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Call for evidence on shortening the settlement cycle

Date: Frankfurt / Main, 15 December 2023

Dear Madam or Sir,

we welcome your initiative to evaluate ways of shortening the settlement cycle and have taken note of your broad-based survey among market participants with respect to this topic. Given the complexity of this subject, we are not yet able to provide a conclusive assessment on the topic of "shortening the settlement cycle to t+1" and must therefore refrain from providing a detailed response to your questionnaire.
In order to be able to make a comprehensive assessment of this issue, we need more time to analyse the possible impacts of a shortened settlement cycle on the market for German Federal securities as a whole. To this end, we need to have further extensive discussions with our banks and trading partners, as well as with service providers in the area of settlement and custody of German Federal securities.
According to a preliminary assessment, in particular the following two issues are affected by this question:

1. Settlement of German Federal securities

The German Federal Government's primary and secondary market activities are managed by the German Finance Agency. In cooperation with the Deutsche Bundesbank the settlement operations are processed. Federal bonds and notes, Federal Treasury notes and Treasury discount papers are usually issued via an auction process. Additionally, secondary market transactions in German Federal securities are executed by the German Finance Agency.
Settlement of Euro denominated bonds is being done in T2S via the CSD Clearstream Banking Frankfurt. From a technical stand point the shortening of the securities settlement cycle to t+1 looks feasible for our EUR-denominated bonds. No technical changes in our post-trade systems may be needed. However, to achieve a comprehensive understanding, we are dependent on feedback from our Members of the Bund Issues Auction Group or other market participants of secondary market activities. The change to

t+1 will require operational efficiency and settlement discipline by all market participants. All market participants should aim to ensure that the required Delivery-versus-Payment instructions are captured on trading date in the CSD settlement systems. This means that the majority of transactions can be settled in T2S during the night batch processes starting on t. Existing non-matched instructions in the morning of t+1 have to be solved immediately since open issues have to be solved intraday.
Federal bonds and notes are additionally issued via syndications. It should be discussed whether it would be permissible to deviate from the planned standard t+1, since currently our syndications are settled t+5.

2. Trading activities in the market for German Federal securities
As part of its debt management, the German Federal Government does not only utilise the primary market, but is also active on both the secondary market for German Federal securities as well as the repo market. In the context of a possible shortening of the settlement period to t+1 it is not only the effect on the feasibility of its own activities, but also the implications for the market for German Federal securities as a whole.
A smooth functioning of the interaction between the cash, repo and futures markets is essential for the issuer, the Federal Government of Germany. This interaction between the three markets enables market makers to offer market participants attractive buy and sell prices for German Federal securities on the cash market at very low transaction costs at all times. Positions set up on the cash market can be easily hedged or covered via the futures and repo markets at very low costs. This leads to an extraordinarily high tradability of German Federal securities and secures very low financing costs for the Federal Government.
A premature introduction of a shortened settlement period could lead to a situation where one of the sub-segments is negatively affected in its functioning. This would lead to a negative effect on the tradability of German Federal securities and thus on the funding conditions of German Federal securities. First discussions with market participants indicated that in particular the activities of market makers in the repo markets could be negatively affected by a shortened settlement period (e.g. short coverings). In our opinion, in-depth analyses are required on this complex of issues, among others, in order to get at a clear assessment with respect to this issue.
Apart from the exclusive view on Germany`s funding activities we would like to draw your attention to the following possible impacts on the fixed income markets in the Eurozone in general: German Federal securities are the benchmark for the Eurozone. If this market segment were to lose liquidity as a result of the shortening of the settlement period and become less attractive for international investors, this could potentially result in the European financial markets as a whole being damaged and thus losing their competitiveness and attractiveness. Reduced attractiveness of the benchmark itself would consequently have a domino effect on all other fixed income asset classes denominated in Euros.

Overall, we assume that the introduction of a shortened settlement period t+1 for the European Union as a whole is a significant project that will require a considerable amount of time and effort. We are very positive about this initiative, especially if the major financial markets of the United States of America, the United Kingdom and the European

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Union would have fully harmonised settlement periods. However, it is an essential requirement that a shortening of the settlement period does not result in any significant temporary or permanent disadvantages for the European sovereign bond markets.
We would very much appreciate if ESMA could examine this issue more closely and analyse the effects on the aforementioned sub-sectors in more detail. We will also be monitoring this issue closely and will be happy to share our thoughts with you at any time.

Yours sincerely

Thomas Weinberg

Dr. Jens Müller