FESE response to the ESMA consultation paper on market outages

Brussels, 13th December 2022

1. Equity markets

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

FESE agrees with the main communication principles identified by ESMA in the consultation paper, including general communications informing about the disruption, regular status updates, and specific communications directly to trading members where it is not possible to communicate the status of orders from the published updates. We would however caution against potential burdensome and unnecessary requirements, which would restrict trading venues' ability to take the necessary steps to resolve a technical incident and to communicate clearly to market participants. In FESE's view, ESMA can best promote market integrity and more consistent resiliency across EU trading venues with high-level guidance, while also allowing trading venues the flexibility necessary to resolve incidents and tailor communications in the most effective manner under the circumstances.

While trading venue outages are rare, they require an appropriate response. With the objective of a more harmonised framework in Europe that builds on the broad consensus in place and supports market participants, FESE adopted in January 2022 a framework for an industry-wide standard protocol on outages in equity markets. This initiative is designed to setting expectations for market participants as regards to the underlying procedures that are to be followed in the event of a market outage in these markets.

Since the publication of the framework and its principles (most of them similar to the ESMA proposals), FESE members have been developing and publishing playbooks on outage protocols, all of them listed in a centralised database.

We wish to emphasise, however, that every trading system is different so there is a risk that very prescriptive guidance will not be appropriate in all cases, so we urge ESMA to take a high-level and principled-based approach, rather than setting out requirements that are too granular and may result in unintended consequences for different platforms.

Furthermore, as per Article 23 MiFIR on the share trading obligation, shares admitted to trading on a regulated market or traded on a trading venue shall be traded on a regulated market, MTF or systematic internaliser (or a third country trading venue assessed as equivalent). Systematic internalisers (SIs) being execution venues considered at the same level as regulated markets and MTFs, FESE suggests that the communication principles in case of an outage should be extended to SIs so that market participants are informed equally about any disruptions and get provided with regular status updates.

Whilst FESE agrees in general with the communication principles, we would like to highlight that information and communication procedures in case of an IT incident are addressed within Article 13 of the European Commission on a Regulation on Digital Operational Resilience (DORA). We welcome that DORA aims at introducing a consistent and streamlined approach for the financial sector towards IT incident classification, notification towards authorities, and communication to customers and the public with a view to increasing the efficiency of current communication procedures and the resilience of the overall ecosystem. This also includes the establishment of information and coordination procedures between relevant authorities on the national and EU level.

Trading venues already comply with Articles 47 and 48 of MiFID II requiring effective systems and procedures to ensure their systems' resilience and orderly trading, also under stressed market conditions. These provisions will have to be assessed against the new DORA standards once applicable.
Hence, we do not think that any additional guidance to the MiFID II/MiFIR framework is necessary.

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

FESE believes that the guidance proposed by ESMA is sufficient. Clear principles around outage communications are useful and FESE members have already provided individual playbooks which are all publicly available for all market participants. Because of the specificities of each system we do not see the necessity to have all playbooks or communication notices under the same template, as long as they are compliant with the guidelines provided by ESMA.

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?

FESE suggests that trading venues should provide clarity on the status of the orders as soon as possible. Indeed, in case of an outage, trading venues have an incentive to get their trading systems back up running as quickly as possible and to allow market participants to trade again; they would consequently provide clarity on the status of the orders and trades for participants as quickly as possible, which might not be possible within a one-hour timeframe. We would also underline that the status of orders and trades can be derived from the nature of the incident, meaning that as soon as the issue has been identified, market participants have general rules available to them to deduct the status of their orders and trades.

Q4: Do you think the possibility to require trading venues to offer an order book purge should be considered in the guidance? If yes, should ESMA provide further guidance on when the integrity of the orders has been largely compromised?

FESE considers it is beneficial to offer an order book purge to every trading participant, especially in cases where the integrity of orders has been compromised to a large degree. However, order book systems differ and the determination of what constitutes "integrity of the orders" should be entrusted to each venue. We would caution against a systematic order book purge in case of an incident. Because it is an extreme measure, we believe trading venues shall be able to assess the relevance for application of this measure in order to guarantee the integrity of the platform and ensure trust of market participants in our systems.

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

The conditions under which a trading venue should reopen vary at the technical level depending on the trading system but, for a proper re-opening, fair and orderly trading and other regulatory responsibilities should be ensured.

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The market should re-open with standardised pre-trading and auction phases depending on the specific markets, guaranteeing the integrity of the orders. This includes securing the consistency between order and trade records at all times and minimising the impact on trades.

In addition, while we note ESMA advises that the purpose of this guidance is not to propose any legislative amendments and that any potential change to the timeframe set out in Article 15(2) of RTS 7 to reopen trading would be subject to a further ESMA consultation, we would still like to take this opportunity to highlight our concerns with regard to the obligations set out in RTS 7 and suggest further consideration is given to the 2 hour recovery time requirement. Trading venues do their utmost to ensure continuity of trading and to resume trading after any incident. Therefore we would welcome any further consideration of this, particularly in light of DORA.

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?

FESE understands the key role that closing auctions play in equity markets. Closing auctions concentrate liquidity to the benefit of issuers and investors and in that regard the current requirements to have in place effective systems, procedures and arrangements to ensure system resilience are fit for purpose. In addition, the proposed measures around postponing the auction to a later point on the same day or using the last traded price as the official closing price are adequate to ensure that disruptions are minimised. These are principles already implemented by FESE members. As per our response to Q5, the key priority for trading venues is to ensure fair and orderly trading and safeguard market integrity.

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.

FESE agrees, ESMA guidance on the use of alternative trading venues would be very detrimental to the market.

Firstly, mandating alternative trading venues appears to clash with one fundamental principle, the possibility to choose where to trade. The arbitrary appointment of a single alternative trading venue in the case of an outage is an anti-competitive measure at odds with the core freedom buyers and sellers enjoy: ultimately investors are free to trade on any venue provided they have confidence in its ability to meet their needs.

Secondly, while switching to an alternative venue in the case of an outage is something that the most sophisticated market participants could potentially handle, it is highly unlikely to be an adequate solution for smaller market participants, notably retail brokers and smaller local institutions. This means they would technically not be capable of shifting flow from one venue to another. In fact, this would increase significantly costs for market participants, which from a cost-benefit analysis and given the high availability of trading systems is very difficult to justify.

Q8: Do you agree that trading venues should have a cut off time (30 minutes before the normal schedule) to inform market participants on whether or not they intend to hold a closing auction?

Yes, FESE agrees that there should be a cut-off time. In case the closing auction cannot take place for the trading session, the last traded price should be considered the official closing price. In addition, it may be practically impossible to keep the cut-off if the outage occurs in the last 30 minutes before the closing call. This is an area where we believe that

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the interests of trading venues and their participants are well aligned, and hence further regulation will add little value.

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?

Yes, in case the closing auction cannot take place for the trading session, the last traded price should be considered as the official closing price.

Q10: Is the lack of a reference price an issue in an outage context? If so, please provide details.

In case of an outage, the last traded price is often used as the reference price, so there still is a reference point on the primary venue. Furthermore, we suggest the nature of reference prices should be understood in the wider context. Reference prices are referenced because they are representative of the market value of instruments, which is why most trading models refer to only one reference price embedded by the primary best bid and offer. This is entirely consistent with order flow competition. Under MiFID II/MiFIR, pre-trade transparent venues, both regulated markets and multilateral trading facilities, can be the most relevant market in terms of liquidity and generate the reference price.
The intrinsic connection of these venues with the creation of reference prices owes to trading venues' robust mechanisms, ensuring transparent, orderly, and non-discriminatory trading. Liquidity begets liquidity. These features are exemplified during periods of market volatility peak, prior to significant announcements by public bodies, or in the event of a main market outage and consequent loss of the reference price, as market makers are not willing to risk trading in other venues.
In view of this, ensuring a strong operational framework to prevent outages and minimise their impact and establishing the last traded price as a backup are appropriate solutions in the context of price referencing.

2. Non-equity markets

Q11: Do you agree with the proposed approach for non-equity instruments? Do you agree that provisions on par. 37-39 can be exempted for those trading venues that do not provide CLOB?

Yes, we believe that paragraphs 37-39 can be exempted for those trading venues that do not provide CLOB. Given the different structure of non-equity markets we do not think it is necessary or appropriate to apply those obligations, the current regime seems appropriate.

As for equities, FESE believes it is also important in non-equity markets that regulators' expectations do not restrict trading venues' ability to take the necessary steps to resolve a technical incident and to communicate clearly to market participants. In our view, ESMA can best promote market integrity and more consistent resiliency across EU trading venues with high-level guidance, while also allowing trading venues the flexibility necessary to resolve incidents and tailor communications in the most effective manner under the circumstances. During a systems disruption, the priority will always be to resolve the issue which is causing the disruption and to communicate clear and actionable information to market participants in order to protect the fairness and orderliness of the market.

While trading venue outages are rare, and even more so in non-equity markets, they require an appropriate response. In parallel to the work done for equity markets, FESE also adopted two distinctive industry-wide standard protocols in exchange-traded derivatives (ETDs) markets and fixed income markets. As ESMA hinted, the principles

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applied to equity markets have been largely extended and, where necessary, adapted to non-equity markets, and in our view, we believe these protocols are sufficient to ensure a robust response in any outage.

In particular for fixed income market, it is important to consider the different structure of the market, where there is not the same reliance on the primary market as is the case for equity, and trading is distributed more widely across several trading venues and systematic internalisers, so there is less of an impact in case of an outage of a single trading venue. We also consider the current requirements, those provided by MiFID and by the forthcoming application of DORA and in particular Article 13 with reference to information and communication procedures in case of an IT incident, are sufficient. Furthermore, we believe some of the proposals would be inappropriate for fixed income markets, such as requiring a 30-minute notice period before restarting trading and requiring re-opening auctions. Instead it should be left to the operator of the trading venue to decide the most appropriate way to restart trading, given their market model.

We encourage thorough analysis of the playbooks and protocols already available, in order to assess what added value further measures by ESMA might bring.

Q12: Is there any particular issue relating to trading of non-equity instruments that should be taken into account in the case of an outage? Where possible please differentiate between bonds and derivatives.

For derivatives markets, we wish to highlight the importance of having general principles for the daily settlement prices. These depend on the underlying assets of the contract and on whether there are deviations from the usual settlement price procedure in case of an outage. If the opening or closing auction of the underlying instrument cannot take place for the trading session, the relevant daily settlement price should be calculated according to the methodology defined by the trading venue for each derivative contract. Given the different systems operated by trading venues in these markets, rigid legal provisions would not be fit for purpose.

Derivative exchanges may have their own process on how to define daily or final settlement prices. In case of non-availability of the price, the trading venue may decide to use the price from the reference market or alternative market, the last price available, back month price, theoretical model prices, etc. We would opt for leaving discretion to trading venues to define which price to use depending on the type of products they offer, asset classes, etc.

Concerning auction mechanisms, some derivative and/or bond markets might run differently from equity markets. Guiding principles on the functioning of equity auctions during an outage should not be directly applied to non-equity systems under a one-size-fits-all approach. It should be left to the operator of the trading venue to decide the most appropriate way to restart trading, given their market model.

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

Whilst trading participants should decide whether to trade the derivative or not if its underlying is impacted by the outage, trading in some derivative contracts is halted in the event markets in the underlying assets experience an outage. This affects rules for establishing daily settlement princes, as noted before.

Q14: In your view is there any further element ESMA should consider in the proposed guidance?

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As already pointed out in our answer to question 1, FESE would like to highlight that information and communication procedures in case of an IT incident are addressed within Article 13 of the European Commission on a Regulation on Digital Operational Resilience (DORA). We welcome that DORA aims at introducing a consistent and streamlined approach for the financial sector towards IT incident classification, notification towards authorities, and communication to customers and the public with a view to increasing the efficiency of current communication procedures and the resilience of the overall ecosystem. This also includes the establishment of information and coordination procedures between relevant authorities on the national and EU level. Trading venues already comply with Articles 47 and 48 of MiFID II requiring effective systems and procedures to ensure their systems' resilience and orderly trading, also under stressed market conditions. These provisions will have to be assessed against the new DORA standards once applicable.
Hence, we do think that any additional guidance to the MiFID II/MiFIR framework is therefore not necessary.
Finally, we encourage thorough analysis of the playbooks and protocols already available, in order to assess what added value further measures by ESMA might bring.

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