Insights

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Market Structure

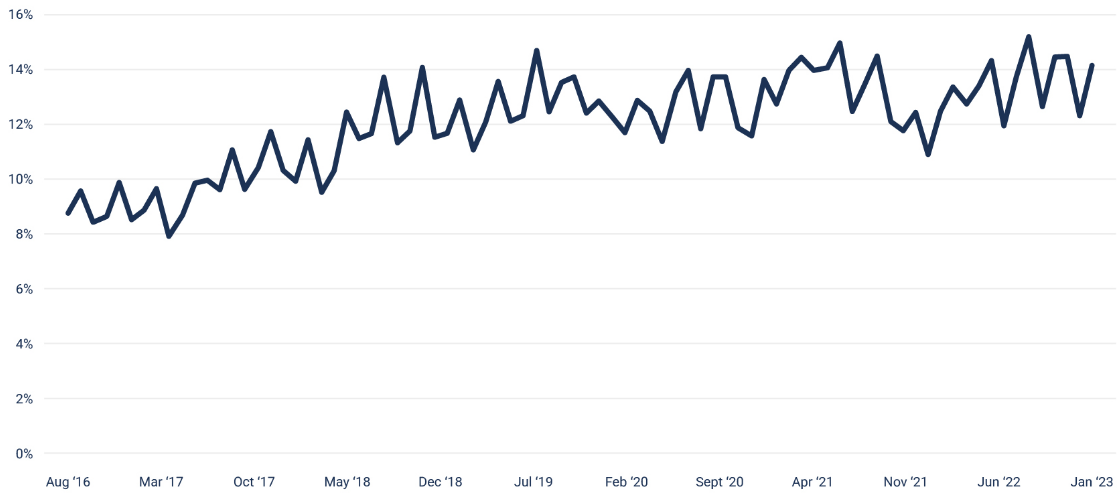
A plan for tackling closing auction outages

Closing auction outages are rare, but they do happen. While recent regulatory efforts have been aimed at outages during normal trading hours, more needs to be done to protect the closing auction. We support an alternative pan-European closing mechanism, but for it to work listing exchanges need to cooperate with their peers.

A technical glitch at one of Europe's largest exchanges last week underlined the need for our industry to prepare for sudden disruptions to our trading infrastructure. For three hours on 13 June, trading was suspended on SIX Swiss Exchange, its most serious outage in a decade. Optiver supports recent regulatory efforts to minimize the impact of outages. In a series of papers, we have called on exchanges to adopt clear and consistent approaches for handling technical issues and changes that could impact operational stability.

Yet more needs to be done to protect the closing auction, which is the most hectic, and arguably the most important, period of the trading day. When you consider that end-of-day auctions attract around 15% of total European equity volumes — spiking to 25% on major option-expiry and index-rebalance days – the possibility of an outage hitting the closing auction is a serious concern.

Closing auction market share



Source: Rosenblatt Securities

While we applaud regulatory efforts to push exchanges to adopt standardized playbooks for outages that occur during normal trading hours, we are surprised that guidance related to the close is so sparse.

Closing auction outages are rare, but they do happen. On 16 November, 2022, a technical issue prevented Nasdaq from establishing a closing price for securities listed across four of its Scandinavian exchanges. Roughly two years earlier, a major glitch at Euronext froze a large chunk of the EU equity market for four hours and left the exchange unable to calculate a closing price.

In the event of a technical glitch, markets still need to perform the vital function of setting price benchmarks for mutual funds and ETFs, as well as settlement prices for derivative contracts. When an unresolvable outage hits the closing auction, we believe listing markets should collaborate with the industry and support an alternative pan-European closing mechanism. Doing so would show that listing markets can set aside commercial considerations to act in the best interests of the market.

There's a precedent for a market-led closing-auction back-up. Under a plan tested as recently as November, US exchanges can step in to run each other's close. Of course European markets have a very different structure from their US peers. That means it may take some time for participants to get comfortable with a back-up system.

For example, smaller or regional brokers might have to establish new direct or indirect market connections to an alternative closing auction venue and modify their post-trade set ups. The back-up auction operator may need to admit securities that it does not already offer for trading to create a truly pan-European back-up. It may also have to distribute additional closing-auction data, which may lead to greater costs for trading firms.

But these challenges are hardly insurmountable. Proper testing by market participants would go a long way toward overcoming them. What's clear is that a market-backed alternative closing auction would be more reliable than other solutions like delaying the close or using the last traded price — both suggested in a recent ESMA consultation. A back-up auction would also deliver better outcomes than a pan-European consolidated tape.

If an auction is delayed too far into the evening it could wreak havoc on stock options exercise prices, which generally expire in the early evening. This could prevent options market makers from properly hedging their exposures, potentially leading to significant market shocks. The last traded price or consolidated tape also may not be accurate closing-price benchmarks, especially if an outage occurs early in the day and market-moving news hits in the interim.

For this to work, listing exchanges need to cooperate with their peers. For instance, derivatives-market operators, mutual fund and ETF issuers would have to recognize the prices set by an alternative closing facility as a benchmark for their products. Regulators could speed this along by requiring stock markets to designate responsibility for their closing auctions under certain outage conditions.

While market participants shouldn't necessarily be forced to connect to the back-up facility, we believe it would eventually become best practice. All this requires effort on the part of the industry, but that should be weighed against the alternative: scrambling for a back-up when the next closing auction goes wrong.

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Further reading

- A news article on the SIX Swiss Exchange outage
- A pair of Optiver papers on building resilience in European equity markets
- A news article about the closing auction outage at Nasdaq Nordics
- An ESMA consultation on market outages

About Optiver

Optiver is a global market maker with offices in Amsterdam, London, Chicago, Austin, Sydney, Shanghai, Hong Kong, Singapore and Taipei. Founded in 1986, today we are a leading liquidity provider, with close to 2,000 employees in offices around the world, united in our commitment to improve the market by competitive pricing, execution and thorough risk management. By providing liquidity on multiple exchanges across the world in various financial instruments we participate in the safeguarding of healthy and efficient markets. We provide liquidity to financial markets using our own capital, at our own risk, trading a wide range of products: listed derivatives, cash equities, ETFs, bonds and foreign currencies.