



ESMA Consultation Paper on market outages – WFE response

16th December 2022

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent the operators of over 250 market infrastructures, spread across the Asia-Pacific region (37%), EMEA (43%) and the Americas (20%), with everything from local entities in emerging markets to international groups based in major financial centres. In total, member exchanges trade around \$100 trillion a year and are home to some 60,000 companies, with an aggregate market capitalisation of around \$120 trillion. The 50 distinct central counterparty (CCP) clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up \$1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for all sorts of investors and companies wishing to invest, raise capital and manage financial risk.

Founded in 1961, the WFE seeks outcomes that maximise financial stability, consumer confidence and economic growth. We also engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

James Auliffe, Manager, Regulatory Affairs: jauliffe@world-exchanges.org

Richard Metcalfe, Head of Regulatory Affairs: rmetcalfe@world-exchanges.org

Nandini Sukumar, Chief Executive Officer: nsukumar@world-exchanges.org

Introduction

The World Federation of Exchanges (WFE) welcomes the opportunity to respond to ESMA's consultation on market outages.

As regulated markets, our members already have procedures and clear guidance on what will happen during interruptions. In light of this, ESMA should consider relying on current market best practices developed by regulated markets for communicating an outage on other venues.

It is important that any guidance is not prescriptive. Trading venues should be able to utilise the most appropriate procedures depending upon event and asset classes traded. Therefore, any guidance should remain high-level. Furthermore, regulatory expectations should not restrict trading venues' ability to take the necessary steps to resolve a technical incident and to communicate clearly to market participants.

Whilst we agree that venues should provide a root cause analysis and remedial plan to their national competent authority (NCA), guidance should note that this is a secondary priority to the resumption of trading. This analysis and plan should not impede the core obligation which is the orderly re-opening of the market. Any guidance should also clarify that the root cause analysis and remedial plan after all incidents would not necessarily be in the public domain as this could damage the exchange by exposing commercially sensitive information or expose systems in a way that could, for example, lead to possible cyber-attack by nefarious actors.

It should always be borne in mind that it may be impossible to entirely rule out the possibility of service interruptions and, given that uncertainty, there has to be flexibility in terms of selecting the correct response and in terms of targets to rectify and analyse issues. Regulated markets invest huge sums in their systems to minimise the risk. However, nothing they do can guarantee there are no technical problems or that cyber-attacks will not occur. Regulated markets are already highly regulated to ensure they have the strongest possible protections against outages. Exchanges are already subject to business continuity obligations and operate relevant contingency measures and back-up arrangements which aim to prevent major disruption to the maximum extent possible during any outage.

Q1 : Do you agree with the main communication principles identified above?

Yes.

As regulated markets, our members already have procedures and clear guidance on what will happen during outages. Furthermore, bringing other venues up to this standard will level the playing field and improve the overall operation of European markets. Accurate and prompt information to the exchange's participants is paramount on all aspects listed by ESMA in the Consultation Paper (e.g., notice of disruption, regular status updates, anticipated time of resumption). Market participants shall also have a clear indication on what to expect in terms of orders' status, depending on the nature of the outage.

Q2 : To promote harmonisation, should the guidance include a template on what trading venues' communication notices should include?

A template may be too onerous and the proposed guidance would be sufficient. Venues should be able to offer the most appropriate procedures depending upon asset classes traded. Further, trading venues need to keep a certain degree of discretion in addressing incidents based on best practice and in line with the existing regulatory and legal requirements.

Q3 : Do you agree that trading venues should have a maximum of one-hour to provide clarity on the status of the orders during an outage? If not, what would be an appropriate timeframe in your view and why?

Whilst we agree with the aim to provide members and participants as much clarity as possible as quickly as possible, a hard target may not be the most appropriate tool. Venues should be encouraged to deliver clarity quickly but that should not come at the risk of releasing incorrect information to meet a regulatory deadline. Indeed, trading venues have a clear incentive to get their trading systems back up running as quickly as possible and to allow market participants to resume their activities on their platform; they would consequently provide clarity on the status of the orders as soon as possible,

Q5: What is your view with regards to the conditions under which a trading venue should reopen trading?

The most important condition is whether the venue is ready to re-open. Venues are obliged to operate fair and orderly markets which is the lead factor in determining if the market is ready to re-open. If not, they may cause further issues. The conditions under which a trading venue should re-open vary at the technical level depending on the trading system.

Q6: What is your view in relation to the closing auction being affected and the procedures that trading venues should have in place to minimise disruption?

Exchanges operating price-forming activity currently provide guidance on how they set alternative closing prices. We agree that exchanges ought to have a clear process to determine the alternative closing price, but the exact process does not need to be further defined by ESMA. In other words, venues should be free to decide what is most appropriate considering their markets, asset classes and market participants

Q7: Do you agree not to mandate trading venues to have an alternative trading venue capable of running the closing auction for them? If not, please explain.

Yes.

WFE agrees with ESMA on this point. There are substantial technological problems with such an approach as it is not as simple as flicking a switch. These problems are exacerbated if they do not operate full price discovery, have significant groups of members and potentially liquidity missing, or they do not operate a compatible full value chain environment, thereby limiting members ability to operate. A lack of standardisation of instruments traded across alternative venues could leave some market participants at a disadvantage while some participants may not have access to such venues in the first place. Derivatives represent an even more challenging case than equities as they do not necessarily trade across multiple venues, but the same issue is also likely present for all instruments.

Nevertheless, there will be some venues who may be able to offer an alternative and they should be free to pursue this.

Q9: Do you agree that the use of the last traded price is an appropriate solution in those cases that a trading venue cannot run the closing auction? If not, what alternative would you propose?

Exchanges currently provide guidance on how they set alternative closing prices on the primary markets. We agree that exchanges ought to have a clear process to determine the alternative closing price, but the exact process does not need to be further defined by ESMA or NCAs. In other words, venues should be free to decide what is most appropriate considering their markets, asset classes and market participants.

Q13: Is there a direct link/connection between an outage on an equity primary market and those derivatives that have these instruments as underlyings?

We understand the norm is that trading in derivatives is halted when trading in the underlying asset is halted.