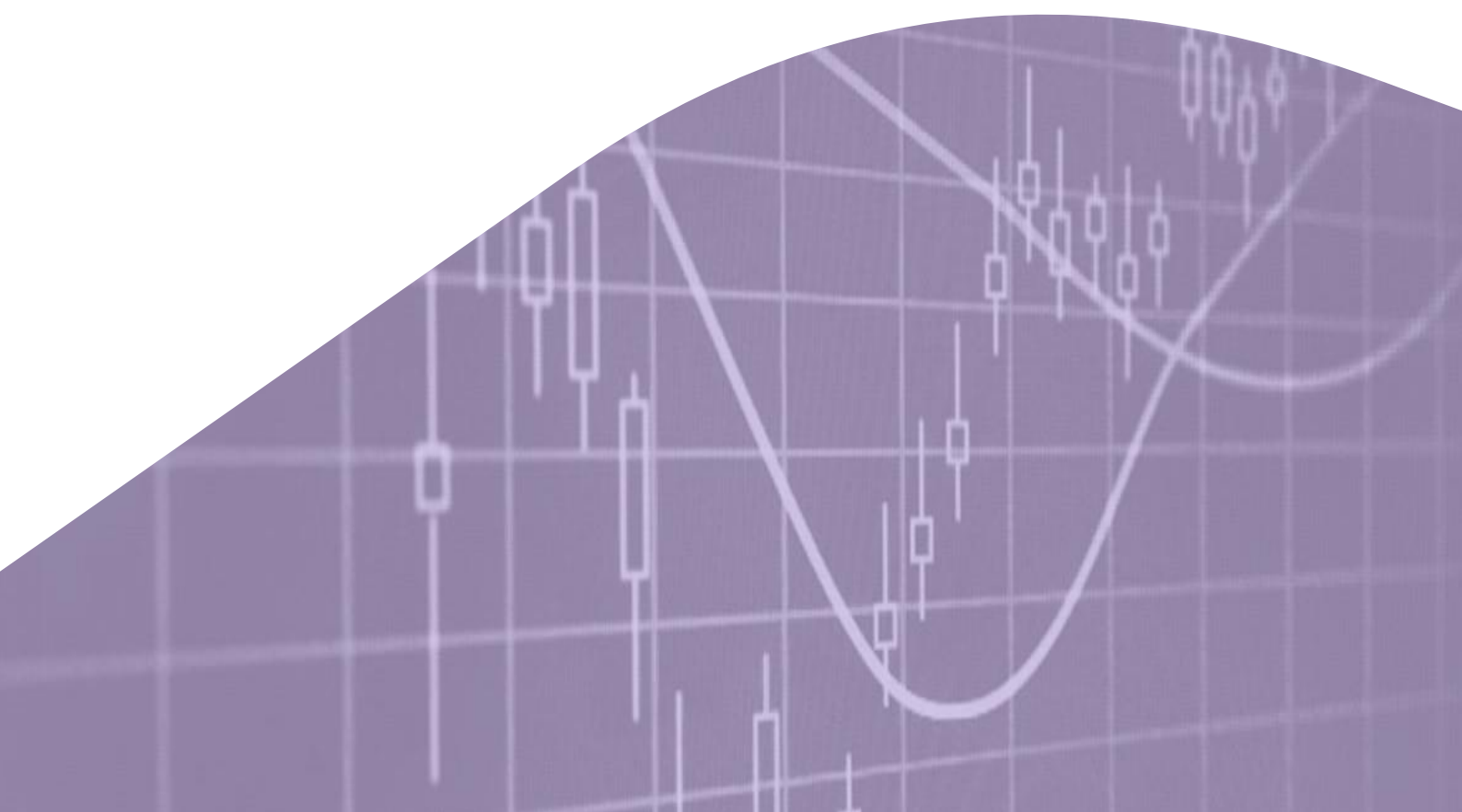


ESMA TRV Risk Analysis

Orderly Markets

Neo-brokers in the EU: Developments, benefits and risks



ESMA Report on Trends, Risks and Vulnerabilities Risk Analysis

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Orderly Markets

Neo-brokers in the EU: Developments, benefits and risks

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Summary

Characterised by innovative, online-only investment services, neo-brokers have grown rapidly in recent years. To gain understanding of their activities, and as part of continual monitoring efforts, ESMA conducted a market survey of EU-based neo-brokers in 2023.

The results confirm that most of the firms' trading volumes originate from retail clients. Share trading accounts for the majority of order volumes. Larger neo-brokers tend to offer wide ranges of securities issued in the EU and the US, while smaller firms tend to specialise in national markets in the EU. Overall, US-issued shares are the most commonly traded, but those issued in the EU represent a significant and growing proportion of trades.

Neo-brokers adapt their business model to the type of financial instrument traded. They generally act as a service provider for clients trading shares and ETFs, but act as counterparty to clients trading CFDs and some other products, executing such trades 'over the counter'. Neo-brokers execute most client orders in shares and ETFs on a limited number of trading venues, which are often not the main national markets. These smaller markets tend to have a higher concentration of transactions from retail orders.

Neo-brokers can bring significant benefits to investors and markets, including promoting capital market participation among households and potentially offering lower transaction prices. Their innovative platforms are convenient and accessible to many consumers. At the same time, they may pose risks, for example if they facilitate trading in risky or complex products potentially not suitable for individual retail clients. Additionally, social media functions are in some cases integrated into retail trading platforms, which may encourage clients to trade without being fully aware of the risks. In general, trading platforms should be designed to promote sensible investment decision-making rather than excessive trading. Users posting investment recommendations must comply with requirements established by the Market Abuse Regulation, as highlighted in a recent ESMA Warning.

Finally, the digital provision of financial services – including through neo-broker platforms – often involves cross-border business, which can promote efficiency and competition. At the same time, it can make it harder for authorities to have a comprehensive view of retail investor activities in their domestic markets, suggesting that monitoring trends, risks and market developments relating to neo-brokers at ESMA level may have added value.

¹ This article was written by Eugeniu Colesnic, Alexander Harris and Valentina Lorusso.

Introduction

Neo-brokers are a new generation of financial entities that enable consumers, mostly retail investors, to invest and trade in financial products online. Their selling point is immediate, user-friendly access via mobile apps and websites, often advertised as providing low-commission trading.² Neo-brokers have grown in market share in recent years, with the pandemic in 2020-2021 acting as a catalyst for increased retail trading more generally.³

Neo-broker clients tend to differ from the general population of investors in their demographic profile and their approach to investing. Recent data from France suggests that neo-broker clients typically invest in more complex products, buy more volatile instruments and trade more frequently than clients of traditional brokers. They also tend to place smaller orders than other clients.⁴

Some studies have shown that neo-brokers often have a higher proportion of new investors and younger investors than traditional brokers do.⁵ For instance, survey evidence from Germany indicates that neo-broker clients tend to be relatively young, with one third of the respondents aged under 26, and less experienced at investing.⁶ These groups tend to have lower levels of financial literacy and knowledge than the wider investor population.

Neo-brokers offer convenient, innovative services that can bring benefits to markets and consumers. However, their growth may also involve risks, notably to orderly markets and consumer protection. Especially in an age where consumers can rapidly share (dis-)information via social media, the widespread and growing offer of online trading services by traditional brokers as well as neo-brokers may in some situations increase the potential for disorderly market events. One example is the risk of 'short

squeezes', as seen in the 2021 GameStop episode.

Consumer protection concerns arise in these situations but also more broadly, as self-directed retail investors use digital means to gain access to investment products. Consumers may take on high levels of market risk (in some cases, amplified by leverage) at the touch of a button, despite not being fully aware of the costs and risks involved. Certain characteristics of the neo-broker client base mentioned above, e.g. inexperienced investors that trade frequently, amplify these concerns.

This article analyses the presence of neo-brokers in EU financial markets. The next section provides an overview of the market in recent years. The article then presents key findings from recent survey-based⁷ evidence on trends in market structure and the business models used by the firms, including an analysis of the potential consequences for markets and consumers. The article concludes by discussing the risks and benefits of these developments.

Market overview

Neo-brokers have grown rapidly in the last few years starting from a low base. The digital services offered by neo-brokers facilitate cross-border business and rapid scaling-up of operations. The total value of neo-broker client assets in the EU surpassed EUR 100bn in 2022, reaching nearly EUR 150bn in 2023 (Chart 1).

The US and UK markets saw comparable increases in total assets over the same period. In China, total neo-broker assets started growing rapidly only following the pandemic.

² The term 'neo-brokers' does not have a legal definition. It refers to a recent wave of digital-only entrants into the financial services market that offer users real-time trading in financial instruments. Chart 1 shows the total value of open positions at year-end, in contrast to Chart 5, which shows total annual trade volumes (i.e. total value of amounts bought and sold during a given year).

³ See e.g. Aramian and Comerton-Forde (2023), Financial Services and Markets Authority, Belgium (2021), OECD (2023). In a study for the French Autorité des Marchés Financiers (AMF), Chatillon, Degryse and Frenay (2021) find that the number of active investors in France (defined as those carrying out at least one transaction in a given

quarter) rose from 1 million just before the pandemic to 2.5 million by 3Q21.

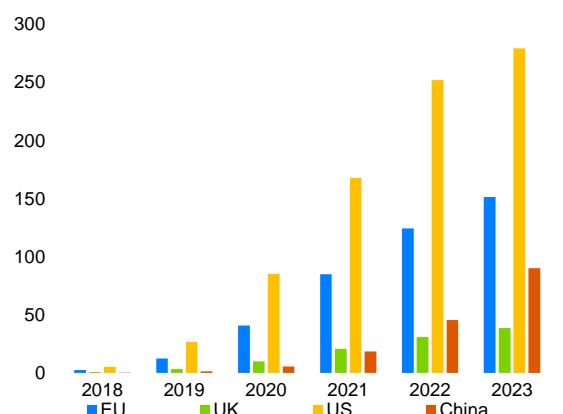
⁴ Autorité des Marchés Financiers, Chatillon, Degryse and Frenay (2021).

⁵ Organisation for Economic Cooperation and Development (2023).

⁶ Kritikos et al (2022).

⁷ In 2023, ESMA conducted a survey with selected EU-based neo-brokers, focusing on their activity from 2019 to 2022. Not all EU member states had a neo-broker in their jurisdiction.

Chart 1
Neo-broker client assets by region
Rapid growth in assets



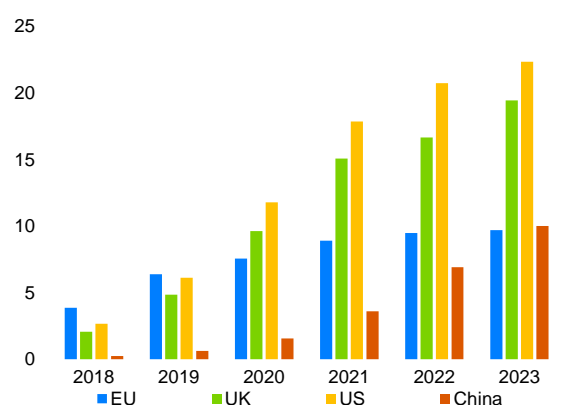
Note: Net assets held via neo-brokers by selected region, EUR bn. Neo-brokers exclude robo-advisors and firms that provide services only to businesses; assets exclude crypto-assets.
Sources: Statista, ESMA.

This comparison follows a longstanding trend of greater household participation in capital markets in the US compared to many other countries. For example, over half of US households own shares in investment funds, versus 13% in the EU.⁸ Despite the rapid growth in neo-brokers, the market remains small from a systemic perspective. Worldwide, neo-broker client assets were under EUR 1tn in 2023.

Globally, in 2023 the leading firms by market valuation were eToro (surveying entities EUR 8bn), Robinhood (EUR 8bn) and TradeRepublic (EUR 5bn).⁹ Other relatively well-known EU-based neo-brokers include BUX, Scalable Capital and flatexDegiro. In some cases, neo-brokers have partnered with, or been acquired by, credit institutions.¹⁰

Neo-brokers have adopted a broad range of business models, with their core business characterised by offering clients easy access to investing. They may do this by executing orders on the client's behalf, acting as intermediaries or dealing on own account. To facilitate access to trading services and curb costs, neo-brokers typically invest in process automation and offer applications designed to be user-friendly. These applications typically enable clients to open an account quickly and easily (often using AI-based identity checks) and to buy and sell a range of products. Applications may feature 'educational' tools intended to enable clients to trade even with no or limited prior knowledge of financial instruments and markets. Some firms provide additional services such as portfolio and wealth management, investment advice, custody and safekeeping of financial instruments.

Chart 2
Neo-broker accounts as % of the adult population
Widespread use especially in the US



Note: Number of neobroker users (or accounts) divided by the adult population, by selected region, %. Neo-brokers exclude robo-advisors and firms that provide services only to businesses; assets exclude crypto-assets.
Sources: Statista, ESMA.

Despite the growth of the EU neo-broker market, their use remains behind that in other parts of the world. Neo-brokers are especially popular in the US, where the number of accounts now exceeds 20% of the adult population, more than twice the share in the EU (Chart 2).

ESMA neo-broker survey: Services and operations

To gain a better understanding of these notable market developments, in 2023 ESMA launched a data collection exercise that involved surveying

⁸ EU figures from the European Central Bank (2023), US figures from the Investment Company Institute (2023).

⁹ Source: Statista. eToro is headquartered in Israel with subsidiaries in the EU. Robinhood is headquartered in the US. TradeRepublic is headquartered in Germany. 'Market valuation' refers either to market capitalisation (for publicly listed companies), or to implied equity value

based on funding rounds (for private companies). No systemic information appears to be available on metrics such as account balances or investment flows.

¹⁰ In 2021, DeGiro B.V. merged with flatexDegiro Bank AG. In 2023, the Dutch bank ABN AMRO announced the acquisition of BUX, which was one of the first Dutch neo-brokers with a client base of around 500,000 users.

entities¹¹ operating in the EU that ESMA identified as neo-brokers based on their online platforms and their business models.¹² In total, the sample of firms represents around 10mn client accounts. The results confirm that the majority of neo-broker trade volumes (>90% among sampled firms) originate from retail investors, mostly from EEA countries. In contrast to findings from some other studies already mentioned above, the neo-brokers surveyed do not have an especially young client base. Around a quarter of trade volumes are by clients aged under 35, in line with the share of that age group in the EU adult population generally. However, around a third of transactions are carried out by these clients, implying that they tend to trade more often and make smaller orders.¹³

Range of products

The survey results emphasise the diverse range of securities that neo-brokers offer. Most widely offered are contracts replicating the performance of shares and ETFs – including so-called ‘fractional shares’ and ‘fractional ETFs’¹⁴, contracts for differences (CFDs), derivatives and crypto assets¹⁵.

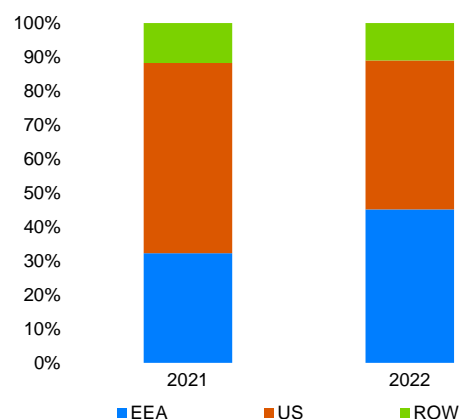
Many neo-brokers offer leveraged trading. High leverage creates risks for investors, including amplifying costs and volatility, and making it more likely that positions are closed out.¹⁶

Only larger neo-brokers tend to offer exposure to US shares, which tend to be among the most-traded on their platforms. In contrast, smaller neo-brokers typically focus on shares of companies in their national market, or other EU markets. Across the sample of firms, US shares were more popular than EEA shares in 2021, but the gap narrowed in 2022. DE, NL and FR were the top locations of issuers in the EU (Chart 3).

Chart 3

Shares traded by location of the issuer

EEA-issued shares become more popular



Note: Percentage of share trade volumes executed for retail clients, by location of issuer, among neo-brokers surveyed. ROW = rest of the world (i.e. non-EEA and non-US). ROW = rest of the world (i.e. non-EEA and non-US).

Sources: Neo-brokers survey 2023, ESMA

Business models

Execution strategies for client orders vary across neo-brokers and largely depend on the financial instrument traded. Neo-brokers offering shares, ETFs and other instruments traded on a trading venue often act as intermediaries executing the orders received by clients in a chosen venue.

Some neo-brokers also offer customised bilateral contracts, executing such trades over-the-counter (OTC). The firms' revenue from OTC trades is often based on the bid-ask spread, and to a lesser extent on commission fees. Where neo-brokers act as intermediaries, their revenue usually includes a transaction-based commission fee. This fee may vary depending on the order size, the number of trades executed by the client in a certain time interval and the type of account to which the client has subscribed.

¹¹ This information, covering the period 2019–22, was collected by ESMA for the purpose of its role in monitoring and assessing market developments and trends. Due to the confidentiality and sensitivity of the collected data, ESMA is not able to disclose further details of the participants. The article uses aggregate statistics to give an overview of market developments in the EU.

¹² Based on a preliminary screening using publicly available information to identify neo-brokers in the EU, the sample appears to cover a large majority of the market.

¹³ Source for population figures: Statista. Across the Euro area, the propensity to own shares does not vary much by age, but average wealth increases with age (source: ECB Household Finance and Consumption Survey 2021).

¹⁴ ‘Fractional shares’, ‘fractional ETFs’ and other contracts replicating shares and ETFs are established between the neo-brokers and the clients, with the aim of replicating the

holding of an underlying stock or ETF (or a fraction thereof), including dividend payments (on a pro-rata basis as applicable). For a fuller description and an account of related investor protection concerns, see [ESMA \(2023a\)](#). Such contracts can be sold only on the broker's platform and may not bestow the holder with voting rights.

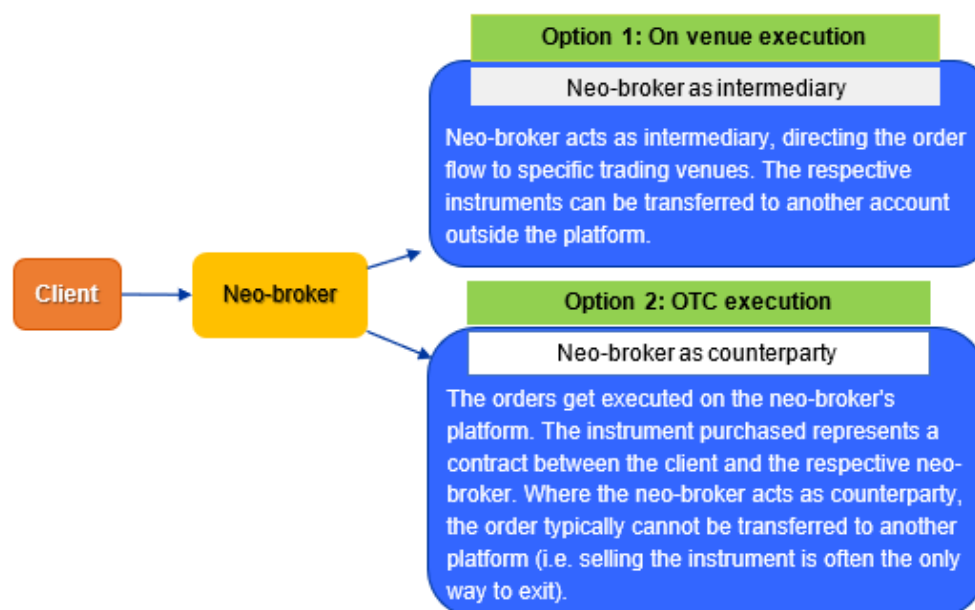
¹⁵ The analysis in this article does not cover crypto-assets in detail, beyond summarising overall trade volumes. Neo-brokers offering traditional financial instruments are not generally the main platforms for trading crypto-assets, despite some recent increases in volumes traded.

¹⁶ For instance, CFDs are leveraged products that raise specific concerns for investor protection as set out in ESMA (2018) and are now subject to MiFIR product intervention measures at national level across the EEA.

Chart 4

Neo-broker execution models

Neo-brokers may execute orders on venue or over-the-counter (OTC)



Note: Schematic account of different execution models available to investment firms, including firms considered as 'neo-brokers' for the purpose of this article.

Source: ESMA

Some neo-brokers also receive payments (known as inducements) from third parties for directing client order flow to them as execution venues. This arrangement is commonly known as *payment for order flow* (PFOF). ESMA (2021a) warned investors of risks around PFOF¹⁷, including around potential conflicts of interest and limited transparency, in particular where firms claim to offer 'zero-commission' trading. The data collection exercise revealed that some neo-brokers receive such inducements, which can be a major share of their revenue. From the perspective of venues, orders subject to PFOF may have contributed to increased trade volumes in recent years. Following a recent ban on PFOF, some neo-brokers may need to change their business models in response and consider business activities such as securities lending or product manufacturing. They may turn to other venue sources such as fixed fee subscriptions,

transaction commissions and other types of inducements (when permitted).

Finally, neo-brokers offering instruments issued in foreign currency typically apply currency conversion fees.

Developments in market structure

The data exercise found that the total volumes of instruments traded by neo-brokers in the EEA steadily increased until 2021, with rapid growth during the initial phase of the pandemic. This growth was in line with a general retail trading boom, as noted above. Volumes quadrupled during 2019-2021, with growth across asset classes, but then dipped in 2022, driven by shares and cryptos (Chart 5).¹⁸ The greatest

¹⁷ Following the entry into force of the revised Markets in Financial Instruments Regulation (MiFIR) on 28 March 2024, a general ban on PFOF is imposed. A Member State where the practice of PFOF already existed may allow investment firms under its jurisdiction to be exempt from the ban, provided that PFOF is only provided to clients in that Member State. However, this practice must

be phased out by 30 June 2026. For details, see [European Council press release on CMU](#) updated 18 October 2023.

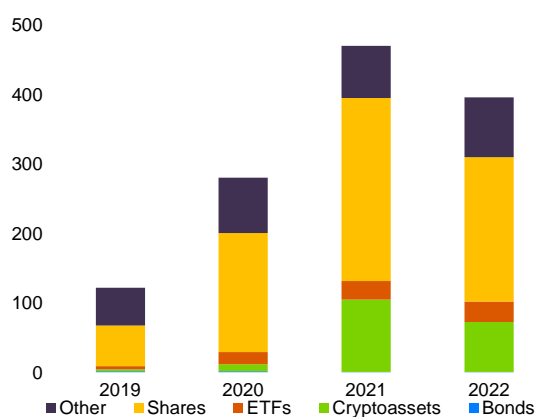
¹⁸ Unless stated otherwise, in the analysis of trade volumes by asset type, 'shares' and 'ETFs' are taken to include

absolute increase came from shares, while in relative terms the highest growth was from crypto-assets (+2,450%) and ETFs (+550%). Trends by numbers of transactions were similar.

The impact of neo-brokers on EU markets depends on the types of instruments traded, the chosen execution methods and total traded volumes. In particular, the data exercise indicates that neo-brokers execute the majority of client orders in shares and ETFs on a few trading venues, which are often “small” venues, i.e. not the largest or most liquid markets for these instruments.¹⁹ At the same time, a portion of the order flow is directed to the main national markets (“main venues”).

Chart 5

Selected instruments by annual trade volumes Shares more traded than crypto, ETFs or bonds



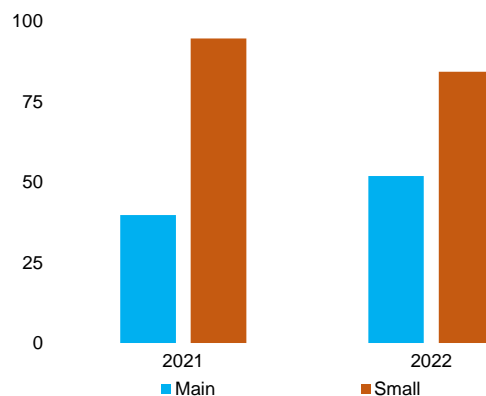
Note: Volume in EUR bn excluding CFDs. CFDs volumes are excluded because as leverage products, they are not comparable with other asset classes. 'Shares' and 'ETFs' include OTC contracts that replicate the performance of equity shares or ETFs respectively (or fractions thereof). Sources: Neobrokers survey 2023, ESMA.

The finding that neo-brokers tend to route many trades in shares and ETFs to small venues could in principle fragment order flow into markets where most trading activity originates from retail traders. Research suggests that such fragmentation could affect the spreads applied by

market makers, based on their assessment of the ratio of informed traders to ‘noise’ traders (i.e. uninformed traders, or those trading for hedging

Chart 6

Main versus small venues Some order flow routed to main venues



Note: Total volume directed by surveyed neo-brokers to selected venues, in EUR bn. 'Main' = two larger venues from the same corporate group. 'Small' = aggregated volumes for five smaller venues. The venues represented are not exhaustive of those used by entities in the survey sample. Sources: Neo-brokers survey 2023, ESMA

or liquidity reasons).²⁰ However, it appears that in practice, prices on smaller venues are often referenced to the prices on the main market. The overall impact on spreads in these venues from neo-broker order flow is therefore likely to be small, especially when viewed in the context of long-term investment returns.²¹

According to the data collected, volumes of shares traded in 2022 by neo-brokers accounted for only 1.5% of the EUR 13.4tn of shares traded across the EEA.²² Given this very small proportion, the routing of trades by neo-brokers to smaller venues is unlikely to have a material impact on trade execution for the market as a whole. Furthermore, neo-brokers channel some order flow to ‘main’ venues (defined and shown in Chart 6). The share of volumes directed to ‘main’ venues increased from 2021 to 2022.

OTC contracts replicating the performance of equity shares and ETFs respectively (or fractions thereof).

¹⁹ Regarding trades in other instruments that neo-brokers mostly execute OTC, no direct impact on market structure is evident. However, there could be indirect effects if neo-brokers trade on venues to hedge their OTC exposure.

²⁰ See e.g. Glosten and Milgrom (1985), Easley and O'Hara (1987), De Frutos and Manzano (2002), Jones and Lipson (2005).

²¹ Additionally, the *direction* of the effect is not obvious. Concentration of retail trades could even be beneficial to retail investors, at least according to economic theory. In a seminal model, Glosten and Milgrom (1985) find that the

spread applied by market makers decreases in the proportion of noise traders, as the market maker has less need to protect itself against informed trading. De Frutos and Manzano (2002) develop a model in which investors obtain lower execution prices when markets are fragmented. In a working paper, Jones and Lipson (2005) find empirical support for this finding from New York Stock Exchange data. Subject to data availability, this could be a topic for further empirical research.

²² The size of the EEA market for shares as of 2022 is from Danieli and Le Moign (2023).

Risks and benefits

Consumer protection issues

Neo-brokers offer convenient, innovative services, and their products may cater to investor needs and preferences. Nonetheless, this accessibility also heightens the risk that consumers do not always understand what they are buying, or trade impulsively. For instance, digital platforms may offer traditional investments alongside volatile, speculative products like crypto assets. Market risk may be amplified by leverage. Consumers may not be aware of the market risks involved in certain products, especially complex products.

ESMA recently issued a discussion paper that among other things highlights certain features available in some online trading applications, such as copy trading and gamification techniques.²³ Such features could encourage frequent trading, whereby investors incur frictional costs. Additionally, they may risk contributing to “herd investing” and the potential for manipulation of securities prices. ESMA has also recently published a Warning²⁴ that highlights certain requirements under the Market Abuse Regulation (MAR) that apply when posting investment recommendations on social media. The Warning also covers risks of market manipulation when posting on social media.

Where neo-brokers offer ‘fractional shares’ or other non-standard products, consumers may gain access to investments that would otherwise have prohibitive minimum investment amounts. However, with this benefit comes risks around complexity (and related costs) if consumers do not understand that these products can be exchanged only with the neo-broker and not on other trading platforms. A recent ESMA public statement²⁵ highlights that ‘fractional shares’, while usually allowing investors to participate in the share performance of an issuer and to receive dividends on a pro rata basis, often do not come with voting rights, unlike most equity shares. Additionally if these or similar products cannot be transferred to other providers, this may be a barrier to switching broker.

Potential for volatility of specific assets

At the start of the pandemic in 2020, increased retail trading was accompanied by a spike in the overall savings rate by households. Some neo-broker platforms offered convenient trading alongside social media and news feeds integrated into their digital interface.

Against this backdrop, early 2021 saw a short squeeze in so-called ‘meme stocks’, most prominently the US video game retailer GameStop. Its share price saw extreme price volatility and elevated trading volumes. The initial explosive price growth resulted from a ‘short squeeze’ whereby retail investors coordinating via social media made large purchases of shares and call options in the presence of very high short positions by institutional investors.²⁶

The episode illustrated how large-scale digital trading by consumers can have a large market impact on the price of particular securities. Social media use may promote such trading and the widespread offer of online trading solutions, including but not limited to neo-brokers, can amplify the occurrence of such events. Additionally, if online platforms rapidly scale up their offerings to an international market, this can come with additional operational vulnerabilities.

Retail participation

Despite the risks around certain kinds of retail investment activity, there are also benefits to greater retail participation in EU securities markets more broadly. The EU’s Capital Markets Union (CMU) initiative encourages retail participation to channel capital towards economic growth and to help individuals achieve their long-term financial goals²⁷. ESMA’s recent position paper on building effective and attractive capital markets in the EU includes recommendations that support these aims.²⁸

Where neo-brokers facilitate retail access to investments in line with investors’ knowledge and experience, financial needs and goals, their growth can bring major benefits to consumers. A key challenge is to ensure that consumers who invest for the first time are informed of the risk-return profile of different financial products and investment strategies. Fundamentally, greater financial literacy will improve outcomes for retail investors, whether they use digital platforms or

²³ See [ESMA \(2023c\)](#).

²⁴ See [ESMA \(2024a\)](#).

²⁵ See [ESMA \(2023a\)](#).

²⁶ See [ESMA \(2021b\)](#), p 12 and pp 32-33, for a summary of the event.

²⁷ For more information on the CMU, see ‘[Capital markets union – A plan to unlock funding for Europe’s growth](#)’.

²⁸ See [ESMA \(2024b\)](#).

more traditional financial services. More generally, trading platforms should be designed in a way that promotes sensible investment decision-making rather than excessive trading (such as frequent intra-day trading) or purchases of risky or complex products.

Conclusion

Neo-brokers have grown in recent years, though still only account for a small share of trading activity in the EU. Characterised by innovative, online-only business models, their use increased rapidly during the pandemic. As the GameStop episode demonstrated, the interaction of convenient, real-time retail trading with social media has the potential to drive volatility in certain market segments (e.g. 'meme stocks'). ESMA has since issued public warnings on related risks.

Given the relevance of these developments to the structure and functioning of markets and to investor protection, ESMA conducted a data collection exercise in 2023 on EEA-based neo-brokers and their activities. The exercise confirmed that retail trading is the firms' core business line. A majority of order volumes provide exposure to shares. Larger neo-brokers tend to offer US- and EU-issued securities, while smaller firms tend to offer only securities issued in their national markets or elsewhere in the EU. Overall, US-issued securities are the most commonly traded, but EU-based securities are an important and growing share of trades.

Neo-brokers adopt different business models. They tend to act as intermediaries for clients trading shares and ETFs and may charge a transaction-based commission fee. However, firms are more likely to act as counterparty to client trades (i.e. trade OTC) for other instrument types such as bonds, where they gain revenue from the bid-ask spread. Some neo-brokers also reported receiving PFOF, i.e. inducements from third parties for client order flow, though a ban on PFOF has since been introduced at EU level.

The impact of neo-brokers on EU markets depends on the types of instruments traded, the execution methods and total traded volumes. The data exercise indicates that neo-brokers execute most client orders in shares and ETFs on a few trading venues, which are often not the main national markets.

As neo-brokers are a recent phenomenon, it remains to be seen how their market presence

and business models evolve over time. However, developments in the FinTech market more generally in recent years point to some possibilities. Neo-brokers may merge, partner with established entities or be acquired.²⁹ They can also be expected to innovate further employing advanced technologies, such as artificial intelligence (AI) and machine learning algorithms and expand their product offering.

Finally, digitalisation of investment services – including the rise of neo-broker platforms – facilitates cross-border activities, which can promote efficiency and competition. At the same time, it can make it harder for authorities to have a comprehensive view of retail investor activities in their domestic markets, suggesting that continued monitoring of neo-broker market developments at ESMA level may have added value.

²⁹ See footnote 10, page 5 for examples.

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