

Scalable Capital's Position on Single Dealer Systems

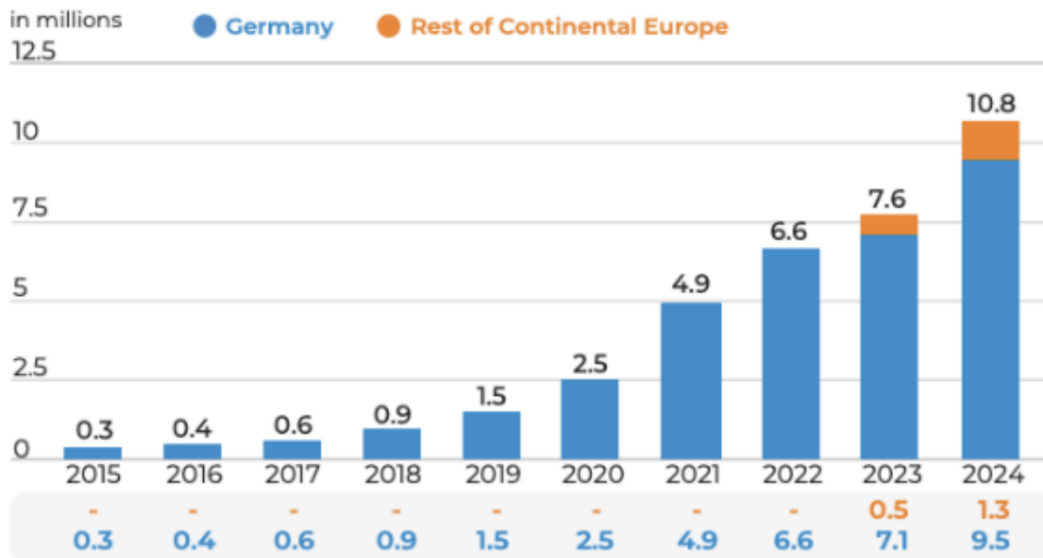
With the recent publication of the Savings and Investment Union, the European Union (EU) has reaffirmed its strong commitment to enhancing capital market access for retail investors. However, an emerging initiative advocates for a reinterpretation of existing regulations that could effectively prohibit single dealer systems practiced in Central and Eastern European countries, e.g. Croatia, Germany and Romania. This initiative obscures the fact that it is precisely the single dealer systems with their associated retail brokers that have led to the flourishing of retail trading in Europe and the formation of an active stock market culture. Younger customers in particular are increasingly choosing to invest their savings in the capital market.

EU regulation, namely the introduction of MiFID II, intended to foster competition in the financial services industry to the benefit of the investor. In particular trading venues and systematic internalisers were regulated and a healthy competition organised, with no particular trading model being mandated for trading venues. This allowed different kinds of venues, designed to meet the needs of specific customer groups particularly well. This includes for very large institutional trading flow the emergence of dark venues where large orders can be handled with reduced market impact and for retail investors the emergence of retail exchanges with particularly low execution cost, long trading hours and a broad range of tradable securities. The low cost of these retail exchanges led to the emergence of zero commission savings plans and very cost efficient access for investors to cost efficient ETFs. These retail exchanges first emerged in Germany, giving investors a low cost trading head start in Europe. As shown by a study conducted by ExtraETF and iShares/Blackrock¹, German retail investors in 2024 were not only saving in larger numbers and larger amounts, but also holding more assets in low cost ETFs than all other Europeans combined. Moreover, according to a survey conducted by BlackRock and YouGov², the percentage of German retail investors in 2024 owning ETFs is double the European average.

¹ "The ETF Savings Plan Market in Continental Europe 2024",
https://cdn.extraetf.com/downloads/research/2024/study/European_Saving_Plan_Study_EN_XE_TF-7112024.pdf

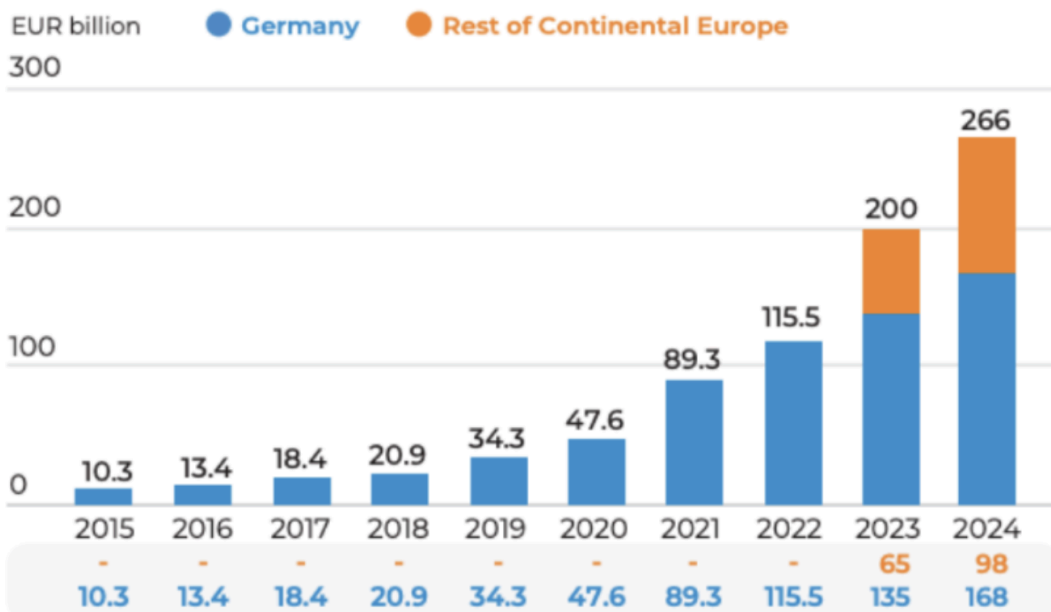
² BlackRock People & Money "The trends shaping investing in Germany"
<https://www.blackrock.com/de/privatanleger/literature/brochure/people-and-money-germany-infographic-english.pdf>

Graphic 1: Number of ETF savings plans



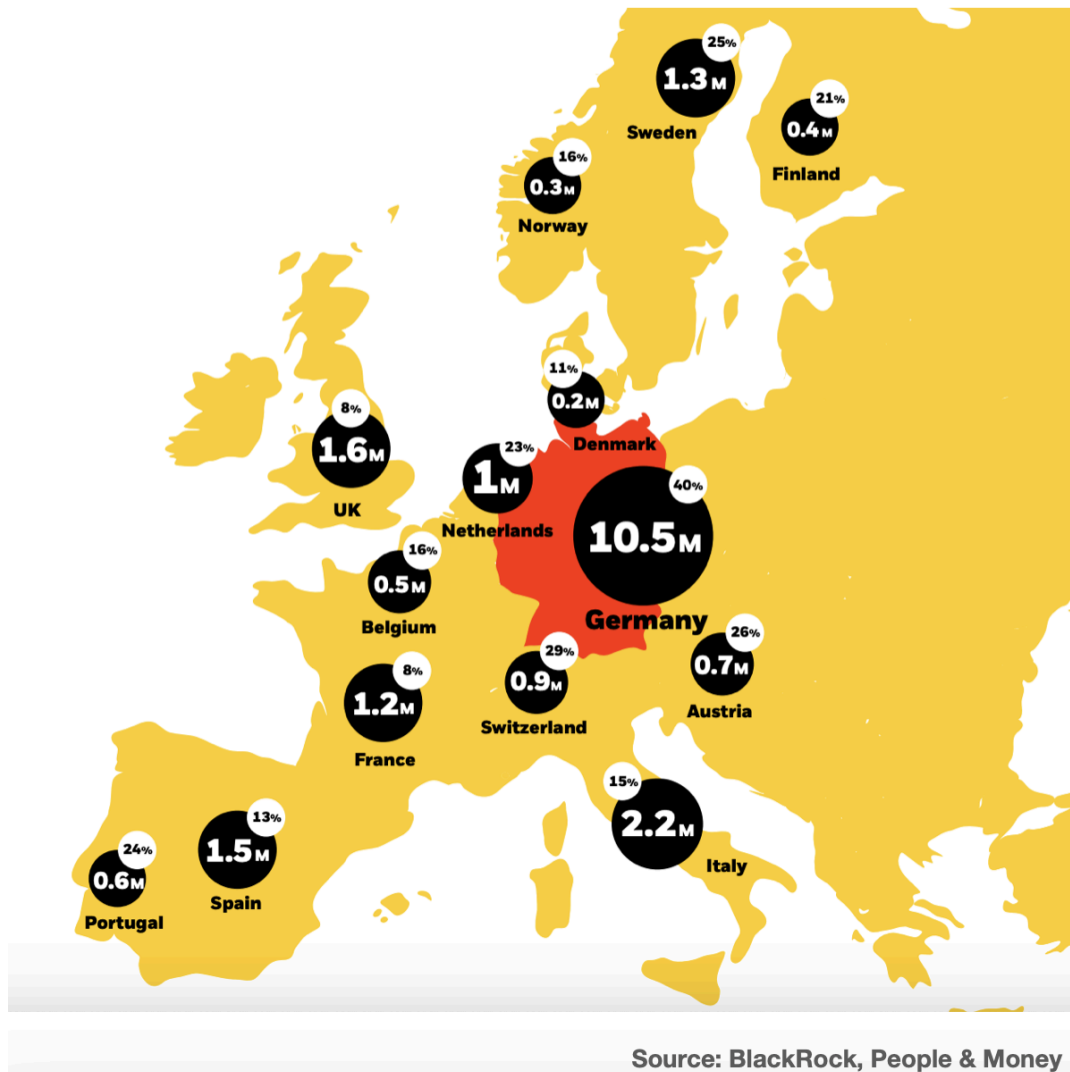
Source: extraETF Research

Graphic 2: ETF assets



Source: extraETF Research

Graphic 3: Number of ETF investors & % of investors who own ETFs



Single dealer systems have become an essential part of completing the EU Capital Markets Union and developing a stock market culture similar, e.g. to that in the United States. This is based on the following considerations.

- 1. Single dealer systems allow transactions in the 10,000+ most traded securities worldwide on a single exchange.**

Single dealer systems make it unnecessary to route orders to dozens of

different exchanges behind which additional clearing, settlement and custody systems. This avoids the need to check which securities are listed on which exchange as well as high execution costs for non-domestic trading venues. All securities are available during the same trading hours which corresponds to the retail investors daylight period. Single dealer systems settle with the same settlement period (currently T+2), so proceeds from a sell transaction can always be used for another buy transaction.

2. Low cost for small orders.

The majority of retail orders are very small in scale with an average order in the low thousands. Following MiFID's best execution principle of best total consideration, taking into account the traded price and the explicit cost, it is essential to keep the settlement cost at a minimum. This is most effectively achieved by aggregating and netting many individual orders together for settlement. This best works in a setup with just one market maker being on one side of most transactions and novating the residual settlement legs. This ensures that clearing and settlement costs are minimized. The need for small order handling is reinforced by the increasingly important trend towards free-of-charge saving plans, which more and more European retail investors are using to build equity positions during good and bad markets.

3. Lower exchange fees through competition.

The existence of several single dealer systems, especially in Germany, ensures additional competition for retail order flow, which benefits retail investors: It has made other major exchanges to also introduce lower fee tiers, allowing retail investors to trade at lower explicit costs also on other major exchanges. Should the competition by single dealer systems go away, the other exchanges could raise their fees again for retail investors as the reason for the lower retail fee tiers disappears.

4. Fair and competitive prices.

The current regulatory regime ensures fair and competitive prices also in single dealer systems. Investment firms serving as flow providers (including retail brokers) are required to comply with best execution requirements, thereby taking all sufficient steps to obtain the best possible result for their clients, in particular taking into account the price and costs. It is important to note that retail brokers are often not only connected to a single dealer system, but offer access to multiple trading venues. This also ensures that favorable prices are

offered. Trading venues are also required to protect customers' price expectations by having in place effective systems, procedures and arrangements to reject orders that exceed pre-determined volume and price thresholds or are clearly erroneous. They also need to temporarily halt or constrain trading in the event of significant price movements in a financial instrument. German trading venues are subject to additional statutory regulations on price formation under the German Stock Exchange Act (*Börsengesetz*). Accordingly, exchange prices must be determined in an orderly manner and reflect the actual market situation of exchange trading.

5. Real-time market data for free.

Low execution costs for exchange trading allow investors to diversify their portfolio and incentivize purchases across a number of different securities and markets. Thus, retail investors necessitate real-time market data access to make informed investment choices. Typically, as this access is expensive and procured for individual trading venues, the cost would be onerous. In contrast, certain single dealer systems such as the European Investor Exchanges make prices available to retail investors for free.

6. Short release cycles for improved services.

The marketplace continues to provide retail investors with new and improved services on a continuous basis (e.g. savings plans, return of Swiss stocks, further extended trading hours, etc). These improvements can be brought to market quickly, where only one or two market makers need to upgrade their systems to offer a better service.

7. Extra transparency beyond MiFID requirements.

MiFID requires trading venues to provide pre-trade and post-trade transparency data. For single dealer systems this data is available for download from the trading venue's website. To provide additional transparency, certain single dealer systems, such as the European Investor Exchange indicate where transactions have been between two retail investors or, when the single market maker was part of a transaction, whether it was a sell or a buy for the market maker.

8. Matching retail investors in a safe environment.

While single dealer systems are flagging the post-trade data publicly, there is little transparency on the actual retail trading volume on other exchanges. The

French regulator AMF has provided an aggregated statistic for Euronext Paris during the early Covid-19 period showing that 1.5% of trading volume had retail investors on at least one side of a trade in December 2019. This implies that retail-vs-retail matches are exceedingly rare situations as these happen only in 1.5% of 1.5% of cases, so in 0.0225% of the volume.

9. Level playing field for market participants.

Single dealer systems do not grant preferential access to the exchange systems (e.g. "co-location") to certain or highest bidding market participants (e.g. with the highest bid). They do not employ specific order types that are only helping large scale traders to hide their order sizes from view (e.g. "iceberg orders"). The order book is closed to all market participants, including the market makers and all retail traders, thereby establishing a level playing field for all participants.

10. Questionable trading practices by high-frequency trading firms?

Allegations have been made against the high-frequency trading business in conjunction with trading practices like spoofing and layering to mislead other market participants, especially retail investors. They cannot interact with this ghost liquidity. Practices like this are connected to events like the flash crashes, that lead to very large price movements in short periods of time. By contrast, retail investors that are currently trading on the existing single dealer systems do not unwillingly become a part of these practices.

About Scalable

Scalable Capital was founded in 2014 with the raison d'être to increase access to capital market investments for retail investors. We service over a million retail accounts in the EU as part of a competitive and growing EU fintech sector. Scalable Capital offers digital wealth management and brokerage services that enable retail investors to invest for their future. With the European Investor Exchange Scalable Capital offers a stock exchange for retail investors in Europe. At the centre of Scalable Capital's business model is providing our clients with the best possible result. Hence, providing our clients the most favourable terms and our own business growth are interdependent.