



The NSE Co-Location Scam, 2019

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Abstract

Also known simply as “colo,” data center colocation refers to a service provided by companies that offer a shared, secure space for enterprise businesses to store hardware related to data storage and other equipment.

The Enterprise Benefits of Data Center Colocation are varied and often misused.

They are: Uptime, Risk Management, Security, Cost, Bandwidth, Certifications, Security, Scalability.

Managed Services implies a multi-faceted advantage over in-house data warehousing.

However, in the Stock Exchanges, Data Co-Location imputes high levered vantage points to an extent where data and information can be selectively disseminated, creating an unfair arbitrage opportunity in an artificially tailored inefficient market system.

National Stock Exchange- the biggest derivatives bourse in Asia was in the headlines recently for all the wrong reasons. For aiding and abetting inefficiencies in data flow.

This article will shed light on what went wrong and how it could have been righted.

Keywords: NSE, Co-Location, scam, SEBI, manipulate, whistle blower, HFT, Algo

1. Introduction

The onset of the 2010's saw the surge in High Frequency Trading amongst the mid-size hedge funds as well as market makers.

A High Frequency trade refers to using super computers to automatically place trade orders within a fraction of a milli second. There are no manual interventions. Ordinary and retail traders take the cue and accordingly form a directional or sentimental bias based on the order flow from the Exchange Server to the retail broker's servers. However, HFT orders are punched in without human intervention and often manipulate ordinary biases due to the strength of sheer volumes.

2. Review of literature

Although Banking Frauds have existed since times immemorial, a superficial scraping of the simplest investigation can reveal the complicity and its consequences, this is unique in a sense as it involves the nexus of the Stock exchange with the Stock Brokers.

In this case, we see that gross negligence was wedded to political highhandedness that birthed a loss of both record and reputation.

3. Objectives of the Paper

The Paper strives to summarise the facts of the NSE Scam, as reported by various media and universally acknowledged to be factual.

The author has no vested interests in any banking institution, but is moved to report this as an academic study.

4. Methodology

The Paper uses data that is corroborated by the SEBI (the main governing bank for the Indian Stock Exchanges)

No primary data has been utilised as there was found to be no scope for subjective or conflicting interpretations.

5. The NSE Co-Location Scam

When NSE allowed preferential access and speed advantages to certain brokers, it created an information race which was easy to manipulate and misguide the intraday sentiments of retail traders.

Certain brokers had direct access to the NSE servers with which they could obtain information faster than the rest. It also paved the way for systemic delay of information to the rest of the brokers.

Insider trading, rigging and fee based services took wings as brokers sought the easy way out to gain propriety over a free driveway of market data and information.

This was made possible only by Co-Location of certain brokers terminals within the NSE premises.

6. Brokers and NSE Nexus

In 2010, a whistle blower brought to the notice of SEBI, that market makers affiliated to certain brokers were gaming the system by being favoured with preferential access to data flow. This was not taken seriously, until the watch dog realised that rules and regulations and compliance was flouted at multiple levels in order to legitimize a crime.

"Access to co-location facilities and HFT trading gave the select brokers differential advantage such as display of market data, viewing order book prior to order execution."

Impact at NSE

SEBI issued show case notices to fourteen NSE officials current and retired, in 2017.

Remember, SEBI stands for Securities and Exchange Board of India and it regulates all Stock exchanges in India, including NSE.

Political Nexus

It was revealed through investigation that the Finance Ministry had vested interests in setting up persons to head

various roles within NSE and also favoured 'Direct Market Access' to brokers of choice and not merit.

Compliance failed and recommendations became the new norm for Business as usual.

Researcher Nexus

Collusion between Technology department of NSE and researcher groups enabled influential entities to access data outside of data flow norms. This created an unfair advantage for the research entities, who would then sell insider information in the garb of parsed and tactile research.

7. Conclusion

The misuse of regulatory discretion and powers has ensured that the system begets a love child of financial fraud and dishonest disclosures.

NSE ought to have been the watch dog over the brokers but decided to risk its reputation by allowing data leaks and information asymmetry.

SEBI has stepped in to investigate, but both SEBI and CBI are caged parrots and puppets in the hands of the Finance Ministry.

At every level you find wilful allowance of gaming the system of trading.

We need to realise that market sentiments are often brokered and tamed by certain clandestine entities in order to confound the long term investors and making investment decisions a game of chance.

8. References

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