

NSE - DARK FIBRE CO-LOCATION CASE- A SNAPSHOT*

CO-LOCATION : CASE IN BRIEF

***Co-location** allows brokers to operate closer to their servers upon payment of additional fees. It helps brokers secure advantage over others due to proximity to exchange servers as data transmission takes less time. Orders reach exchange servers faster than those who have not availed of the facility.*

Under the NSE co-location facility, trading members can place their servers in the exchange's data centre, where they get faster access to the price feed, helping in swift execution of trades. The NSE's co-location facility provides access to brokers for a cost to execute trades faster.

***A dark fibre or unlit fibre**, with respect to network connectivity, refers to an already laid but unused/ passive optical fibre, which is not connected to any active electronics/equipment's and does not have other data flowing through it and is available for use in fibre-optic communication.*

During 2015, the Securities and Exchange Board of India (SEBI) received a complaint from a whistleblower alleging various irregularities in respect of Co-location facility provided by National Stock Exchange (NSE). It was alleged that some brokers in collusion with a few top NSE officials had abused the co-location facility. A select set of brokers in collusion with NSE officials got the first access to the NSE's servers giving them a head start. NSE was then using tick-by-tick (TBT) server protocol to relay data to members; means the user who gets the access to the system first would receive data earlier than the rest. It was also alleged that Directors/KMPs for discharging various functions at NSE, failed to ensure fairness, openness, transparency and to provide fair, equal, unrestricted and transparent access to its co-location facilities and trade data etc., to all market participants in conformity with the SEBI (Stock Exchanges and Clearing Corporations) Regulations, 2012. (hereinafter referred to as **SECC Regulations**).

Various irregularities were noticed during preliminary investigation by SEBI and a common show cause notices was issued in the year 2017 to a number of entities including Noticees (herein referred to the group of individuals to whom notice were issued by SEBI). Investigation so conducted by SEBI revealed various irregularities in addition to the preliminary findings and accordingly, another show cause notice was issued during 2018. During April, 2019, SEBI directed NSE to deposit a sum of Rs 62.58 crore plus interest in co-location case that allowed the usage of Dark Fibre. SEBI further, directed NSE not to introduce any new derivative product for the next six months.

ALLEGATIONS

1. NSE allowed Sampark Infotainment Private Limited to provide lease lines in NSEs colocation facility despite not being on authorized service provider of NSE
2. The Noticees have also allegedly acted in violation of NSE circular in which, NSE had authorized only four (04) specific Telecom Service Providers from whom its brokers could avail the P2P connectivity.
3. 'Sampark' did not possess the necessary license from the Department of Telecommunications

to provide the required Point to Point (P2P) connectivity to the brokers of NSE.

4. Directors/KMPs have failed to ensure fairness, openness, transparency and to provide fair, equal, unrestricted and transparent access to its co-location facilities and trade data etc., to all market participants in conformity with the SECC Regulations

ISSUANCE OF SHOW CAUSE NOTICE(S)

Show Cause Notice -1 (2017 SCN)

On the basis of preliminary findings, the Show Cause Notice was issued on May 22, 2017 to the number of entities including the Noticees cover the following allegations:

- a) NSE's system architecture allowed the Tick -by- Tick (TBT) price information to be disseminated sequentially in the order in which the stock brokers were connected/logged-into the server. However, multiple TBT servers at NSE have experienced varied load and have started at different points of time. Further, the back-up servers were allowed to be accessed by certain stock brokers(s) as load on such servers was low.
- b) The above set-up enabled 'first-to- connect' stock brokers to receive data ahead of others and thus, they were able to react to the information earlier than the rest of the stock brokers.
- c) Differential access in the form of 'dark fibre' was given to a certain brokering firms/ members at NSE, especially to connect across NSE and BSE colocation facilities at least 4-5 months ahead of other members.

Subsequent to the issuance of the 2017 SCN, a detail investigation into the complaint was carried out by SEBI to find out possible violation of provisions of **SEBI Act**", Securities Contracts (Regulation) Act, 1956 and/or the Rules and the Regulations made there-under such as **SECC Regulations** and SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (**PFUTP Regulations**).

Show Cause Notice -2 (2018 SCN)

Investigation so conducted by SEBI revealed various irregularities in addition to the preliminary findings and accordingly another Show Cause Notice dated July 03, 2018 was issued to different entities/ persons for violations of different provisions of SEBI Act, SECC Regulations and PFUTP Regulations by them as alleged in the 2018 SCN.

It was observed that the allegations made in the 2017 SCN were repeated *qua* some of the entities in the 2018 SCN, who are common Noticees in both the SCNs and the proceedings arose out of 2018 SCN were disposed of by SEBI vide orders dated April 30, 2019.

However, while disposing of the allegations made in the 2017 and 2018 SCN, it was noticed that some of the allegations made against few other Noticees in the 2017 SCN remained outstanding for disposal. Therefore, said allegations which had not dealt with or disposed of in any of the orders passed by SEBI are mentioned below:

- (i) NSE allowed Sampark infotainment Private Limited to lay down a line from NSE's COLO building to BSE's Rotunda Building.
- (ii) NSE Circular Ref. no. NSE/MEM/12985 dated August 31, 2009 On "Co location Services at NSE premises' also requires to take one or more leased line to the colocation facility from any of the following four service providers for the purpose of setting up or modifying parameters, trading related activities and hardware, software, network related access, software download / upload and monitoring and data downloads:
 - A. MTNL
 - B. TATA

- C. Bharti or
- D. Reliance
- (iii) It is observed that NSE allowed Sampark Infotainment Private Limited to provide lease lines in NSEs co-location facility despite not being an authorized service provider of NSE.
- (iv) By allowing an unauthorized service provider to lay dark fibre/ lease line NSE has acted in contradiction to its own policy

Further, it has been alleged that the Noticees covered in the proceedings who were Directors/KMPs for discharging various functions at NSE, failed to act in a manner to ensure fairness, openness, transparency and to provide fair, equal, unrestricted and transparent access to its co-location facilities and trade data etc., to all market participants in conformity with the SECC Regulations.

SUBMISSION BY NOTICEES

1. Dark fibre team was not reporting to them at any point of time during their tenure as employees or consultants of NSE. Therefore, the Noticees did not have any role in relation to either allowing the 'Sampark' to lay down the dark fibre line.
2. No specific or independent evidence available on record pointing out the liability of the Noticees. Show cause notices were issued based on the complaints received and some preliminary observation thereon by SEBI.
3. Functional reporting of the Co-location team was with the business development team and none of the Noticees was part of the business development team at the relevant point of time.

SEBI OBSERVATIONS

1. The SEBI observed that the allegations pertaining to the involvement of the Noticees have been made only because of their association in some capacities with NSE during the relevant period of time. Since, it is the liability of a Director and/or KMP for breaches, if any, ought to be determined by taking into consideration, the specific functions entrusted to such Directors or KMPs by virtue of their position or designation in the organisation.

Directors/KMPs are entrusted fairness, openness, transparency and to provide fair, equal, unrestricted and transparent access to its co-location facilities and trade data etc., to all market participants in conformity with the SECC Regulations. Directors or KMPs are also abide by the Regulation 26(1) and 26(2) of SECC Regulations.

2. It was further observed that none of the Noticees was occupying the position of a Director or KMP in NSE, when 'Sampark' was allowed to lay down dark fibre lines to establish P2P connectivity between the two stock exchanges for a few selected stock brokers during the relevant period i.e. April – July 2015.
3. None of the Noticees was working /employed with NSE either in the capacity of a Director or as a KMP. Thus, SEBI did not find any evidence or any material that establishes or even remotely indicates any role played by any of the Noticees as far as establishment of P2P connectivity by 'Sampark' is concerned.
4. It is further observed that, no records are available that shows the role played by the Noticees in permitting "Sampark" to either lay down the dark fibre optical lines or to continue with the services despite the fact that "Sampark" did not possess the desired eligibility to provide such services.

CONCLUSION

Considering the facts and circumstances arose out from the replies and personal hearing, SEBI exonerated the Noticees (nine current and former officials of NSE) as they could not be held responsible for any misconduct or non compliance in dark fibre issue and hence, disposed off proceedings initiated against the Noticees.

REFERENCES

Order no. WTM/SM/EFD1/EFD1_DRA3/6433/2019-20 dated January 16, 2020 in the matter of NSE- Dark Fibre. Detailed order is available at

https://www.sebi.gov.in/enforcement/orders/jan-2020/order-dated-january-16-2020-in-the-matter-of-nse-dark-fibre_45694.html
