

HIGH FREQUENCY TRADING: CHALLENGING ITS VALIDITY

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It was the ending of the 18th century which saw the techniques and methods were being developed in the stock market. In 1990's it was the period which started with the electronic trading in the stock market .It was the period which saw the internet on the rise and the stocks and commodities were traded first time electronically .After a decade the private players tried to violate the stock market and by gaining the more market pie they introduced the High Frequency Trading in the market.

It was recently in the famous award winning book Flash Boys written by Michael Lewis who again came out with the controversy surrounding the High Frequency Trading .In this paper the writer will tell you about what is High Frequency trading is all about and how these are being the violations of the cyber law in US and how the India need to make amendments in its IT laws to regulate such type of trading activities and the writer will also try to look the validity of such type of trading.

Key words: - High Frequency Trading, US Stock Market, Michael Lewis, IT Act 2002.

What is high frequency trading?

The regulators around the world have been trying very hard to curb this type of trading .But before regulating it or before making it legal or illegal the basic question arises what is high frequency is all about and how it came into the existence .

Basically it is a type of trading practice in which security practices are turned over very fast and by using the latest technology to gain the first momentum or first gain of the market by leveraging the technology.¹

These type of trades often provides distortion in the pricing of the trades .And they are also responsible for the manipulation by the insiders by using the difficult algometric codes to take the benefit in the financial market. Usually round about 18.9% of the trading in the NSE after 2010 is been done through the complex algometric ways and 25.95% is been done through the on location trading at the NSE.²

“Better algorithms with mathematically proven strategies that consume liquidity and faster systems with very low latency are the need of the day. Since laws of physics have to be obeyed, member’s systems have to come closer to the exchange trading systems to meet the requirements of lower latencies and faster execution. Co-location at exchange premises is the mechanism used by exchanges to achieve these objectives,” according to the NSE website.

Even this new type of High Frequency Trading is now been used by the big investment banks such as JP Morgan, Barclays etc. This type of trading has been gone to the sphere of the US treasury market and it has gone to the every aspect of the finance and the capital market.³

SEBI TAKING INITIATIVES TO CURB HIGH FREQUENCY TRADING

SEBI is considering some changes to be brought to the capital market trading to reduce the influence of the High Frequency Trading.

¹ www.capgemni.com High Frequency Trading: Evolution and the Future

²<http://www.thehindubusinessline.com/markets/stock-markets/logic-behind-high-frequency-trades/article7633782.ece> last visited on 1/3/2016.

³<http://www.businessinsider.in/High-frequency-traders-are-now-dominating-another-huge-market/articleshow/49081076.cms> last visited on 1/3/2016

- **Batch Auction system** –The SEBI is considering to use this batch auction system which was been developed by the US academicians to try to curb the black box trading and high frequency trading .According to this system the bids would be collected from all the windows and after that matching them with the same batch bids and allot the securities according to the higher bid .As this type of trading will restrict the first mover advantage which is been provided by the HFT .As those traders who are using this will have a advantage over it while those who are not using will not have an advantage .
- **Minimum Resting Time** –SEBI is also considering hard to introduced this system to stop the activity of “spoofing” which means that the global traders makes the bid in the market and when they see that the large amount of bids have made they usually take out their bids and this cause big problem in the capital market .They usually do it with the technique of the High Frequency Trading .So the SEBI is trying to curb such type of practice by regulating such type of spoofing.⁴

Even the RBI showed the signs of caution regarding the High frequency trading and the also trading as what they have observed that the with the use of the fast servers and the high techniques the traders usually cancel the 90 percent of the bid trade and this can cause the financial crises like the 2008 and it can cause the collapse of the entire economy.⁵

MONEY LIFE v. SECURITY BOARD EXCHANGE OF INDIA

In this case the editor of the money life site written an article against the NSE that the NSE has not taken any steps to prevent the abuse of the high frequency trading and the also trading and the some officials of the NSE have provided some kind of information regarding the trades to some traders so that they can gain and have the advantage .After

⁴http://articles.economicstimes.indiatimes.com/2015-09-07/news/66297462_1_hft-high-frequency-traders-high-frequency last visited on 1/3/2016.

⁵ <http://www.thehindubusinessline.com/markets/stock-markets/sebi-may-check-highfrequency-algo-speed-to-curb-manipulation/article7375299.ece> last visited on 1/3/2016.

the publication of the article the NSE filled the defamation case against the Money life site for the amount of 100 crore .But in the High Court of Bombay the money life company stated that they have got the information from the Singapore Hedge Fund Company and they have done the detail analyses of these trading and the traders who are using such type of technique they can take the advantage over the others who are not using it .⁶In continuance with the argument the Money life company put the 51 question in the High Court regarding the validity of the HFT .The judgment gone in the favor of the company and court asked the SEBI to give the compensation to the editor and to the company.⁷

The advantage and the disadvantage of the High Frequency Trading

Advantage

- The High frequency have the better connectivity to the market –that simply means that the trader know do not have to go to the broker to place the bet against a security know it's in the hands of the trader to easily bet .
- The high frequency trading have the advantage of providing the speed trading and with the use of algo trading techniques the trades are been done in the millisecond.
- The HFTs have an impeccable understanding of the market micro-structure: what happens after you submit an order to your broker? Where does your order go, how is it executed, how are orders prioritized? HFTs are experts on this, but very few retail investors even understand the basics.⁸

Disadvantage

⁶ <http://www.livemint.com/Consumer/bSbicKbeBuaIg9cirU7aYJ/Court-fines-NSE-Rs50-lakh-in-defamation-case-against-Moneyli.html> last seen on 1/3/2016.

⁷ <http://www.moneylife.in/article/action-on-high-frequency-trading-sebi-says-fact-finding-exercise-already-underway/43814.html> last seen on 1/3/2016.

⁸ <http://www.businessinsider.com/3-advantages-of-high-frequency-trading-2012-9?IR=T> last visited on 3/3/2016.

- The biggest disadvantage of such type of trading is that only the persons and banks who are using the high band with cables for trading only they can use and with the first advantage of the bet they can take the benefit of the market .Even they can use the fiduciary betting techniques to make the more money for themselves and by violating the securities and cyber laws.

SPOOFING IN THE HIGH FREQUENCY TRADING AND CYBER LAWS VIOLATIONS.

Before making the High Frequency Trading liable for the cybercrime activities we need to know the complete knowledge about the word spoofing and how the traders can use this technique to spoofing activities.

'Spoofing' is falsifying the origin of an internet communication in order to mislead the recipient. It's widely used to create bogus emails or web pages in order to steal money, passwords or banking credentials.⁹

Know when the trades of such huge amount are been done through the computers the use of the High Frequency Technique the traders are been using the wrong advantage of such type technique by the spoofing.

The curious case of Coscia

It is a high profile case in America .It all started in the year 2011 when the famous trader of the boutique investment firm which basically trades in the energy commodities its one of its traders named Coscia used the spoofing method while doing the High frequency trading .And this trading was been carried out with the spoofing activity .As while he bet in the trade during 2011 and within few days he took out the money from the betting and

⁹ <http://www.bbc.co.uk/webwise/guides/about-spoofing> last visited on 2/3/2016.

with this activity he had made millions of dollars .The judgment gone against the trader and the court have charged the trader for the spoofing in the capital market and have violated the laws regarding the cybercrime and financial crime by using the also trading and the high frequency trading .¹⁰

Conclusion

While concluding the topic the researcher has made following observation regarding it;-

- Although the HFT have made many advantages but at the end it works on the computers also and it can be manipulated by the traders by hacking or spoofing.
- Only the banks and the trading company who have the HFT and super computers can be benefited by it.
- The betting on the shares can be done at the milliseconds with the HFT.
- There are high chance of hacking in the HTF is there.
- The laws in India are not been made properly to curb the HTF.

¹⁰ <http://www.theguardian.com/us-news/2015/nov/04/us-high-frequency-trader-convicted-first-spoofing-case-michael-coscia> last seen on 2/3/2016.