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Germany torpedoes "Payment For Order Flow" ban

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Spectacular turnaround in the "Payment for Order Flow" dispute: According to information from Finanz-Szene and Finance Forward, Germany wants to torpedo the EU Commission's planned ban on the controversial remuneration practice. A confidential position paper of the German government states literally and in no uncertain terms: "Germany strongly opposes the inclusion of the general ban on payment for forwarding client orders for execution."

According to our information, Berlin is not alone in its opposition to the "PFOF" ban. In fact, more than half a dozen EU countries are said to oppose the Brussels plans. The Netherlands, on the other hand, continues to be a clear supporter of the ban (here the ban is already national law) - which allegedly also applies to France. Background: The "PFOF" practice makes business difficult, especially for classic large stock exchanges such as Euronext, which is based in Amsterdam and Paris. However, all sources agree that Germany has also taken the lead in Brussels among the critics of the ban.

Payment for order flow" is the term used for special kickbacks in share trading. In concrete terms, this model works in such a way that retail brokers receive payments for this from the trading venues through which they process their buy and sell orders (see also our ancient piece -> The business model of the zero-fee broker Trade Republic). Accordingly, the brokers can offer their services to the end customer at a lower price.

It is true that traditional players such as ING Diba, Comdirect or FlatexDegiro also collect corresponding fees. However, the controversial payments are more critical for new brokers such as Trade Republic, since they generate a significant part of their income through "payment for order flow". If the kickbacks were banned - as planned by the EU Commission - the fintech brokers would probably have to realign their revenue model. In view of the massive resistance, however, insiders interviewed by the financial scene now doubt that the plans for a ban presented at the end of November (see also -> Now it's official: "Payment for Order Flow" ban in EU draft) will really become law. Especially since Brussels has recently indicated to industry representatives that it is reviewing its own plans.

The BMF sides with Trade Republic

The German position paper, dated 7 March, was penned by the Federal Ministry of Finance and is addressed to the Council of the European Union - the Brussels representative body of the EU member states. In five pages and in unusually sharp words, the BMF describes the proposal to prohibit "payment for order flow" as "premature". The authors argue that empirical practice lacks "any evidence" that the ban is in the interests of those it is intended to protect - namely investors. A BMF spokeswoman confirmed the BMF's authorship of the "non-paper", but did not want to comment further.

The "German delegation" mentioned in the paper does not fundamentally deny that the payments of the trading venues to the retail brokers harbour a potential conflict of interest. However: the existing regulatory framework (which, for example, requires market participants to provide "best execution" of stock orders) would "sufficiently reflect" the impending conflict of interest.

Interestingly, the paper also states that a PFOF ban would be a "bitter setback for the just observed more active participation of retail investors in financial markets, especially by neobrokers". And further: In Germany alone, 2 million investors had invested in the stock market for the first time in recent years - a development to which neobrokers had contributed "significantly".

If you like, you can see in this a partisanship of the German government for the local online or neobrokers such as FlatexDegiro, Trade Republic or Scalable Capital - and a weakening of the position of Deutsche Börse, which, like Euronext, is suffering from the fact that retail trading is increasingly moving to alternative trading venues such as Tradegate in Berlin or LS Exchange in

Düsseldorf (see in particular point 7 of our analysis -> "Payment For Order Flow: Where the real lines of conflict run).

Why the exchanges could lose twice

Also interesting: The BMF writes that before issuing "further bans" and thus possibly triggering "dangerous side effects", it first urgently needs "further market data". This argument is apparently aimed at the mandatory introduction of the so-called "Consolidated Tape", which the EU Commission is also striving for. The background to this is that the "consolidated tape" would force all players to ensure transparency in market and settlement data, so that it can be determined in real time or at least ex post whether investors are possibly being cheated in the settlement of their trades.

In fact, the introduction of this "consolidated tape" is also highly controversial. For this construct would also hit Deutsche Börse and Euronext particularly hard: Both earn not only from exchange trading, but also from the licence fees for the use of market data, which have been rising for years. In 2021 alone, Deutsche Börse generated a pre-tax profit of €181 million in the index and analytics business, an increase of 46% on the previous year. The "consolidated tape" would deprive data providers of the exclusivity of their "raw material". According to reports, the stock exchanges are therefore also in favour of ensuring transparency "ex ante": investors should already see the exact commissions, total prices and the most favourable trading venues when they place their orders - instead of giving them the opportunity to check "ex post" whether they might have got off better somewhere else.

In other words, if the "consolidated tape" comes into effect but the "PFOF" ban does not, then the big exchange operators would have lost twice.