



February 28, 2020

CETFA Shares its Insights on Yesterday's TMX Markets Trading Halt

The TMX confirmed late yesterday that “all systems are ready for the start of business” after a technical issue stopped trading on the Toronto Stock Exchange (TSX), TSX Venture Exchange (TSXV) and TSX Alpha Exchange (Alpha) on the afternoon of February 27. And they began operating, as promised, on February 28.

This ETF Flash Note will provide you with CETFA insights into the temporary outage and a balanced assessment that underscores the resilience of ETFs. It is important to emphasize that even if one exchange is not functioning, ETFs can continue to be traded through other exchanges, as well as on Alternative Trading Systems (ATS).

Key Events & Their Significance for ETF Investors

On Thursday Feb. 27, mounting financial anxieties and macro-economic pressures associated with COVID-19 roiled markets and pushed down the S&P/TSX Composite Index by almost two per cent.

About 1:45 p.m. ET, the TMX announced that the TSX, TSX Venture and TSX Alpha Exchange were subject to a technical halt. It froze existing order entries submitted to all of its platforms, preventing any modifications or cancellation to existing open orders. The Montreal Exchange (where derivatives are traded), also halted. TMX-operated exchanges could not reopen before the end of the trading day and has since explained that: “The interruption was caused by a system capacity issue within the messaging technology component of TMX's trading engine.” ([TMX Provides Update on Market Outage and Confirms Friday Market Opening](#))

As coverage by BNN Bloomberg stated: “Heavy selling may have contributed to the technical problem.” However, importantly, it noted: “To be sure, Canadian traders have the ability to divert some of their trades to rival exchanges such as Nasdaq Inc. and NEO Exchange.” ([All systems ready for TSX Friday after outage snafu: TMX Group](#))

The TMX last experienced a partial trading halt almost two years ago when ETFs were already firmly established in the Canadian investment market. On April 27, 2018, the TSX and its derivatives market closed for more than two hours, also for technological reasons.

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Implications for ETFs & The Resilience of the Model

Yesterday's halt is significant to ETF investors because the S&P 500 Index fell an additional 2.2% after the TMX exchanges closed and the theoretical S&P/TSX Composite Index was estimated to be 1.21% below its halted level.

A stop in the middle of a volatile trading day is understandably challenging for ETFs. ETF net asset values (NAVs) are materially calculated based on the closing price on the TSX of their underlying securities as the TSX is responsible for the majority of Canadian securities trading. ETFs continued trading on other exchanges after the TMX halt, which means the closing price of ETFs – the last trade on the TSX specifically – could deviate significantly from their official NAV. This could lead to the perception that the ETFs and their NAVs were misaligned.

However, the ETF management model has inherent flexibility to address such situations. In extreme scenarios, it allows for discretion to be applied, so that a "fair value" close may be prudently calculated by the ETF manager when the official close cannot be determined. When trading resumes, any gap that may exist between the ETF price and its NAV will be narrowed and closed.

ETFs Have Withstood & Can Withstand Temporary Halts

The temporary halt on TMX exchanges – or on any exchange – does not undermine the ETF model or its demonstrated financial benefits: low trading cost, tax-advantaged returns, wide range of options, etc. Atypical, infrequent trading system "glitches" do *not* detract from these proven strengths, and the emotionally charged context in which recent events occurred should be taken into account.

ETFs continue to be excellent investment vehicles for managing market exposure in periods of excessive and erratic volatility today as they were in 2018 when a brief outage on the TSX has occurred.

The CETFA hopes you have found this analysis of recent trading events to be informative and helpful and welcomes your questions and comments. For more information about ETFs and our educational activities, please visit: cetfa.ca.

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