Germany boasts a highly developed and mature market for asset servicing. Amid opportunities to seize, and challenges to overcome, experts believe that Germany is on the forefront of innovation.

The current mood of the market indicates that Germany’s market consolidation continues to develop. This is with approximately 85 percent of the market by volume serviced by some 10 international players.

Large global custodians service predominantly large mandates with high rates of service standardisation while niche asset servicing players are slowly being absorbed by larger players. One example of this is CACEIS’s acquisition of KAS Bank’s pensions fund administration business in Germany.

Meanwhile, disruptive innovations have the power to change the picture. Some experts say the German asset servicing industry has lost weight in concert with other global financial players and markets.

“Disruptive innovations are required to put a spotlight on this local industry; not about offering the same products and services at lower costs,” says Sven Ludwig, senior advisor, governance, risk and compliance at ifb group.

Distributed ledger technology (DLT) and blockchain still need to prove itself to become such an innovation.

“Maybe the Digital Collateral Protocol (DCP) from DekaBank is this big bang. Likewise, the Smart Derivative Contract initiative of DZ BANK and BayernLB...”
has the potential to become the use case to finally make DLT take off,” Ludwig notes.

According to Ludwig, there are three major German banks simultaneously at the forefront of innovations. Innovations which can lead to a substantial cost reduction within the asset servicing industry. With this in mind, could this be the last wakeup call for the German asset servicing industry?

Opportunities to seize

Germany’s asset servicing industry has a handful of opportunities at its fingertips including technology, digital assets, the TARGET2-Securities (T2S) platform plus growth in German equity and debt markets and environmental, social and governance (ESG).

Technology plays an important role in Germany’s asset servicing industry and is an area of opportunity. Ludwig suggests that DCP from DekaBank or the Smart Derivative Contract initiative of DZ BANK and BayernLB have the potential to be adopted in the asset services industry and become game-changers.

“Removing the need for reconciliation vaporizes many frictions including the necessity for daily cut-offs. Service levels become incredible from today’s perspective – light speed is the only remaining limitation,” says Ludwig.

If indeed the Smart Derivative Contract initiative of DZ BANK and BayernLB does prove to have the potential to become the use case to finally make DLT take off then it could provide a number of opportunities.

Over-the-counter (OTC) derivatives are far less standardised than other financial products and their tailor-made benefits come at a cost. The initial processing and the ongoing management of the life cycle events are described as complex.

Ludwig comments: “With the Smart Derivative Contract, a huge fraction of these rather manual processes vanish magically. Almost everything is agreed up-front with some lines of code. DLT ensures its integrity including all valuations.”

In addition to this, experts agree derived cash flows are per definition, identical and automated executable. The post-trade operations of OTC derivatives become fully scalable and costs are dramatically reduced.

But Ludwig highlights that most importantly, if DLT technologies become a regulatory and legally approved integral part of today’s business processes then the floor is opened for all subsequent innovations.

Alongside developments in technology such as DLT and the evolution of the market, the German government is continuing to take steps to authorise depositaries to service digital assets allowing depositaries to use a third-party to hold such assets and today, private equity funds are increasingly holding cryptocurrencies in their portfolios.

On 1 August the Federal Ministry of Finance (Germany) proposed legislation to modernise German securities law and the associated supervisory law. The proposed legislation will also foster innovation and the potential use of DLT debt securities which are initially registered with a crypto-security registrar. The issuance of digital bearer bonds will be enabled on a DLT infrastructure without requiring a certificate. The law is expected to enter into force in Q1 2021.

This could lead to start-up companies and fintechs located in Germany engaging in competition with traditional players based on their expertise in terms of technology and digital processes.

“Technology is key to service development in the asset servicing industry. Client demand for new servicing solutions depends greatly on a group’s technical proficiency, financial strength and ability to spread the cost of development across multiple clients,” says Gernot Wurzer, head of sales at CACEIS Bank, Germany Branch.
In addition to technological opportunities, the number of financial institutions leaving the clearing (cash equity clearing) space is on the rise due to the growing cost of service provision, and that it no longer represents a core part of their business strategy.

“Ongoing market developments, such as the merger of exchanges, creation of central counterparties (CCPs), transaction collateralisation and bringing volume on-exchange, requires a significant commitment in order to be able to continue offering clearing and settlement services,” comments Wurzer.

Wurzer also observes that many institutions are electing to outsource this service and focus on their core business, and there have been several unfortunate cases where banks’ strategic decisions have left their clients in a difficult position.

The T2S platform is also providing opportunities in Germany. T2S is a new European securities settlement engine which aims to offer centralised delivery-versus-payment (DvP) settlement in central bank funds across all European securities markets.

Philippe Mueller, head of issuer CSD services at Clearstream, explains: “An opportunity for further evolution is the ongoing gradual alignment of transaction platforms and the streamlining of multiple process chains accounting for market specialities. With Clearstream’s centralised T2S access hub and links to various global markets, we leverage the German market to have a single gateway to all markets and business domains.”

“We embrace further harmonisation efforts across Europe in order to achieve harmonised markets and lean processing for all market participants, thus ensuring high quality, reduction of complexity and cost, made possible via consolidation of network management as well as operational and IT processes,” Mueller adds.

Further to this, Ankush Zutshi, vice president, corporate actions and securities processing at IHS Markit, believes that the German equity and debt markets are bound to grow.

Germany’s government plans to issue around €500 billion in bonds in 2021 to help fund economic recovery post the coronavirus crisis. It also issued its first ever green government bond last year in August 2020, a class of debt that has grown in recent years as a part of assets linked to ESG aims.

Zutshi cites: “Professionally managed ESG assets have grown to around $40 trillion globally, Germany already got €33 billion of orders for the new green bonds. These developments should get new portfolio investment into Germany as the country’s debt is considered the safest in the eurozone and serves as a risk-free benchmark for bonds and also 50 per cent of conventional funds in Germany are investing in this growing fixed income asset class.”

Germany is one of the largest hubs for sustainable funds in Europe and as per BVI the assets invested in open-ended sustainable funds have now exceeded the €129 billion mark.

In turn equity issuances are also bound to grow although the year 2020 was muted in terms of initial public offerings (IPOs), according to Zutshi.

However, Zutshi highlights that studies indicate it is expected to be back to the previous level of 12 to 15 IPOs issuing around €3.6 billion in new capital. “This should provide future growth opportunities for both asset managers and asset servicers,” adds Zutshi.

**Challenges**

With plenty of room for growth in Germany, industry experts believe that some of the main challenges for the asset servicing industry are around regulation such as the Central Securities Depository Regulation (CSDR).

The settlement discipline requirements include allocation and confirmation requirements, mandatory settlement functionality enhancements at the CSDs, transparency requirements with respect to settlement fails; but experts say the greatest impact, however, relates to cash penalties and mandatory buy-ins.

Britta Woernle, director, market advocacy, Deutsche Bank Securities Services, says: “The SDR will drive the need for increased settlement efficiency and hence operational performance will become of vital importance across the industry. In response to these requirements, Deutsche Bank Securities Services is exploring how real-time data and settlement analytics can provide clients with a risk view of their settlement horizon, including a view of trades at risk of penalties and buy-ins.”

“These dashboards will provide performance-related insights, such as where and why trades are failing, whereby the dashboards will also suggest remedial action that can be taken,” explains Woernle.

Elsewhere in the regulatory sphere, following a detailed consultation in 2020, the second Markets in Financial Instruments Directive (MiFID II/MiFIR) is under review with a MiFID II/MiFIR Refit due in this.
The proposed MiFID changes bring forward the review of some investor protection and research provisions, which are intended to drive investor participation in EU capital markets.

“The proposal eases the burden imposed by requirements on the disclosure of costs and charges, suitability testing and best execution whilst also encouraging online and distance communication,” says Michael Bowder, market information and collateral/RFP Western Europe at Deutsche Bank Securities Services.

Bowder also notes that the changes intend to encourage greater analyst coverage and drive up the trading in SME stocks and fixed income instruments, by proposing an exemption of small and mid-cap companies and fixed income instruments from the research unbundling rule.

Wurzer adds: “There are several challenges that the market is facing in Germany. However, Germany is by no means the only country facing these particular challenges. For instance, I would include the ever-increasing regulatory demand on the asset servicing industry, pressure on fees, investments into digitalisation and automation, the emergence of cryptocurrencies and digital assets on an industrial scale as well as others.”

The Securities Financing and Transactions Regulation (SFTR) was another complex piece of regulation. SFTR requires EU counterparties to report their securities finance transaction details to a registered trade repository.

“The firms have had to address the fundamental challenge in the aggregation of all relevant information from different source systems in combination with the necessity of a timely survey, preparation and transmission of business data but still significant volume of errors is expected. The German regulator, BaFin, has also issued guidelines on applications for crypto-asset custody and institutions are working towards getting licenses enabling them to provide services for this new asset class,” affirms Zutshi.

In line with other markets around the globe, the pandemic only amplified these challenges around regulation. The regulators in Germany also tweaked the laws to help companies adapt to the pandemic.

Zutshi explains that relief provided under COVID-19 Mitigation Act (CMA) allowed virtual shareholder meetings, and this has been allowed for 2021 as well.

Experts attest that in asset servicing, the market saw high numbers of settlement transactions and an increased need for digital solutions such as e-signatures.

Over the course of the second half of 2020, roughly 715,000 cash payment instructions with an overall volume of approximately €390 billion were successfully processed in the German market, according to Mueller.

Clearstream’s Mueller concludes: “Despite the challenges due to COVID-19, we saw that the asset servicing industry in Germany is in a fundamentally stable and crisis-proof state. Corporate actions were processed with the same consistency and high quality as before the pandemic situation.”