

Unseen lawmakers of India's markets

Institutions exercising public regulatory power must not remain outside meaningful oversight

Imagine a commonly used algorithmic trading strategy suddenly being classified as manipulative. The consequences could be severe: Penalties, suspension, even criminal exposure. If Parliament or the Securities and Exchange Board of India (Sebi) were to create such a classification, it would ordinarily involve public consultation, legislative scrutiny, and a transparent law-making process. Yet market infrastructure institutions (MIIs) exercise comparable normative power through their rulebooks, without comparable democratic oversight.

India's securities market has historically operated through a layered regulatory architecture. Parliament enacts the statute; the government frames rules; Sebi issues regulations and subsidiary instructions; and MIIs operationalise the system through their rulebooks. This framework has largely balanced legislative intent, regulatory flexibility, and institutional execution. The proposed Securities Markets Code, 2025 (SMC), however, marks an important conceptual shift. It recognises MIIs as institutions performing public and regulatory functions that actively shape market behaviour through normative instruments.

MIIs are not ordinary private companies or mere transaction platforms. They perform public functions, derive authority from statutes, provide essential market infrastructure, and affect the rights of investors, intermediaries, and issuers. Their instruments determine market access, trade execution and settlement, risk management, surveillance, enforcement, and dispute resolution. They shape market conduct as much as Sebi regulations.

Consider the example of a stock exchange. It typically operates through a layered rulebook comprising rules, byelaws, regulations, and circulars. Together, they create a binding legal regime for market participants.

The rules form the constitutional backbone of the exchange, governing membership, disciplinary powers, and oversight of trading members. They empower the exchange to regulate members, impose penalties, and determine continued access to market infrastructure. Comparable matters, when exercised by Sebi, are governed by parliamentary statutes. If

such matters require legislative treatment when exercised by Sebi, it is difficult to justify leaving analogous powers of MIIs outside comparable scrutiny.

The byelaws constitute the operating code of the market. They define the rights and liabilities of members and constituents, regulate contracts and settlements, and provide for arbitration, defaults, margins, and investor protection. The SMC prescribes, for byelaws, substantially the same procedural safeguards that apply to Sebi regulations.

Regulations and circulars translate this framework into operational requirements. They prescribe compliance obligations, technical standards, codes of conduct, inspections, and consequences for non-compliance. They function much like Sebi's subsidiary instructions. Yet, unlike Sebi's instruments, much of this normative framework remains outside equivalent procedural discipline and legislative scrutiny.

The importance of MII rulebooks has received judicial recognition. In *Rusoday Securities Ltd v. National Stock Exchange of India Ltd.* (2021), the Supreme Court acknowledged the enforceability of exchange actions, including suspension and expulsion of members, when undertaken in accordance with its byelaws and rules. The decision reinforces that MII rulebooks are binding frameworks carrying public consequences.

Indeed, these instruments may even confer statutory sanctity on transactions notwithstanding inconsistencies with other laws. Clause 46 of the SMC provides that any contract traded on a stock exchange shall be legal and valid if entered into in accordance with the Code and the rules, regulations, or byelaws made thereunder, notwithstanding anything inconsistent contained in any other law. MII rulebooks, therefore, may effectively override conflicting legal restrictions through statutory recognition.

The constitutional dimension is equally significant. These instruments resemble subordinate legislation in both form and effect. Subordinate legislation falls within the discipline of Article 13 when it affects fundamental rights. MII instruments can restrict the right to carry on business under Article 19(1)(g), affect property



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interests protected under Article 300A, and impose serious civil consequences. Their normative character can no longer be treated as incidental or contractual.

Clause 148 of the SMC provides that every rule, regulation, byelaw, and subsidiary instruction made or issued under the Code shall be laid before Parliament. However, "regulations" in this context refer to regulations framed by Sebi, not those issued by MIIs. Likewise, "rules" refers to rules framed by the Union government, not rules of MIIs. "Subsidiary instructions" refers only to instruments issued by Sebi. Consequently, only MII byelaws are subject to comparable legislative visibility, while their rules, regulations, and circulars remain outside. This asymmetry creates the possibility of regulatory arbitrage. If parliamentary scrutiny applies only to byelaws, MIIs would naturally have an incentive to rely increasingly on rules, regulations, or circulars to achieve substantially similar outcomes with fewer procedural constraints.

The principal actors in the securities market ecosystem are the government, Sebi, and MIIs. The government is accountable to Parliament. Sebi is a statutory regulator and subject to statutory controls. MIIs, by contrast, are private corporate bodies, exercising significant public and regulatory functions. They possess the least democratic legitimacy among these actors.

The SMC identifies three categories of MIIs, but empowers the government to designate additional institutions as MIIs. Further, access to MII services is effectively compulsory. Securities trading can take place only on the platform of a stock exchange, and securities can be held only in dematerialised form through depositories. When investors and intermediaries are compelled by law to transact through these institutions, the case for legislative scrutiny of MII rulebooks becomes correspondingly stronger.

To be sure, MIIs require operational flexibility and agility to respond to market developments. Excessive legislative control could impair their efficiency. The goal, therefore, is not to restrict delegated norm-making, but to ensure minimum standards of transparency, accountability, and democratic oversight.

The SMC points to a more coherent normative structure. Sebi issues binding norms principally through regulations and subsidiary instructions. Similarly, MIIs may issue byelaws and circulars, which correspond to Sebi regulations and subsidiary instructions. Matters presently contained in MII rules and regulations may then be consolidated into byelaws. This would make the law available in one place, enhancing ease of doing business.

Consequently, the same procedural safeguards, transparency standards, and legislative scrutiny that apply to Sebi's instruments should apply symmetrically to their MII equivalents. The SMC cannot allow these norm-making structures to operate outside constitutional and parliamentary discipline.

The authors are legal practitioners and have worked for Sebi. The views are personal