controlled by persons resident outside India, will be considered as indirect foreign investment and will be subjected to reporting and filing requirements by the RBI and accordingly, applicability of PN 3 needs to be analysed from this angle as well.[18] The onus of ensuring compliance of provisions under the FDI Policy are on the investee company and any violations of the FDI regulations would attract penal provisions under FEMA, which may involve a penalty of up to three times the sum involved in such contravention where the amount is quantifiable or up to Indian rupees two lakhs where the amount is not quantifiable and unwinding of the transactions among other penal actions.[19]

Reporting requirements

Under the current regulatory regime of India, all FDI inflows into India, whether in the form of downstream investments or direct investment through share purchase, are subject to mandatory reporting requirements to the RBI. The details furnished through these filings have played a

15 Companies (Significant Beneficial Owners) Rules 2018, r 2(e).

16 Prevention of Money Laundering (Maintenance of Records) Rules 2005, r 9(3).

17 NDI Rules, rule 2(s).

18 NDI Rules, sch VIII cl 4.

19 Government of India, Department for Promotion of Industry and Internal Trade, 'Consolidated FDI Policy Circular' (29 October 2020) https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf accessed 14 June 2023.

key role in tracking FDI inflows into India. In addition to the screening mechanism under exchange control laws, the government has fortified the implementation of the FDI system by amending supporting legislation. For instance, if a person who is a citizen of a land-bordering country is to be appointed as a director of an Indian company, they are required to first obtain clearance from the MHA before being allotted their unique director identification number (DIN).[20] Under the merger control laws of India, if a merger or cross-border compromise between an Indian company and a company or body corporate that has been incorporated in a land-bordering country is to be effected, a declaration with the details of the transferor and transferee along with an affirmation of whether prior approval under the NDI Rules is required to be obtained or not, is to be submitted to the relevant National Company Law Tribunal (NCLT). In case prior approval is required, then such approval would have to be enclosed as part of the declaration.[21]

On 31 May 2023, the Securities and Exchange Board of India (SEBI), which is the securities regulator watchdog of India, floated a public consultation paper wherein additional mandatory disclosures relating to foreign portfolio investors (FPIs) have been considered at the policy level.[22] India has increasingly seen a pattern of investments coming in from land-bordering nations, through the FPI route, attempting to circumvent PN 3 oversight. However, SEBI has now considered categorising FPIs into high-risk, medium-risk and low-risk categories, where high-risk FPIs will be subject to additional granular disclosure requirements pertaining to beneficial ownership.[23]

India has been forthcoming when it comes to facilitating foreign investments. While PN 3 and the approval routes under the NDI Rules may appear to be restrictive in nature, they are not prohibitive. From a practical standpoint, FDI approvals from the government have not been forthcoming when investors have been reluctant to share details of the ultimate beneficial owners (UBOs). Since UBOs exercise decisive control, it becomes a key aspect of the screening process. Often, hesitance to disclose UBO details is viewed with circumspection, thereby resulting in either the prolonging

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20 Companies (Appointment and Qualification of Directors) Amendment Rules 2022, r 8.

21 Companies (Compromises, Arrangements & Amalgamations) Amendment Rules 2022.

22 Securities and Exchange Board of India, 'Consultation Paper on Framework for Mandating Additional Disclosures from Foreign Portfolio Investors (FPIs) that Fulfil Certain Objective Criteria to Guard Against Possible Circumvention of Minimum Public Shareholding Requirements' (May 2023) https://www.sebi.gov.in/reports-and-statistics/reports/may-2023/consultation-paper-on-framework-for-mandating-additional-disclosures-from-foreign-portfolio-investors-fpis-that-fulfil-certain-objective-criteria-to-1-guard-against-possible-circumvention-of-minim-_71946.html accessed 14 June 2023.

23 *Ibid* 21.

of the review process or rejection of the FDI application. However, we have also generally observed post-facto approvals being accorded by the RBI and the government, subject to the settlement process. Therefore, it becomes important to note that the screening of investments under the Indian regime stems from protection of the national interest as opposed to a mere politically motivated retaliatory response.

Other regulatory developments

India has made certain ardent efforts to protect domestic interests through regulatory developments. For instance, the recent Foreign Exchange Management (Overseas Investment) Rules notified in 2022, which regulate overseas investments made by persons resident in India, contain pricing guidelines.[24] According to these Rules, price considerations for the transfer or issue of equity shares of a foreign entity to a person resident in India must be decided on an arm's-length basis. Further, before any payment in pursuance of the share acquisition is processed, the relevant bank is required to ensure that the pricing is in compliance with arm's-length pricing. Therefore, to an extent, the pricing guidelines protect the interests of persons resident in India by ensuring that all purchase considerations paid through outward remittance are on an arm's-length basis.

India in comparison to other jurisdictions[25]

In the recent past, several countries have enacted laws to screen FDIs for the purpose of protecting and securing 'national interests'. The United States was one of the first countries to embark on this journey, with the enactment of the Foreign Investment Risk Review Modernization Act 2018 (FIRMA).[26] The European Union (EU) soon followed suit with Regulation (EU) 2019/452 'Establishing a framework for the screening of foreign direct investments into the Union' (the 'EU Regulation'), to enable Member States to screen FDIs 'which establish or maintain lasting links between investors from third countries including entities and undertakings carrying out an economic activity in a Member State'.[27]

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24 Foreign Exchange Management (Overseas Investment) Rules 2022, r 16.

25 The analysis set out under this section is based on the information available to the authors through public records and public searches. All views expressed thereunder are the personal views of the authors.

26 Foreign Investment Risk Review Modernization Act 2018.

27 Regulation (EU) 2019/452 of the European Parliament and of the Council, 'Establishing a Framework for the Screening of Foreign Direct Investments into the Union' (Official Journal of the European Union, LI 79/1, 21 March 2019).

The following section attempts to provide a high-level comparison between the Indian and other global FDI regimes, in an attempt to delineate the narrow or broad-based practices adopted by different governments in terms of the scope of FDI laws, prescribed thresholds and sectors covered, among others.

Targets

India currently has a combination of a sector-specific and investor-nationality-specific FDI regimes. This is not uncommon among other jurisdictions, since certain sectors are considered more critical than others and warrant special scrutiny and protection. Further, certain countries from the geopolitical context pose greater political risks.

The sector-specific screening and approval regime in India is well captured within the NDI Rules and the FDI Policy, where the scope is narrower and pertains to FDI within select sectors made in Indian entities.

Investors covered

When it comes to investor-nationality-specific screening and approval regimes, PN 3 plays a vital role since it is broad based. PN 3 covers not only direct investments made by citizens or entities registered in the land-bordering countries of India, but also covers the instance of transfer of ownership of any existing or future FDI in India (direct or indirect), whereby beneficial ownership is held by a person from a land-bordering country. Furthermore, Rule 6 of the NDI Rules has restricted any investment from citizens or entities of Pakistan from making FDI into the Indian defence, space and atomic energy sectors even under the approval route of the central government.[28]

Sectoral scope

The Indian regime is narrower when compared to certain other jurisdictions, such as the United Kingdom, in terms of the scope of targets and sectors covered under domestic FDI laws.

In the United Kingdom (UK), the National Security and Investment Act 2021 (NSIA), which was made effective from 4 January 2022, has a broad definition of qualifying entities. Qualifying targets include not just targets incorporated in the UK but also those incorporated outside the UK, which render services and supply goods and services to persons in the UK. Therefore,

28 *Ibid* 9, r 6.

all FDIs made into qualifying targets, which, inter alia, satisfy the above requirement, will be subject to screening.[29] Further, the NSIA has identified land, tangible moveable property and ideas, information and techniques that have commercial or economic value (such as algorithms, source codes and designs) as 'qualifying assets'. Therefore, any FDI transaction that provides the investor with control over a qualifying asset of a qualifying entity will be subject to screening.[30]

The United States regulates FDI in critical technology, critical infrastructure and sensitive personal data (collectively 'TID business').[31] TID business includes entities that produce, design or develop critical infrastructure and technology and entities that maintain or collect the sensitive personal data of citizens of the United States, directly or indirectly.[32] Since a lot of B2B entities and corporations deal with sensitive personal data, not limited to the financial services and health sector, the scope of review is wide.

France regulates FDIs in sensitive activities (as set out under the French Monetary and Financial Code), inter alia, including the following sectors: defence and security, public health, big utilities and critical infrastructures (ie, energy, telecoms, transport, water supply), R&D in critical technologies and activities relevant in terms of food security).[33]

Similar to the 'beneficial interest' concept captured in the Indian PN 3, under the Slovakian FDI regime, 'foreign investor' includes a person who has a registered office in an EU Member State but is controlled by or has a beneficial owner who is a non-EU person.[34]

Investment thresholds

In terms of the thresholds covered under the Indian regime, the NDI Rules prescribe different investment caps for different sectors, depending on the criticality and sensitivity of such sectors. For instance, in the defence sector, while 100 per cent FDI is permitted, investments up to 49 per cent

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29 National Security and Investment Act 2021, s 7.

30 *Ibid*.

31 US Government Presidential Documents, 'Executive Order on Ensuring Robust Consideration of Evolving National Security Risks by the Committee on Foreign Investment in the United States' (20 September 2022) Vol 87, No 181 57369.

32 31 Code of Federal Regulations s 800.248.

33 France, Investment Policy Hub, UNCTAD, available at https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3468/france-expands-and-clarifies-its-fdi-screening-regime.

34 Slovak Republic, 'Law on checking foreign investments and amending some laws' (Temporary version effective from 1 March 2023 to 28 March 2023) (29 November 2022) 497/2022 Coll s 4.

can be made under the automatic route and investments exceeding 49 per cent are permitted only with the prior approval of the central government. Separately, in the case of FDI into the print media sector, FDI up to 26 per cent is permitted subject to obtaining the prior approval of the central government. This broadly covers the sector-specific thresholds specified for countries that do not share a land border with India.

India follows a regime similar to the UK, where specific investment thresholds subject to approval have been prescribed for 'sensitive' sectors. In the UK, any acquisition of interest or material influence in one of the 17 sensitive sectors and acquisition of 25 per cent, 50 per cent or 75 per cent of the votes or shares in a qualifying entity (not falling within the 17 sensitive sectors) requires notification to the Investment Security Unit (ISU).[35]

Under PN 3, there is no prescribed threshold for notifying FDI from land-bordering countries when regulating the investments made by 'beneficial owners' hailing from land-bordering countries. Owing to ambiguity in relation to the notifiable investment thresholds, even a minor investment to the tune of five per cent indirect shareholding may require the prior approval of the central government and clearance from the MHA. Similar broad-based concepts have been captured in other jurisdictions.

For instance, in the United States, FIRMA categorises transactions into controlled transactions and covered transactions. The definition of 'control' is broad under FIRMA, as any investment that grants the investor the right, whether exercised or not, to direct or decide important matters relating to an American entity, will be deemed to be a controlled transaction. With respect to covered transactions, any investment that grants a foreign investor with access to material non-public information or observer rights on the board or provides substantive decision-making power over an American entity will be covered for the purpose of FDI screening.

In the EU, Slovakian FDI laws consider not only the control acquired by an investor through voting rights and shareholdings but also the increase in effective participation over the affairs of the target company and acquisition of ownership interests over the strategic assets of a Slovakian target entity.[36]

In Ireland, the law governing FDI screening requires notification not only of a transaction or an acquisition that enables the foreign investor to exercise control over an Irish entity, but also that any proposal considered to effect such a transaction be notified to the Minister for Enterprise, Trade and Employment.[37]

35 NSIA, ss 8 and s 9.

36 Slovakia Bill, s 12(1).

37 Ireland, 'Screening of Third Country Transactions Bill 2022, 2022 (No 77a of 2022) ss 12 and 15 https://enterprise.gov.ie/en/legislation/legislation-files/screening-of-third-country-transactions-bill-2022.pdf (Slovak Bill) accessed 14 June 2023 (Screening of Third Country Transactions Bill 2022).

Screening powers and notification requirements

All FDI inflows into India, whether in the form of downstream investments or direct investments through share purchases, are subject to mandatory reporting requirements to the RBI. Generally, in the case of share allotments to non-residents, a foreign currency gross provisional return ('Form FC GPR') is to be filed by the Indian entity receiving the FDI, within 30 days of the date of issue of the equity instruments and in the case of a share transfer from a resident to a non-resident and a foreign currency transfer of shares ('Form FC TRS') is to be filed by the resident transferor within 60 days of the date of transfer of the equity instruments.[38] In relation to sectors subject to government approval under the NDI Rules, no action in relation to an investment exceeding the investment thresholds can be made without obtaining the said approval. Further, for FDIs from land-bordering countries, no action can be taken pursuant to the investment transaction without obtaining the approval of the relevant department of the central government and clearance from the MHA. In case of violation of Form FC GPR and Form FC TRS filings, the penalty includes the payment of fines as well as compounding of offences through settlement. Further, in the case of any FDI transaction being undertaken without the necessary approvals from the central government, the transaction may be called in for post-facto review at any point and be subject to compounding under FEMA.

The Indian FDI regime is very similar to the regimes in Germany, Ireland, Italy, the Netherlands and Slovakia in terms of the screening powers that may be exercised by the authority concerned.

Under the German FDI regime, the German Federal Ministry for Economic Affairs and Energy has the power to call in a transaction for review, when there is an acquisition of atypical control or influence in terms of the acquirer enjoying the right to decision-making in the management of the German target entity or the foreign investor has veto rights in making strategic business decisions and access to certain information rights of the German target entity.

In the Netherlands, the Investments, Mergers and Acquisitions Security Review Act (the 'Vifo Act'), which came into effect in June 2023, not only introduced an ex ante notification obligation but also has retrospective application on all FDI transactions entered into from 9 September 2020 (and which closed before the entry into force of the regime). The Bureau Toetsing Investeringen (BTI) has the power to review an investment transaction within eight weeks (with extensions being possible) after the notification or

38 RBI Master Direction – Foreign Investment in India (2018), Annex 1 p 1.3.

of the issuance of an intimation to the parties that a review decision would be required.[39]

In Italy, the golden power decrees accorded to the Presidency of the Council of Ministers (the 'Presidency') bestows the Presidency with the power to oppose a transaction or prescribe conditions and modifications to a transaction or to block the transaction through the exercise of veto powers, if there is a reasonable security concern stemming from the investment.[40]

Under the Irish FDI laws, irrespective of whether a transaction is notifiable or not, the Minister for Enterprise, Trade and Employment is empowered to commence a review of a non-notified transaction after the later of five years from the date on which the transaction is completed, or six months from the date on which the Minister first becomes aware of the transaction.[41]

Similar to the above jurisdictions, in India, the RBI, along with the central government, has the power not only to review notified transactions that are subject to government approval and security clearance but have the power to carry out post-facto review of non-notified transactions in case of any potential breach of the FDI policies of India. For instance, a case of 20 per cent FDI into India in a 100 per cent FDI permitted sector, where a few of the investors at the UBO level are from land-bordering countries and hold an aggregate of five per cent of the equity shares, may be called in for review, owing to a possible trigger of PN 3. Therefore, there is always the possibility of the RBI or the central government exercising their screening powers on a post-facto basis for non-notified transactions, depending on the particulars of the investment and the subjective risks that the government may foresee.

National security tests

While the Indian FDI laws have not indicated a 'national security test' based on which transactions will be subject to review, the statement and objects given under PN 3 articulate that the policy is intended to govern and curb opportunistic takeovers and acquisitions of stressed and strategic assets of Indian companies. While PN 3 was introduced during the Covid-19 pandemic, the policy is still in existence and continues to monitor and govern FDI from land-bordering countries and the same is sector agnostic.

The Indian FDI regime in relation to possible indications of a 'national security test' is very ambiguous and unclear when compared to jurisdictions such as the United States and Netherlands.

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39 *Ibid* 32.

40 Law Decree No 15 March 2012, art 4.

41 Screening of Third Country Transactions Bill 2022, s 12(2).

In the case of the United States, under FIRMA, national security risks are assessed keeping in mind the following situations:[42]

- where the transaction involves a country of special concern, which has demonstrated or declared a strategic goal of acquiring a certain type of critical technology or infrastructure that can affect United States' leadership in areas related to national security; or
- where a covered transaction has the potential to create or exacerbate cybersecurity vulnerabilities in the United States; or
- where a transaction is likely to expose personal identifiable information of citizens to foreign governments.

Under the Dutch Vifo Act, the BTI considers whether a given investment, merger or acquisition activity:[43]

- disrupts the continuity of vital processes in the Netherlands; or
- affects the integrity and exclusivity of knowledge and information containing critical or strategic information for the Netherlands; or
- creates an unwanted strategic dependence of the Netherlands on other countries.

The Court of Justice of the European Union in Case C-106 dealt with the question of the applicability of EU FDI Screening Regulation 2019/452 in light of the fundamental freedoms of free movement of capital and freedom of establishment. In passing its ruling, the Court stated that acquisitions by EU-based investors will not be subject to the Screening Regulation, unless such acquisition falls within the prescribed ambit. Further, the Screening Regulation, which restricts fundamental freedoms, can only be justified on the grounds that bona fide and serious threats to national security are assessed.[44]

In the recent past, the ISU in the UK has provided conditional clearance to a few FDI transactions, while also blocking a few transactions owing to national security concerns. For instance, in the matter of UPP Corporation Limited/L1T FM Holdings UK Limited, dated 19 December 2022,[45] FDI in the fibre network sector was prohibited, as the investment was linked to Russian sanctioned investors. Similarly, in the matter of HiLight Research Limited/SiLight

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42 *Ibid* 25, s 1702 9(c).

43 *Ibid* 33.

44 *Ibid* 9.

45 Acquisition of UPP Corporation Ltd by L1T FM Holdings UK Ltd: Notice of Final Order (UK government, 19 December 2022) https://www.gov.uk/government/publications/acquisition-of-upp-corporation-ltd-by-l1t-fm-holdings-uk-ltd-notice-of-final-order/acquisition-of-upp-corporation-ltd-by-l1t-fm-holdings-uk-ltd-notice-of-final-order accessed 14 June 2023.

(Shanghai) Semiconductors Limited, dated 19 December 2022,[46] FDI in the sector of the advanced material semiconductor industry was prohibited as there was a potential for the investor to use HiLight's technology to build capabilities that may compromise UK's national security. The ISU has also issued conditional clearance, for instance, in the matter of David Brown Santasio SA/Stellex Capital Management LLC, dated 22 February 2023,[47] wherein the transaction involved FDI in the defence sector. The FDI was approved subject to the condition that all the capabilities be retained in the UK in order to ensure continuity of supply of defence technologies. The global FDI regime is still in its transformative stage. However, prima facie, it is clear that securing national interests and protecting critical and strategic sectors of the host state are key factors that guide the FDI screening process.

While laying down a clear national security test can greatly benefit investors and investee entities in receiving FDI and mitigate potential risks, retaining ambiguity at the policy level in terms of the factors that will be considered by the government in screening transactions allows room for apportioning the element of fluctuating geopolitical risks. India appears to follow this approach for the same reason.

Where does India stand?

In juxtaposing the Indian FDI regime backed by the host of exchange control regulations, supporting legislations and policies with the regime adopted by countries such as the UK, United States and EU Member States, it is clear that the subtext of protectionism can be largely attributed to nationalistic tendencies. India has not been prohibitive when it comes to permitting FDI inflows even at a time of rising geopolitical tensions and has been accommodative of FDI approvals.

With respect to the scope and thresholds that trigger approval, the NDI Rules and the FDI Policy clearly lay down the investment caps for each sector where FDI may be made. This obviates any confusion stemming from the interpretation of terms such as 'control'. In relation to notification requirements, India has a

46 Acquisition of UPP Corporation Ltd by L1T FM Holdings UK Ltd: Notice of Final Order (UK government, 19 December 2022) https://www.gov.uk/government/publications/acquisition-of-hilight-research-limited-by-silight-shanghai-semiconductors-limited-notice-of-final-order/acquisition-of-hilight-research-limited-by-silight-shanghai-semiconductors-limited-notice-of-final-order accessed 14 June 2023.

47 Acquisition of UPP Corporation Ltd by L1T FM Holdings UK Ltd: Notice of Final Order (UK government, 22 February 2023) https://www.gov.uk/government/publications/acquisition-of-david-brown-santasalo-sarl-by-stellex-capital-management-llc-via-its-subsidiary-gear-bidco-sarl-notice-of-final-order/acquisition-of-david-brown-santasalo-sarl-by-stellex-capital-management-llc-via-its-wholly-owned-subsidiary-gear-bidco-sarl-notice-of-final-order accessed 14 June 2023.

mandatory approval requirement for all FDI related transactions, whether the same pertains to share purchase, share transfer or downstream investments. In case any transaction is executed without obtaining the prior approval of the concerned authority, penalties under the FEMA become applicable. However, under Indian laws, such non-approved transactions are not generally considered void. Non-compliance can be regularised through settlements. The RBI, along with the government, has the power to call in and review transactions post-closing, if the authorities foresee a security risk. However, unlike the United States and Netherlands, Indian laws do not clearly specify the factors that are considered when screening FDI transactions. A lot of uncertainties have been observed with respect to this aspect.

India's efforts towards strengthening and securing the investment landscape are not only restricted to FDI laws. In upholding its commitment to anti-money laundering laws and securing the investment landscape for foreign investors, India has restricted investments from Financial Action Task Force (FATF) non-compliant jurisdictions. Accordingly, investors from or through FATF non-compliant jurisdictions are prohibited from directly or indirectly acquiring 'significant influence' in the existing investee non-banking finance company (NBFC) as well as companies seeking certification of registration. The term 'significant influence' is defined as having more than 20 per cent of the actual and potential voting power. This consequentially prohibits prospective investors from FATF non-compliant jurisdictions from acquiring more than 20 per cent of the voting rights in NBFCs.[48]

Conclusion

An overview of the various FDI screening regimes makes it clear that nationalism is the subtext attached to FDI policies in today's globalised world. As far as India is concerned, steps in the right direction are being taken in a comprehensive manner. India has moved past the stage of single-window clearance systems and is making efforts to streamline and ease the process of FDI inflows into India. India's commitment to the FATF to fight the issue of money laundering and terrorism financing, and to incorporating these elements into domestic FDI laws, is a promising step towards a more secure investment regime. However, one of the key issues that surrounds India is the aspect of enforcement owing to the sheer volume of foreign investments that India receives. This aspect is also being addressed by effective data sharing between the various regulators and with the use of technically driven solutions for investigations.

48 Reserve Bank of India, 'Investment in NBFCs from FATF non-compliant jurisdictions', RBI Circular No RBI/2020-2021/97, DOR.CO.LIC.CC No 119/03.10.001/2020-21 (12 February 2021) https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI55F5B16F787E1A4B0EBA0F5B30D7A650B6.PDF accessed 14 June 2023.