

Regulatory architecture 2.0

Part two of a three-part series on the Securities Markets Code focuses on regulatory reform as it moves from discretion to institutional design



M S SAHOO &
V ANANTHA NAGESWARAN

The Securities Markets Code, 2025 (SMC/ Code), introduced in the winter session of Parliament and at present under examination by the Standing Committee on Finance, marks a decisive shift to what may be described as *regulatory architecture 2.0*. It replaces the *architecture 1.0* designed around the Securities and Exchange Board of India (Sebi) in the mid-1990s and subsequently replicated, with variations, across regulatory domains. Unlike its predecessor, which focused largely on functional empowerment, the new architecture places regulatory governance at the centre. This piece examines three core levers that the code uses to make that shift: Board composition, independence, and accountability.

Board composition: At the heart of any regulator lies its governing board (GB). Conceptually, the GB's primary responsibility is to act as a hands-on principal, holding management accountable for conduct and performance. Effective discharge of this role requires an external interface within the GB: Members who participate fully in decision-making, have a stake in outcomes, yet remain sufficiently detached from day-to-day operations and not beholden to management. Part-time members (PTMs) perform this function. They can do so meaningfully only when present in sufficient numbers; ideally, PTMs should be at least equal in number to whole-time members (WTMs), enabling them to

shape decisions rather than merely legitimise managerial outcomes. The SMC broadly reflects this governance logic. It provides for a board of 15 members comprising a chairperson, three ex-officio members, and 11 other members, of whom at least five are WTMs. The remaining members are expected to bring independent judgement, professional diversity, and an external perspective into board deliberations, strengthening internal accountability. This design would stand enhanced if the code were to specify that no more than five of the 11 members may be WTMs, reserving at least six positions for PTMs. A persistent constraint in board design has been the availability of suitably qualified and independent individuals to serve as PTMs. Individuals in active employment, profession, or business are often unwilling to serve on a full-time basis, while stringent conflict-of-interest norms limit eligibility. In this context, the SMC's enhancement of the upper age limit for PTMs to 70 is a pragmatic and governance-enhancing reform. It recognises that regulatory oversight benefits from seasoned judgement and professional detachment, and materially expands the pool of eligible independent members. Equally important is the composition of expertise. Given Sebi's mandate, the GB must reflect a balanced mix of disciplines, including law, economics, technology, and markets. The SMC accordingly requires representation from different disciplines, with an endeavour to include at least three members with securities-market expertise. For a modern, knowledge-intensive regulator, this could be refined further by mandating minimum representation across key disciplines, for instance, at least one WTM and one PTM with legal expertise, similar to Sebi's prescriptions for boards of market infrastructure institutions (MIIs).



ILLUSTRATION: BINAY SINHA

Independence: The SMC retains and reinforces Sebi's functional independence, enabling it to frame regulations, conduct inspections, and adjudicate contraventions without recourse to any organ of government. It also preserves autonomy over financial and human resources. Institutional independence is further supported through eligibility criteria, fixed tenures, removal safeguards, and post-tenure cooling-off restrictions on employment with governments, market intermediaries, and other securities market participants. At a deeper level, however, regula-

tory independence depends on the professional strength of leadership, particularly the chairperson and WTMs, to withstand pressure from organised interests and the pulls of fear and favour, to avoid regulatory capture. A term of five years is insufficient to acquire deep domain mastery, institutional confidence, and decisional authority in complex markets; by the time such expertise is acquired, the term is often nearing completion. Further, individuals with demonstrated capability are unlikely to abandon established careers to join a regulator for a short, finite tenure.

Renewal-dependent tenures may dilute independence by making incumbents implicitly attentive to the preferences of the appointing authority. Regulatory independence would be better served by recruiting capable individuals at mid-career and offering tenures that run until a fixed retirement age, preferably aligned with government service, irrespective of the age at entry. Nominee members, who are part-time, present a related concern. By design, they tend to reflect the perspectives and institutional preferences of the organisations they represent, diluting collective responsibility and blurring accountability. While the GB itself is expected to act as the principal, independent judgement is best preserved through individually appointed members (some of whom are part-time, and the others whole-time) rather than departmental representation. Legitimate coordination of interests is better achieved through structured inter-institutional cooperation mechanisms, which the code separately provides for. **Accountability:** The SMC establishes an elaborate accountability framework for the exercise of Sebi's quasi-legislative, executive, and quasi-judicial powers (Part I, published on December 23, 2025). Beyond this, the code elevates transparency from a matter of good administration to a statutory obligation. Sebi is required to maintain a universally accessible electronic database on securities markets, and publish regulations, subsidiary instructions, and orders of adjudicating officers and ombudsmen. The code mandates Sebi to make regulations governing the meetings of the GB and publish its decisions. It also mandates Sebi to undertake periodic research, regulatory impact assessments, and audits of the functioning and performance of securities markets and service providers, and publish the results. Reform efforts increasingly recog-

nise the need for an objective, formal, and periodic assessment of the performance of regulators. The International Financial Services Centres Authority Act, 2019 mandates an annual performance review, and the Insolvency and Bankruptcy Board of India commissioned an external evaluation in 2021. The SMC requires Sebi to review its own performance, and the proportionality and effectiveness of its regulations. This framework would be significantly strengthened by mandating an independent external evaluation at defined intervals, consistent with Sebi's own requirements for MIIs. The code addresses conflicts of interest comprehensively. Members of the GB are required to disclose any direct or indirect interests, including those of family members, and Sebi is mandated to frame regulations to govern the same. Members may be removed if they acquire interests likely to prejudice their functions. The code has another issue to address. Sebi is a board. The general superintendence, direction, and management of the affairs of this board vests in a board. This dual usage risks role confusion or reversal, making it difficult for the latter to steer the former. Notwithstanding that, the regulatory architecture articulated in the SMC has relevance beyond the securities markets. Its provisions on institutional design, governance, transparency, and accountability could be distilled into a standalone regulatory governance code. Such a code could serve as a template for establishing new regulators and as a benchmark for modernising existing regulatory statutes, allowing sector-specific laws to focus on substantive regulation. Tomorrow, Part III: When market infrastructure institutions become the state MS Sahoo is a former whole-time member, Sebi. V Anantha Nageswaran is chief economic advisor, Government of India. The views are personal

THE CODE ADDRESSES CONFLICTS OF INTEREST COMPREHENSIVELY. MEMBERS OF THE GOVERNING BOARD ARE REQUIRED TO DISCLOSE ANY INTERESTS, INCLUDING THOSE OF FAMILY MEMBERS, AND SEBI IS MANDATED TO FRAME REGULATIONS TO GOVERN THE SAME