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WHEN THE MACHINE MANIPULATES: ALGORITHMIC TRADING, MARKET FRAUD, AND THE REGULATORY GAP IN SEBI'S PFUTP FRAMEWORK

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ABSTRACT

Algorithmic and high-frequency trading now account for the majority of transactional activity in Indian equity and derivatives markets. The primary legal instrument for policing this activity, the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, was designed around a model of fraud as a deliberate human act susceptible to proof through intent, knowledge, and individual agency. Three structural tensions have emerged that this model cannot accommodate: the difficulty of attributing manipulative intent to an autonomous algorithm; the opacity of black-box trading strategies to regulatory oversight; and the absence of statutory provisions capable of addressing cross-product manipulation in a market where derivatives volume exceeds cash-market volume by an order of magnitude unmatched globally. The July 2025 enforcement action against Jane Street Group, the largest market manipulation proceeding in SEBI's institutional history, illustrates each of these gaps concretely. Drawing on Indian securities jurisprudence, SEBI's own recent regulatory instruments, and the comparative frameworks of the European Union and the United States, this article proposes a dedicated AI Market Conduct Regulation: a statutory instrument introducing effect-based liability for algorithmic manipulation, mandatory pre-deployment strategy disclosure, and cross-segment surveillance obligations proportionate to the risks that autonomous trading poses to price discovery and investor protection in Indian capital markets.

Keywords: Algorithmic Trading, Market Manipulation, PFUTP Regulations, SEBI, Jane Street, High-Frequency Trading, AI Regulation, Securities Law

I. INTRODUCTION

On 3 July 2025, the Securities and Exchange Board of India issued an interim ex parte order against Jane Street Group, a United States-based proprietary trading firm, and four affiliated entities, alleging a coordinated scheme to artificially move India's benchmark Bank Nifty index across eighteen derivative expiry days between January 2023 and May 2025.[1815] The order calculated that Jane Street accumulated net gains of approximately ₹36,502 crore over that period through options positions whose profitability was, on SEBI's account, directly dependent on the cash-market price movements the firm engineered. SEBI impounded ₹4,843 crore as proceeds of alleged market manipulation, imposed a temporary ban on the entities' market access, and froze their Indian assets. Jane Street

[1815] Securities and Exchange Board of India, Interim Ex-Parte Order in the Matter of Index Manipulation by Jane Street Group and Others, Order No. WTM/AB/IVD/IVD-SEC-7/2025-26 (July 3, 2025) (India) [hereinafter Jane Street Order].

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promptly challenged the order before the Securities Appellate Tribunal.[1816]

The question whether Jane Street manipulated Indian markets is live, contested, and presently sub judice. This article does not seek to resolve it. The more fundamental question it addresses is anterior: whether India's legal framework for market manipulation is architecturally capable of resolving such questions with analytical coherence and consistent application. When a trading strategy operates through an algorithm executing thousands of instructions per second across multiple market segments simultaneously, the foundational concepts of securities fraud law, subjective intent, deliberate deception, and identifiable human decision-making begin to misfire against the facts.

The principal statutory architecture for addressing this conduct, the PFUTP Regulations 2003, read with Section 12A of the SEBI Act, 1992,[18171818] was conceived when algorithmic trading was nascent. Subsequent judicial development, most significantly in *SEBI v. Kishore R. Ajmera*[1819] and *SEBI v. Rakhi Trading*[1820], has progressively relaxed the evidentiary requirements for establishing manipulation, permitting inference from trading patterns in the absence of direct evidence of intent. But judicial adaptation of an existing framework and structural legislative adequacy are different things, and the Jane Street case has exposed the difference.

This article is structured as follows. Part II surveys the existing statutory framework and its doctrinal trajectory. Part III identifies three structural gaps that algorithmic trading has opened in that framework, using the Jane Street matter as the primary analytical lens. Part IV examines comparative regulatory models in the European Union and the United States. Part V proposes a legislative reform agenda for India.

II. THE EXISTING FRAMEWORK AND ITS DOCTRINAL EVOLUTION

India's market manipulation regime operates through two interlocking instruments. Section 12A of the SEBI Act prohibits any person from employing a manipulative or deceptive device in connection with listed securities.[1821] The PFUTP Regulations give that prohibition its operational content: Regulations 3 and 4 collectively prohibit wash trading, artificial price ramping, the creation of false trading appearances, and a range of further unfair market practices. The definitional foundation of the framework is Regulation 2(1)(c), which characterises fraud to include any act or omission — irrespective of whether deceptive conduct accompanies it that induces another party to transact in securities.[1822] This formulation was a deliberate departure from the 1995 predecessor regulations, which required proof of a specific intent to deceive. The drafters of the 2003 Regulations recognised that such a standard was too demanding for enforcement practice and broadened the definition accordingly, making it possible, in principle, to establish manipulation without proving that any individual subjectively intended to defraud.

The Supreme Court has given meaningful effect to this doctrinal reorientation. In *SEBI v. Kishore R. Ajmera* (2016), the Court held that trading patterns assessed in terms of their sequencing, timing, and commercial irrationality constitute sufficient circumstantial evidence to establish manipulation on the civil standard of preponderance of probabilities.[1823] In *SEBI v. Kanaiyalal Baldevbhai Patel* (2017), the Court endorsed a broadly purposive construction of the PFUTP Regulations to reach manipulation

[1816] Jane Street Group v. Sec. & Exch. Bd. of India, Appeal No. 413 of 2025 (Securities Appellate Tribunal Sept. 9, 2025) (India). See also Ayush Anand, Sebi Refuses More Data to US Trading Firm Jane Street as Probe Deepens, Bus. Standard (Sept. 9, 2025), https://www.business-standard.com/markets/news/sebi-refuses-more-data-to-us-trading-firm-jane-street-as-probe-deepens-125090900511_1.html.

[1817] Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, regs. 3–4 (India) [hereinafter PFUTP Regulations].

[1818] Securities and Exchange Board of India Act, 1992, § 12A(a)–(c) (India) [hereinafter SEBI Act].

[1819] Sec. & Exch. Bd. of India v. Kishore R. Ajmera, (2016) 6 SCC 368 (India).

[1820] Sec. & Exch. Bd. of India v. Rakhi Trading Pvt. Ltd., Civil Appeal No. 4556 of 2012 (Supreme Court of India Feb. 8, 2018) (India).

[1821] SEBI Act, supra note 4, § 12A(a)–(c).

[1822] PFUTP Regulations, supra note 3, reg. 2(1)(c).

[1823] Sec. & Exch. Bd. of India v. Kishore R. Ajmera, supra note 5.

techniques not specifically enumerated in the regulatory text.[1824] And in *SEBI v. Rakhi Trading Pvt. Ltd.* (2018), the manipulation finding turned on the commercial irrationality and circularity of the trading activity itself, without any requirement for evidence of collusion or agreement between the implicated parties.[1825]

These developments reflect a legitimate and responsive judicial instinct to prevent technical evasion of a fraud-prevention framework. Their limitation is structural: they developed to address human actors, colluding traders, dishonest brokers, insider-dealing promoters, and their logic depends on the reconstruction of human decision-making from behavioural evidence. An algorithm's output is not a decision in any legally cognisable sense; it is the product of mathematical optimisation applied to market data. The circumstantial inference model cannot be applied to it in the same way, and the attempt to do so produces precisely the interpretive uncertainty that the Jane Street case demonstrates.

SEBI has acknowledged these limitations through several recent instruments. The Viswanathan Committee on Fair Market Conduct observed in 2018 that the PFUTP architecture was poorly suited to addressing manipulation carried out by means of technological intermediaries.[1826] The 2025 circular on algorithmic trading introduced a categorisation framework and a Unique Algo ID system for algorithm providers.[1827] And the November 2024 Consultation Paper on AI in financial markets proposed a framework for assigning regulatory responsibility when AI-driven tools produce harmful market outcomes.[1828] Each of these instruments represents genuine regulatory engagement with the problem. None addresses the structural gaps that the Jane Street matter has made visible.

III. THREE STRUCTURAL GAPS: THE JANE STREET CASE AS DIAGNOSTIC

A. The Intent Attribution Problem

SEBI's interim order against Jane Street alleged violations of the PFUTP Regulations' provisions prohibiting conduct that creates a false or misleading impression of market activity.[1829] Jane Street's position, advanced in its SAT appeal, is that its activity constituted legitimate cross-product arbitrage between the cash equities, futures, and options segments of the Bank Nifty complex a fundamentally different characterisation of the same trading record.

The interpretive difficulty is exacerbated by SEBI's own internal investigative record. According to submissions made in the SAT proceedings, an earlier analysis by SEBI's Integrated Surveillance Department had concluded that Jane Street's activity could not be shown to have influenced the Bank Nifty index beneficially for its options positions in approximately ninety per cent of the trading windows examined.[1830] A subsequent investigation prompted by a complaint from an external market participant reached a different conclusion. The divergence illustrates a core methodological problem: where the alleged manipulator is an algorithm, the determination of whether manipulation occurred may turn on the analytical methodology applied to its output, and the law currently provides no framework for selecting between competing methodologies.

[1824]Sec. & Exch. Bd. of India v. Kanaiyalal Baldevbhai Patel, Civil Appeal No. 2595 of 2017 (Supreme Court of India) (India).
[1825]Sec. & Exch. Bd. of India v. Rakhi Trading Pvt. Ltd., supra note 6.
[1826]Securities and Exchange Board of India, Report of the Committee on Fair Market Conduct 22 (T.K. Viswanathan, Chairman, Aug. 2018) (India) [hereinafter Viswanathan Committee Report].
[1827]Securities and Exchange Board of India, Circular on Algorithmic Trading by Retail Investors, Circular No. SEBI/HO/MRD/MRD-PoD-3/P/CIR/2025/14 (Feb. 2025) (India) [hereinafter 2025 Algo Circular].
[1828]Securities and Exchange Board of India, Consultation Paper on Proposed Amendments with Respect to Assigning Responsibility for the Use of Artificial Intelligence Tools by Market Infrastructure Institutions, Registered Intermediaries and Other Persons Regulated by SEBI (Nov. 2024) (India) [hereinafter SEBI AI Consultation Paper].
[1829]Jane Street Order, supra note 1, regs. 3, 4(1), 4(2)(a), 4(2)(e) (PFUTP Regulations, supra note 3).
[1830]Jane Street Group v. Sec. & Exch. Bd. of India, supra note 2, ¶¶ 12–14 (submission of senior counsel Darius Khambata, S.C.),.

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This is the intent attribution problem. For human traders, manipulative intent is conventionally established through communications evidence, internal documentation, and the economic irrationality of specific transactions.[1831] An algorithm generates none of the first category and produces the second in volumes that defy case-by-case analysis. Its operators may in good faith have instructed it to execute a cross-product arbitrage strategy, while the strategy, at the scale and market concentration at which Jane Street operated generated outcomes that, to an external observer, are indistinguishable from deliberate manipulation. The current framework has no doctrinal vocabulary for distinguishing these cases at the ex ante design stage, and enforcement consequently risks attributing liability based on outcomes rather than intentions, a standard that serves neither deterrence nor fairness.

The penalty provisions in the SEBI Act compound this difficulty. Section 15HA calibrates sanctions to the conduct and culpability of individual or corporate actors, a design premised on the existence of an identifiable decision-making agent.[1832] Applied to an autonomous algorithm, the attribution of liability to the employing firm is defensible in principle but requires a presumptive framework for constructive knowledge that the current statute does not provide.

B. The Black-Box Opacity Gap

The second structural gap concerns the regulator's access to algorithmic strategies. The 2025 SEBI circular on algorithmic trading formalised a distinction between 'white box' algorithms, whose logic is disclosed to the relevant exchange, and 'black box' algorithms, whose internal decision rules remain proprietary to the operator.[1833] Providers of black-box algorithms are required to register as research analysts and maintain internal documentation. They are not required to disclose their strategy logic to SEBI or to the exchange in any form adequate for prospective surveillance.

The Jane Street proceedings illustrate the practical consequences. SEBI's forensic reconstruction of the alleged manipulation consumed approximately two and a half years of retrospective data analysis before a recognisable pattern emerged.[1834] By that stage, the NSE had issued a caution letter that went unacted upon, the alleged manipulation had concluded, and the proceeds had been accumulated. Post-hoc forensic enforcement of this kind is structurally inadequate where the harm, artificial settlement-price distortion occurs and becomes irreversible within the trading day.

Without access to the strategy specification the algorithmic design parameters, trigger conditions, and risk management rules determining whether a given algorithm constitutes an arbitrage mechanism or a manipulation instrument requires the regulator to rely entirely on output analysis. As the divergent conclusions drawn from Jane Street's own trading data demonstrate, output analysis is methodologically indeterminate. SEBI possesses the statutory authority under Section 11B of the SEBI Act to require disclosure of algorithmic strategy documentation,[1835] but it has not operationalised that power for this purpose. The result is a black-box gap: the regulator can observe what the machine did; it cannot determine what the machine was designed to do.

C. The Cross-Product Manipulation Blindspot

The third gap is specific to the distinctive architecture of Indian financial markets. India's derivatives market is, by notional volume, the largest in the world, and the ratio of derivatives to cash market turnover running at approximately four hundred to one during the

[1831]Bhavin Patel & Natasha Aggarwal, Proof of Market Manipulation: The Jane Streebasedbased on ont Case, IndiaCorpLaw (Oct. 10, 2025), https://indiacorplaw.in/2025/10/10/proof-of-market-manipulation-the-jane-sbased ontreet-case/.

[1832]SEBI Act, supra note 4, § 15HA.

[1833]2025 Algo Circular, supra note 8, ¶ 5.3,.

[1834]National Stock Exchange of India, Caution Letter to Jane Street Group Entities (F,,eb. 6, 2025) (India); Jane Street Order, supra note 1, ¶ 18.

[1835]SEBI Act, supra note 4, § 11B.

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relevant period is without parallel among major economies.[1836] This structure creates a potent economic incentive for cross-product manipulation: a participant holding large derivative positions has a corresponding incentive to influence the underlying cash market in the direction that increases the value of those positions. Jane Street's alleged conduct concentrated morning purchases in Bank Nifty constituent stocks to inflate the index, combined with short options positions designed to benefit from the consequent afternoon reversal, represents a textbook deployment of this mechanism.

The PFUTP Regulations prohibit transactions that create false trading appearances, but they contain no provision specifically directed at cross-product manipulation. No position-concentration trigger operates across market segments, no requirement that exchanges flag intraday correlations between directional cash activity and pre-existing derivatives exposures, and no settlement mechanism adjustment to reduce the financial reward from concentrated interventions at expiry. The 2025 algorithmic trading circular is directed at retail participation and is silent on institutional cross-product strategies. Academic commentary has noted that SEBI's characterisation of Jane Street's expiry-day conduct as a 'manipulative device' may generate regulatory uncertainty for any high-frequency participant whose strategy produces price effects near settlement windows, including participants pursuing entirely legitimate arbitrage activity.[1837] That uncertainty is a direct consequence of the cross-product blindspot: absent statutory definitions adequate to the structure of Indian derivatives markets, the boundary between permissible arbitrage and prohibited manipulation is drawn ad hoc through interim enforcement orders.

IV. COMPARATIVE PERSPECTIVES: EU AND US APPROACHES

The structural deficiencies identified above are placed in sharper perspective by comparison with the regulatory frameworks of jurisdictions from which India's largest algorithmic trading participants principally originate.

The European Union's regulatory approach, principally the Markets in Financial Instruments Directive II (MiFID II) and its associated delegated regulations, imposes prospective accountability obligations that India's framework does not.[1838] Investment firms engaged in algorithmic trading must notify the competent authority and the relevant trading venue of their strategies before deployment. They must maintain documented risk controls and pre-deployment testing records. They must implement kill-switch mechanisms capable of halting all algorithmic activity instantaneously. And their strategies must not contribute to disorderly market conditions a standard that captures manipulative effects regardless of the operator's subjective intent. The MiFID II framework thereby addresses the intent attribution problem at the source: by requiring disclosure of strategy design before deployment, it makes the distinction between arbitrage and manipulation visible to the regulator prospectively rather than forensically.

The United States' approach addresses the same problem from a complementary direction. The Dodd-Frank Act introduced a codified prohibition on spoofing the placement of orders with the intention to cancel before execution under the Commodity Exchange Act.[1839] While an intent element is retained, American enforcement practice has developed evidentiary standards capable of establishing

[1836]Jane Street Order, supra note 1, ¶ 47.

[1837]Umakanth Varottil, Jane Street and the Expiry Day Trap: Unpacking SEBI's Crackdown on Algorithmic Manipulation in India, Oxford Bus. L. Blog (July 30, 2025), https://www.law.ox.ac.uk/business-law-blog/blog/2025/07/jane-street-and-expiry-day-trap.

[1838]Council Directive 2014/65/EU, on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU, art. 17, 2014 O.J. (L 173) 349 (EU); Commission Delegated Regulation 2017/589, Supplementing Directive 2014/65/EU with Regard to Regulatory Technical Standards Specifying the Organisational Requirements of Investment Firms Engaged in Algorithmic Trading, arts. 1–12, 2017 O.J. (L 87) 417 (EU).

[1839]Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 747, 124 Stat. 1376, 1739 (2010) (codified at 7 U.S.C. § 6c(a)(5)(C) (2018)).

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algorithmic intent through version-controlled code repositories, algorithm change logs, and trader communications records that traders are required to maintain and that regulators can access under warrant. The United Kingdom's Financial Conduct Authority has similarly issued guidance requiring pre-deployment testing documentation, version-controlled code, and real-time risk control records as standard compliance obligations for algorithmic market participants.[1840]

India has none of these requirements. There is no pre-deployment strategy notification obligation for institutional participants. There is no requirement to maintain version-controlled algorithm repositories. There is no statutory cross-product manipulation standard. The SEBI AI Consultation Paper acknowledges that assigning responsibility for autonomous AI decisions to human principals raises questions that the current framework cannot answer,[1841] but the paper remains at the level of conceptual proposal rather than legislative prescription.

V. TOWARD AN AI MARKET CONDUCT REGULATION FOR INDIA

The analysis in Parts II–IV establishes that the gaps in India's framework are not correctable by further judicial interpretation of the PFUTP Regulations. They require dedicated statutory intervention. This article proposes a three-component AI Market Conduct Regulation.

The first component is an effect-based liability standard for algorithmic manipulation. Under the proposed standard, an algorithmic strategy that demonstrably produces price distortions inconsistent with legitimate liquidity provision as measured by its price impact relative to prevailing market depth, its timing in relation to derivative expiry windows, and its departure from patterns characteristic of bona fide market-making would attract a presumption of manipulation without requiring proof of the operator's subjective intent. The operator could rebut the presumption by demonstrating, through pre-deployment strategy documentation, that the algorithm was designed and operated in good faith as an arbitrage or market-making instrument. This structure, analogous to the reverse-burden models familiar in product liability and environmental regulation, is appropriate in the algorithmic trading context because operators possess superior information about their strategy design and because the informational asymmetry between regulator and participant is otherwise insurmountable.

The second component is a mandatory pre-deployment disclosure regime for institutional algorithmic participants exceeding a specified market concentration threshold. Any firm whose orders account for more than a prescribed share of traded volume in any index constituent on any trading day should be required to: (a) maintain version-controlled algorithm code and strategy specifications accessible to SEBI under a warrant procedure; (b) file strategy summaries not proprietary source code with the relevant exchange before any new strategy deployment; and (c) provide post-trade strategic explanations within a defined timeframe upon regulatory request. SEBI possesses the enabling authority for these requirements under Section 11B of the SEBI Act,[1842] and what is required is the legislative mandate that removes ambiguity about the scope of that authority in the algorithmic strategy context.

The third component is a cross-product manipulation standard calibrated to India's derivatives-heavy market structure. SEBI should be required by statute to maintain real-time position-concentration surveillance that flags intraday correlations between large directional cash market activity and pre-existing derivatives exposures held by the same

[1840] Financial Conduct Authority, Algorithmic Trading Compliance in Wholesale Markets (Feb. 2018, updated guidance 2022) (U.K.), https://www.fca.org.uk/publications/multi-firm-reviews/algorithmic-trading-compliance-wholesale-markets.

[1841] SEBI AI Consultation Paper, supra note 9, at 8.

[1842] SEBI Act, supra note 4, § 11B.

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participant. Exchanges should be under a corresponding obligation to share cross-segment data with the Integrated Surveillance Department on a real-time basis. And the volume-weighted average price methodology for index derivative settlement should be reviewed with a view to extending the calculation window or introducing participation caps during expiry periods, measures that would reduce the financial incentive for the type of expiry-window concentration that the Jane Street order describes.

These proposals are not designed to eliminate algorithmic trading or to disadvantage sophisticated participants. Algorithmic market-making and statistical arbitrage provide genuine benefits to price discovery and market liquidity. The proposals are designed to ensure that the regulator can identify, prospectively and with statutory clarity, the boundary between strategies that serve those functions and strategies that exploit market microstructure at the expense of retail investors and orderly price formation. Secondary commentary on the Jane Street proceedings has noted that the absence of this clarity already poses a risk of chilling legitimate high-frequency activity,[1843] and that the costs of that uncertainty fall disproportionately on market participants who lack the resources to sustain prolonged enforcement litigation.

VI. CONCLUSION

India's securities markets have been reshaped by algorithmic trading. The legal framework responsible for maintaining their integrity has not been correspondingly updated. The PFUTP Regulations, 2003, remain a well-constructed instrument for the era in which they were drafted. The Supreme Court's jurisprudence in *Ajmera*, *Patel*, and *Rakhi Trading* has extended the framework's operational reach with considerable doctrinal ingenuity. But the three structural gaps identified in this article, the intent attribution problem, the black-box opacity gap, and the cross-product manipulation blind spot, cannot be resolved by further judicial construction. They require legislation.

The Jane Street matter has furnished a precise and public demonstration of these failures: a two-and-a-half-year investigation, an interim order of exceptional length and complexity, a contested SAT appeal, and a fundamental unresolved question about whether the impugned conduct constitutes manipulation or arbitrage. These are the characteristics not of a framework functioning at its limits but of a framework operating beyond them.

The European Union and the United States have each developed statutory responses to the emergence of autonomous algorithmic trading that impose prospective accountability, reduce informational asymmetry between regulator and participant, and establish cross-product surveillance proportionate to the risks that high-frequency trading poses in their respective markets. The November 2024 SEBI AI Consultation Paper signals that India recognises the necessity of a comparable response.[1844] What is now required is the translation of that recognition into legislative text before the structural inadequacies of the current framework are exploited, at greater scale and greater cost, by the next generation of algorithmic participants.

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[1843] Patel & Aggarwal, supra note 17.

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