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Market Structure

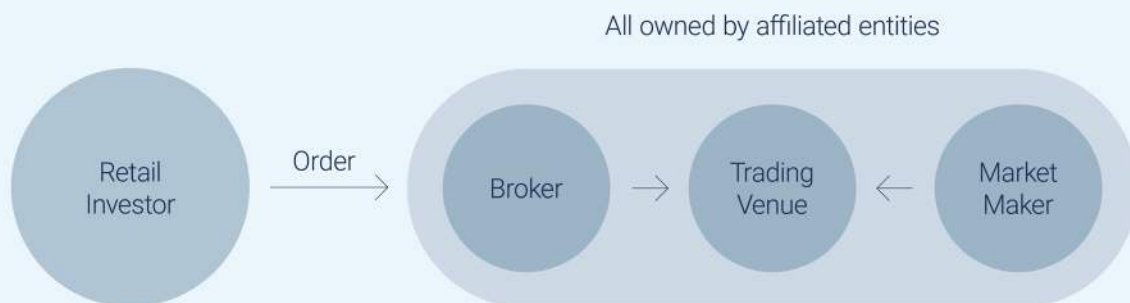
PFOF is going away, but the problem isn't

Ahead of upcoming MiFID rules that ban PFOF, some firms are introducing new structures that directly link single market-maker venues with affiliated brokers. These structures offer even less competition for retail order flow than their predecessors.

In an apparent win for small investors, new MiFID rules that ban payment for order flow (PFOF) take effect across Europe from 2026. This practice – where market makers pay brokers for the privilege of trading against retail order flow – has been criticized for nurturing conflicts of interest, undermining best execution and reducing market transparency. Regulators are clamping down in the hope that eliminating PFOF ensures fairer markets and better outcomes for small investors.

However, what seems like a step forward may, in reality, be a step sideways – or even backward. Ahead of the ban, some German firms are pioneering new, tightly-integrated structures that directly link single market-maker venues with affiliated brokers. These setups are even more closed off than their predecessors, raising concerns they could exacerbate, rather than eliminate, the very risks regulators are targeting.

New single market maker models



Source: Optiver

Here are some practices we have recently observed in the market:

- A retail broker that claims to have over 1 million subscribers has partnered with a regional German stock exchange to launch a new retail-focused exchange, which it now offers as an additional execution venue.¹ This alternative exchange currently has two market makers: one affiliated with the broker and an independent market maker.
- The most prominent single market maker venue is launching a broker, which should help the firm to capture more captive retail order flow. According to the broker's website, orders are placed "exclusively" on the affiliated single market-maker venue.

We first raised concerns with single market-maker venues back in 2022, when PFOF was capturing headlines on the other side of the Atlantic. In the majority of these European models, retail brokers send all or most of their customer orders to an exchange that has a single preferred market maker per instrument or per product type. The market maker may pay a per-order fee (PFOF) to the retail broker and is often owned or affiliated with the exchange.

A slightly different scenario exists where brokers offer their customers a choice of where they'd like their order executed. In brokers' marketing or client-facing interface, preference is given to one particular venue, usually one that operates a single market maker model.

Finally, practices also exist where a third party covers clearing or custody fees when brokers route their orders to them. This is in effect a cost discount or bundled service that incentivises brokers to send client orders to specific institutions for execution.

While the upcoming PFOF ban was intended to curb the practice in Germany, it won't capture scenarios where retail orders are sent to markets where affiliated liquidity providers get preferential treatment, or in some cases have exclusive access to order flow. Various regulators including the Dutch AFM and Spain's CNMV have highlighted the worse execution quality offered by these venues.

Now, with the PFOF ban looming, single market-maker venues are tightening their relationships with affiliated brokers. These new structures offer even less competition for retail order flow than their predecessors. This is because the affiliated market-makers no longer even have to pay for retail order flow, but may still get to execute it on highly preferential or exclusive terms.

Better outcomes for affiliated market makers – but potentially worse outcomes for retail investors. Is this really what regulators had in mind?

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¹ It's important to keep in mind that just because a retail broker offers more than one trading venue, it doesn't mean each venue has a fair shot at executing a retail order. ESMA, for example, has cited "investor protection concerns" in the way some brokers that offer retail investors a choice of venue present those providing PFOF "in a more prominent or appealing manner."



About Optiver

Optiver is a global market maker founded in Amsterdam, with offices in London, Chicago, Austin, New York, Sydney, Shanghai, Hong Kong, Singapore, Taipei and Mumbai. Established 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 through competitive pricing, execution and 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.