RegCORE Client Alert

Financial Services: Overview of relevant points from the German Coalition Agreement 2021

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On September 26, 2021, the 20th German Bundestag of the Federal Republic of Germany was elected. The centre-left party, the Social Democratic Party of Germany (**SPD**) emerged as the strongest party and quickly begun discussions to form a new coalition government for the 2021-2025 legislative period. The SPD had already been the junior partner in the previous coalition with the CDU/CSU (since 2013) under the Merkel chancellorship.

The SPD's Olaf Scholz will replace Merkel as chancellor. Scholz had previously been the Finance Minister under the most recent cabinet and thus he marked the “continuity candidate” amongst party leaders in the 2021 Bundestag elections. The post-election exploratory talks to form a new government resulted in coalition negotiations in which the SPD approached the centre-left green party, Bündnis 90/Die Grünen **(the Greens**) and the centre-right Free Democrats (**FDP**).

The negotiations ended on November 24, 2021 and culminated with the presentation of the Coalition Agreement[1]. In German politics, a coalition agreement serves to publicly present consensus on the parties' most important shared goals and objectives under the new cabinet. In the following sections below, we provide a short overview of key points that are relevant for financial services market participants. Sustainable finance and climate change priorities set in the Coalition Agreement are discussed in our separate coverage.

The Coalition Agreement and key themes – a commitment to the EU

The Coalition Agreement which was unveiled bears the title "Dare for more progress – an alliance for freedom, justice and sustainability". The new incoming cabinet, in addition to advancing efforts to combat climate change (see our separate coverage on this), plans to focus on reforms to improve social justice, digital transformation, security and the economic competitiveness of Germany. Financial services and market participants are set to play a key role in delivering change over the next legislative period. Crucially, while the

[1] The full text of the Coalition Agreement is available here.

Coalition Agreement presents reforms for Germany, the points detailed therein will likely be of relevance for policymakers across the EU-27's national capitals as well as for EU-policymakers in Brussels, Paris and Frankfurt.

As an overarching message, the Coalition Agreement is dedicatedly pro-European and committed to completing a number of legislative and institutional reforms that have been advanced or been proposed at the EU-level. Specifically, the new German government is committed to the EU's Conference on the Future of Europe, an important means of advancing dialogue on EU constitutional reform. The German government is also supportive of giving the European Parliament the "right of initiative", a commitment to a single electoral system and transnational lists for European Parliament elections, a push for increased transparency in European Council decision making, and equally strengthening consideration of small-to-medium sized enterprises' (i.e., reflective of the importance of the German *Mittelstand*) specifics in EU rulemaking.

Crucially, this Coalition Agreement proposes that the new incoming cabinet hold itself to pursuing a faster pace and possibly some more ambitious aims when delivering change both in Germany as well as across the EU-27. While this is welcome, it is possibly also reflective of an incoming government that is seeking to drive the bounce-back from the impacts of the COVID-19 pandemic which put a pause to a number of reforms in the pipeline or already in various stages of delivery.

The EU´s Banking Union, Capital Markets Union projects and EU Financial Market Regulatory reform

The Coalition Agreement's aims are clear in the need to complete the EU's Banking Union. Completion is necessary in order to strengthen the EU's Single Market and thus the European economy but therefore also the global competitiveness of German and European financial services firms and the counterparties, clients and communities they engage with. The following measures are intended to contribute to this endeavour:

- The 2021 Bundestag election was expected to break the deadlock on Germany's stance on the proposed "third pillar" to Banking Union i.e., the European Deposit Insurance Scheme (**EDIS**). Already during late 2019 and 2020, statements by Olaf Scholz, as then Finance Minister sought to break the contentious discussion on EDIS and propose compromise solutions that would be acceptable to the domestic electorate without derailing the EU's progress. The Compromise Agreement now cements Germany's compromise position on EDIS. While the new government still remains cautious on any form of mutual risk sharing, the compromise offered foresees a European reinsurance mechanism for national deposit guarantee schemes. Contributions are to be differentiated according to risk and this is subject to three key preconditions being met:
  - Risk exposures in bank balance sheets must be subject to further reduction – notably with respect to an overreliance on government bonds;
  - The EU's Bank Recovery and Resolution Regime (BRRD II and SRM II) must be strengthened further;
  - The Institutional Protection Schemes (IPS) of German savings and cooperative banks must be safeguarded and unaffected as part of delivery of the compromise position;
- The Coalition Agreement is supportive of implementing Basel III/IV's core requirements as applied in the EU through CRR III/CRD VI, into German law. In this context, the Coalition Agreement highlights the need to reduce competitive disadvantages faced by small banks and proposes to push for more proportionate risk-based supervision. Similarly, the German government plans to ensure that investment-conditions are not hampered by the implementation of the new prudential regulatory standards as well as the continued (systemic) impact of extraordinary support and/or relief measures that were put in place to support the economy in light of COVID-19;
- While no concrete proposals are put froward on how to complete Capital Markets Union – and this may be partly due to the EU Commission's revised regulatory reforms having been published at the same time the Coalition Agreement was being finalized - there is broad support for efforts at the EU and national level to do so. Specifically, the Coalition Agreement does however point to workstreams on the MiFIR/MiFID II review and a need to strengthen market transparency including with respect to high-frequency trading as well as reducing position limits for (agricultural) commodities; and
- On Solvency II, the Coalition Agreement will focus on how to embed climate risk into evidence based and risk adjusted prudential capital requirements in a manner that facilitates also liability-driven investments. Germany will push for a greater ability to apply risk-based adjusted proportionate regulatory and supervisory requirements to non-complex insurance firms and pension providers.

Modernising German financial markets

- The German financial market (and the domestic legislative framework) is to be made more future-proofed and innovative. This includes the following targeted measures:
  - IPOs, capital increases and dual class shares are to be made easier for growth companies and small and medium-sized companies;
  - "Shadow banks" are to be adequately regulated and supervised in accordance with the standards advocated by the Financial Stability Board;
  - Distortions caused by high-frequency trading are to be limited by means of suitable market rules (see also points above at the EU level);
  - The establishment, takeover, restructuring or capital strengthening of banks and financial service providers should be possible more quickly than before (see points below at the EU level); and
- Efforts to continue to remove barriers to cross-border capital market transactions in the EU are to be accelerated. There is also a passing nod at support for cross-border mergers of EU banks. Ultimately, this may mean further modernisation efforts in respect of German law but concurrently support and leadership being provided to deliver corresponding support to Capital Markets Union and other workstreams at the EU level.

Advancing reforms in the payments, FinTech and cryptoassets ecosystem

The Coalition Agreement sets out the aim that digital financial services are to play an even greater role in Germany in the future. This includes advancing the following actions:

- On payments, the Coalition Agreement has expressed support for an independent and thus pan-European payment infrastructure which hints at support for the European Payments Initiative (the **EPI**). The EPI, as part of the Eurosystem's 2019 relaunch of its Retail Payments Strategy, is an European Central Bank based payment-integration initiative aimed at creating a pan-European payment system and interbank network to rival those of international non-EU headquartered systems. The EPI would build upon the EU's Single European Payments Area (**SEPA**) and previous efforts to introduce a pan-European card scheme. The EPI would, by using SEPA architecture[2], complete SEPA and therefore allow pan-EU acceptance in a more meaningful manner;
- On FinTech the Coalition Agreement expresses a clear ambition that Germany should strive to become a leading jurisdiction for FinTechs, InsurTechs, market platforms and neo-broker. Despite this ambition, regulatory action and lengthy application processes, notably with respect to neo-brokers and InsurTechs over the past 18 months have sent a very different signal. As a wider-reaching goal, the Coalition Agreement commits to fostering a "level-playing field" amongst traditional and digital business models including BigTech. Such a level-playing field may however mean increased prudential regulatory requirements for such market participants using a digital distribution model; and
- On digital assets and cryptoassets, the Coalition Agreement provides support for the EU's Markets in Crypto Assets Regulation, the Regulation on a Pilot Regime for DLT Market Infrastructure as well as the EU's Digital Operational Resilience Act. The Coalition Agreement however remains lukewarm on the ECB's central bank digital currency priorities even if Germany will "constructively support" the project.

Improving financial consumer protection in Germany

Financial consumer protection measures in Germany are to be strengthened by the following targeted actions:

- Increased focus on consumers' individual circumstances, especially when granting consumer loans;
- Protection against over-indebtedness caused by interest rates that are not in line with the market and usury in all forms of loans;
- Limitation of costs for early repayment penalties;
- Restrictions on residual debt insurances (Restschuldversicherungen) a form of payment protection insurance (PPI) which has been banned or otherwise severely restricted in a number of financial markets;
- Review the rules on credit scoring;

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[2] Such as SEPA's Instant Credit Transfer scheme (SCT Inst) and the Eurosystem's TARGET Instant Payments Scheme (TIPS).

- A comparison website for account fees is to be set up at BaFin; and
- Finalize the implementation of the EU's Whistleblowing Directive.

Institutional regulatory reform – improving BaFin and building the EU's AMLA

The Coalition Agreement confirms that the current reform path charted by the outgoing government (and spearheaded by the then Finance Minister and now Chancellor, Olaf Scholz) will press ahead so as to further strengthen the role of Germany's financial services regulator, the BaFin. Specifically with respect to improving BaFin and financial-crime prevention in Germany as well as the building of AMLA, this includes the following targeted priorities:

- Information sharing arrangements within BaFin and with other national and international competent authorities will be increased. The BaFin will also be required to act more promptly when it comes to its role in the supervisory process concerning the establishment, acquisition and/or restructuring of financial services providers. The BaFin will also receive greater powers in respect of reviewing prospectuses and the supervision of lightly regulated financial markets;
- The Coalition Agreement is supportive of the EU's proposals for replacing the existing Anti-Money Laundering (**AML**) Directives with a harmonized AML Regulation. The same is true of the efforts at the EU-level to create a central Anti-Money Laundering Authority (**AMLA**) which the Coalition Agreement states should ideally be headquartered in Frankfurt. In the eyes of the new government, AMLA should police AML compliance for those subject to compliance obligations under the EU AML Directives but also those persons in the cryptoasset ecoysytem;
- Recommendations from the latest FATF audit of Germany are to be implemented in German law in the future. Specifically, immediate priorities include:
  - Improving the quality of the data in the Transparency Register and establishing a data protection-compliant link to other relevant registers existing in Germany; and
  - The Financial Intelligence Unit (**FIU**) i.e., German Customs (*Zoll*) will itself receive greater powers and resources to combat financial crime (including illicit work and related predicate offences), and the supervision of AML compliance and reporting of suspicious activity/transactions. These new powers apply to financial services providers and certain non-financial services providers. Moreover, the FIU will equally set-up liaison officers with the Criminal Justice Offices (Landeskriminalämtern) of each of the German Federal States. The FIU will also be tasked with providing greater feedback to supervised entities.

Strengthening the EU's Economic and Monetary Union

The following points are set out in the Coalition Agreement as intended to be advanced so as to strengthen the EU's Economic and Monetary Union:

- Support the "streamlining" of the EU's Stability and Growth Pact (SGP) and 'orientate the fiscal policy towards the overarching objectives', which could be interpreted as hinting at a softening or flexible interpretation of the SGP – although this might be difficult given the incoming Finance Minister's position as a fiscal hawk;
- Adopt more flexibility in the use of the EU's Budget. There is however but no reference to making Next Generation EU (NGEU) a permanent fixture. This is the case even if the Coalition Agreement also calls for efforts to promote a drive towards investment at the EU level; and
- Return to the constitutional debt break in 2023 but 'evaluate how it is applied'. Nonetheless Germany will make the necessary investments within these limitations and especially expand investments in 2022.

Delivering digitalisation more broadly

Advancing digitisation is one of the core elements of the Coalition Agreement and is included in many topics. The following digitisation measures are likely to be of particular interest for the financial services sector:

- Administrative processes and engagement with authorities are to be further digitised and de-bureaucratised;

- In the digital sector, the number of early stage investment is to be increased by supporting start-ups via founder grants and through a portion of the Future Fund reserved for this purpose;
- A digital start-up option for companies is to be promoted. For example, it should also be possible in the future to establish a company with contributions in kind and other resolutions via video communication;
- Small and medium-sized companies are to be supported in their digitisation efforts by receiving straightforward funding; and
- Investments are planned in key digital technologies such as Artificial Intelligence (AI), Quantum Technologies, Cybersecurity, Distributed Ledger Technology (DLT) and other future technologies.

Simplifying the German tax system

With regard to the tax system, the Coalition Agreement provides for a comprehensive catalogue of measures. In principle, the changes are intended to simplify the tax system for people and companies. The following points are particularly noteworthy for companies:

- Provide tax breaks for investments in climate change and the digital transformation. Investment premiums for climate protection and digital assets. For example, in 2022 and 2023, taxpayers are to be enabled to deduct from their taxable profit a proportion of the acquisition and production costs of fixed assets acquired or produced in the respective year that serve this purpose in particular ("super depreciation");
- An extended loss offset is to be extended until the end of 2023 the loss/carry-forward is to be extended to two immediately preceding assessment periods;
- Further development of import turnover tax to achieve a level playing field in European competition; and
- To strengthen the German economy, an adjustment of the option model and the taxation of retained earnings is being evaluated.

Combating tax evasion and aggressive tax structuring activity in Germany

The Coalition Agreement provides for increased strategic action against tax evasion, financial market crime and money laundering. The following measures, among others, are planned for this purpose:

- Fight tax evasion and strengthened exchange of information based on the OECD and FATCA;
- Commitment to delivery of the OECD tax reforms;
- Domestic tax loopholes in the acquisition of real estate by corporate groups ("share deals") are to be closed;
- The reporting obligation for cross-border tax structuring is to be extended to national tax structuring by companies with a turnover of more than 10 million euros;
- Abusive dividend arbitrage transactions are to be prevented. To this end, greater use is to be made of technical possibilities such as blockchain, and tax losses suffered to date are to be consistently reclaimed and collected. For detection purposes, the exchange of data and information between financial supervisory authorities and tax authorities should already be possible in cases of suspicion;
- The coalition will continue to push for the introduction of global minimum taxation; and
- Income flowing out of Germany is to be taxed appropriately. To this end, withholding taxation is to be expanded. The interest barrier is to be supplemented by an interest rate barrier.

Outlook

The Coalition Agreement is certainly full of a number of goals that are ambitious as to their breadth and pace. While this is welcome, the devil will remain in the detail and any delivery by the German government of those plans will have to work hand-in-hand with development at the EU level so as to provide the requisite certainty and interoperability needed both at implementation at the national level and creating the level playing field across the EU.

It will be important that Berlin ensures ensures that what is well intended is also well done while not losing sight of the Coalition Agreement’s overarching (pro-EU) theme; to dare to make more progress.

About us

PwC Legal is assisting a number of financial services firms and market participants in forward planning for changes stemming from these proposals.

If you would like to discuss any of the developments mentioned above, or how they may affect your business more generally, please contact any of our key contacts or PwC Legal's RegCORE Team via de_regcore@pwc.com or our website.

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