OPINION

Regulatory governance, finally codified

The Securities Markets Code embeds legitimacy, proportionality, and accountability into market regulation. The first of a three-part series

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The Securities Markets Code (SMC), 2025 consolidates the Securities and Exchange Board of India (Sebi) Act, the Securities Contracts (Regulation) Act, and the Depositories Act into a single, contemporary statute. More importantly, it brings regulatory governance to the forefront of market regulation. Drawing on lessons from the evolution of regulations, judicial scrutiny, regulatory experience spanning three decades among Indian regulators, and global best practices, the code addresses concerns around democratic legitimacy, proportionality in enforcement, and institutional accountability in securities regulations.

The code addresses a wide canvas: Board composition, independence and accountability, conflict management, transparency, regulatory sandboxing, investor charter, governance of market infrastructure institutions (MIIs), and ease of doing business, which are matters for another day. A regulator is a mini-state, having quasi-legislative, executive, and quasi-judicial powers. This piece focuses on how the SMC governs the delivery of these services.

Rule-making: In securities regulation, the volume of regulations vastly exceeds that of the statute, while subsidiary instructions — circulars, master circulars, and guidelines — often dwarf both. This has fuelled concerns about 'circular raj' and a democratic deficit in law-making. The SMC responds decisively by embedding transparency, consultation, and legitimacy into the rule-making to minimise unintended consequences and avoid unwanted regulations.

The code draws a clear and principled distinction between regulations and subsidiary instructions. Regulation-making begins with public consultation. Draft regulations, not just discussion papers, must be published, public comments invited, and a general response to such comments disclosed. Regulations can be made only by the governing board; this cannot be delegated. The board composition, allowing up to six independent members, ensures that regulation reflects voices beyond the executive and the regulator's full-time establishment. Participatory regulation thus becomes a statutory norm, not a discretionary courtesy. Periodic review is mandated to ensure continued relevance, while departures from consultation are permitted only in narrowly defined urgent cases.

Subsidiary instructions, by contrast, are confined to clarificatory and procedural matters, and cannot substitute for regulations. Even these may be issued by the chairperson with a whole-time member (WTM), or by two WTMs, underscoring that interpretative guidance also requires application of mind at the board level. Advisory committees are formally embedded, institutionalising expert and stakeholder input for subsidiary instructions. Though advisory, they enhance deliberation, regulatory quality, and public trust.

Governance discipline extends even to the bylaws of MIIs. The bylaws must promote the objectives of the code, ensure non-discriminatory access, foster transparency, minimise market abuse, and enable interoperability. They are subject to public consultation and require Sebi's approval, with limited, reasoned exceptions, aligning private rule-making with public regulatory values. Even rules made by the government require prior publication.

The architecture culminates in parliamentary scrutiny. All rules, regulations, bylaws, and subsidiary instructions must be laid before Parliament, anchoring regulatory autonomy firmly within democratic oversight. While the SMC mandates regulatory impact assessment studies, it could have mandated such assessment for making and reviewing regulations.

Adjudication: Securities laws provide for multiple, siloed proceedings — enquiries leading to suspension or cancellation of registration, and adjudication resulting only in monetary penalties. The flaw is structural: The regulator's mind is effectively made up about the type of sanction at the initiation stage, before the gravity of the contravention is fully established. Parallel proceedings sometimes lead to contradictory findings. The SMC corrects this infirmity by consolidating enforcement into a single proceeding, enabling appropriate outcomes — suspension or cancellation, cease and desist orders, monetary penalties, disgorgement, and remedial or preventive directions, once the contravention is finally determined.

The adjudication process is grounded in principles of natural justice. Proceedings begin with a show cause notice explaining the alleged violation and enclosing the documents and material relied upon, and providing an opportunity to respond within a specified time. The adjudicating officer (AO) exercises the civil court-like powers and must dispose of the show cause notice by a reasoned order.

Enforcement outcomes must be proportionate, considering intent, duration, frequency, unlawful gains, investor harm, and impact on market integrity, as well as aggravating and mitigating factors. Settlement of administrative and civil proceedings, too, must reflect the nature, gravity, and impact of the contravention. This shifts securities enforcement away from checkbox compliance, towards calibrated regulation, where sanctions are predictable, reasoned, and defensible, strengthening both deterrence and legitimacy.

The code disciplines the use of interim orders. The securities laws empower the regulator, pending or on completion of inspection/investigation, to issue interim orders to prevent further harm to investors and the market. At times, decades can pass between the interim order and the final order, making the accused suffer for much longer than what the contravention would otherwise warrant. The SMC allows interim orders, ordinarily preceded by a hearing, and valid for a maximum of 180 days, which can be extended only by a reasoned decision of designated board members, with an outer limit of two years. Interim measures thus remain truly interim, protective, not punitive.

Executive action: The SMC establishes a unified registration framework governing application, scrutiny, grant, conditions, refusal, and surrender, with due process embedded throughout. Inspection and investigation powers are similarly disciplined: They require written orders, must follow prescribed procedures, are subject to time limits, transparency, and proportionality, and require reasons for extension. Investigators must quantify unlawful gains or investor losses, ensuring outcome-oriented enforcement. Importantly, no inspection/ investigation may be initiated after eight years from the date of contravention.

The code addresses long-standing public law concerns arising from the fusion of regulatory functions. Drawing lessons from recent judicial interventions, it statutorily separates fact-finding from adjudication. Any person involved in inspection, investigation, interim orders, or settlement consideration is disqualified from acting as an AO in the same matter. It also prohibits the AO from investigating/ inspecting the person or considering its settlement application against whom it has issued the show cause notice. This firewall embeds institutional fairness directly into the statute.

IF IMPLEMENTED IN LETTER AND SPIRIT, THE CODE HAS THE POTENTIAL TO RECALIBRATE TRUST BETWEEN THE REGULATOR, THE MARKET, AND INVESTORS

Having raised the bar so decisively, the government will be entitled to expect regulated entities to reciprocate that trust by mature, fair and responsible conduct towards the public, while preserving market integrity, financial stability, and the national interest.

Sebi was India's first modern regulator; the SMC cements that leadership role in statutory form. In doing so, it offers a credible blueprint for regulatory governance within the financial sector and beyond. If implemented in letter and spirit, the code has the potential to recalibrate trust between the regulator, the market, and investors. Its real test, however, will be whether these governance disciplines become embedded in everyday regulatory practice, and whether they inspire similar reform across India's wider regulatory state.

Tomorrow, Part II: Regulatory architecture 2.0: Regulatory reform moves from discretion to institutional design

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