

Sebi needs a new regulatory structure

The stock market regulator's adjudication and executive functions should be independent of each other

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The Securities Appellate Tribunal (SAT) recently held a whole-time member (WTM) of the Securities and Exchange Board of India (Sebi) responsible for misleading the tribunal. The WTM had allowed Sebi to issue a letter falsely claiming that he had passed an order. Actually, he had never passed any such order. This is a serious case of misconduct. But merely blaming the WTM would be akin to missing the forest for the trees. Underlying this incident is a deeper fault in the regulatory architecture of Sebi — the lack of a separate adjudication wing.

In *Adventz Finance Pvt. Ltd. v Sebi*, SAT gave Sebi seven weeks time to hear Adventz's case and dispose of the matter. The WTM heard Adventz within seven weeks. But he neither passed any order nor sought an extension. Instead, a note and a draft letter were prepared by junior Sebi officers. These were "approved" by the WTM. Then a letter was issued by a chief general manager (CGM) falsely claiming that the WTM had passed an order rejecting Adventz's case. Later, Sebi admitted before the SAT that the WTM had never passed such an order.

This incident is a major embarrassment for Sebi. It happened because there is no separate adjudication wing within the regulator. This is evident from two facts. First, the WTM who heard the matter did not draft the letter himself. Instead, it was drafted by junior executive officers of Sebi. The WTM merely "approved" the draft. What was supposed to be an adjudication order requiring application of judicial mind by the WTM was effectively reduced to a cyclostyled letter drafted by the regulator's junior staff.

Second, even after the WTM's "approval", the letter was not issued by the WTM but by the CGM — another consequence of lack of separation of adjudication functions. What was supposed to a reasoned quasi-judicial order by an adjudication officer (WTM) got translated into a letter by an executive officer (CGM) of the regulator. These were possible because of lack of a separate adjudication wing within Sebi. This lack of separation allowed the adjudication officer (WTM) to exert direct influence over an executive officer (CGM) to issue a patently false communication.

This flaw in regulatory architecture is hardwired in the law. The Sebi Act, 1992 does not require Sebi's adjudication functions to be ring-fenced within an internal adjudication wing, separate from the executive wing. Instead, one individual may perform both adjudication as well as executive functions. For example, the Sebi (Delegation of Powers) Order, 2010 vests WTMs with functions over and above adjudication functions. WTMs are responsible for approval of Board memoranda for subordinate legislations, approval of circulars, furnishing statements or returns, etc. Clearly, the 2010 Order does not insulate the adjudication functions of Sebi from its executive functions.

In advanced common law jurisdictions, the adjudication functions of a regulator are operationally kept separate from the other regulatory functions. This is because a regulator is a "mini-state". Just as the judiciary of a state needs to be independent from its executive, the adjudication functions of a regulator need to be independent of its executive functions. For example, when the US Securities and Exchange Commission (SEC) initiates a proceeding, the adjudication functions are performed by independent adjudicators called administrative law judges (ALJs). The ALJs can pass cease-and-desist orders; orders barring access to the securities industry, etc.



Sebi's Mumbai headquarters: The Adventz Finance case was a major embarrassment for the regulator

Similarly, in UK, the Financial Conduct Authority (FCA) has a Board committee called Regulatory Decisions Committee (RDC). It takes decisions relating to enforcement and supervisory actions, firm authorisation, etc. The RDC is operationally separate from the rest of FCA. Because of this internal separation, the ALJ or RDC cannot instruct an executive officer of the respective regulators to issue a letter falsely claiming that an order has been passed without actually passing it.

The **Sebi Act must be amended to create an adjudication wing within the regulator, separate from the board's executive wing**

In India, Sebi does not have any such internal separation between adjudication and executive functions. Certain adjudication functions are conducted by WTMs. But unlike ALJs in the United States or the RDC in UK, WTMs are not independent

adjudicators separate from the executive wing of Sebi. WTMs perform executive functions too. Hence they have direct influence over Sebi's executive staff. That's why in the instant case the WTM could influence the CGM to issue a letter falsely claiming that an order had been passed.

Unless WTMs and other officers performing adjudication functions are completely insulated from Sebi's executive functions, mishaps like the one above could recur in future.

This defect in the current financial regulatory architecture was identified by the Financial Sector

Legislative Reforms Commission (FSLRC) chaired by Justice B N Srikrishna. Based on a holistic review of the international best practice, it recommended creation of a separate administrative law wing within the regulator. It will comprise one administrative law member (ALM) and other administrative law officers (ALOs). ALOs must be operationally segregated, independent and neutral from the rest of the regulator. ALOs must not be given any of the regulator's executive functions. The ALM will be a board member of the regulator and be responsible for oversight of the ALOs. The ALM will also be responsible for appraising the performance of the ALOs. Under this arrangement, an ALO can never be the direct superior of any regulatory executive. They would work separately, ring-fenced from each other. Consequently, an ALO will never be able to instruct an executive officer to issue a letter like the one mentioned earlier.

While condemning the irresponsible conduct of the WTM in the *Adventz Finance* case, SAT also directed that a copy of the order be sent to the finance minister as well as the chairman of Sebi. Policymakers should take this opportunity to implement the FSLRC's recommendations and fix the defect in the current regulatory architecture of Sebi. The Sebi Act must be amended to institutionalise a separate adjudication wing within Sebi, insulated from the regulator's executive wing.

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