RegCORE Client Alert

The incoming German government's "coalition agreement" and the focus on ESG: A real move forward?

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ESG coalition agreement

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Two months following the German election, three political parties have agreed to form a so-called "traffic-light" "Ampel" coalition representing their political colors: red for the social democratic center-left party, the Socialist Party of Germany (**SPD**), who will hold the chancellorship, yellow, for the center right liberal Free Democratic Party (**FDP**), who are expected to hold the Finance Ministry and green for the center left green party, the Bündnis 90/Die Grünen (**the Greens**), who will, amongst other appointments, hold the Environment Ministry.

This new coalition government published on 24 November its goals for the 2021-2025 legislative period in a 178-page coalition agreement[1], which bears the title "Dare for more progress – an alliance for freedom, justice and sustainability." In that document, it is clear that the traffic light is set to green with an ambitious pace for legislative and non-legislative reforms - but what are their concrete plans with regard to ESG and also sustainable finance?

During the election campaign, sustainability was already one of the most prominent topics in election manifestos. Unsurprisingly, climate policy was particularly emphasized by the Greens. However, the prominence of this topic was never questioned by the other parties, including the SPD and FDP.

Climate change is in the media always referred to with expressions such as "the greatest human task of our time". This formulation already hints at the enormous efforts involved in tackling this task. While the new German government's ESG priorities may have a national focus, the coalition agreement's general pro-European agenda, means that domestic efforts, will have a bearing on the direction of EU policymaking in Brussels – including beyond the EU's Green Deal.

[1] The full version of the coalition agreement is available here

The complexity of the issue

The coalition agreement starts with the topic “Modern state, digital awakening and innovations”. The second set of topics is entitled "Climate protection in a social-ecological market economy”. However, any review of the coalition agreement is quickly drawn to the topic in the preamble, where the Paris climate protection targets are clearly referred to once again and a clear commitment is made to the 1.5-degree Celsius target. Furthermore, carbon neutrality is a goal that is set to be achieved by 2045 at the latest. This marks a compromise amongst the Greens who, in their electoral manifesto[2], had advocated for such a goal to be achieved by 2040, the FDP who had set a goal for 2050 and the SPD that had pushed for 2045. The coalition agreement also supports full delivery of the EU’s “Fit for 55” program.

Another important topic, which is also directly addressed in the preamble of the coalition agreement, is the phase-out of coal and coal-fired plans. Ideally, this should be completed by 2030 – down from 2038[3]. What exactly is meant by the term "ideally" in this context remains open. Although it is made clear in the chapter on the coal phase-out, particularly with regard to the vagueness of the phrase "ideally," that there is actually no real alternative to an early coal phase-out due to the decision of the German Federal Constitutional Court on climate targets[4] and the plans set out in existing or forthcoming EU regulations. Consequently, a clear commitment to a definitive phase-out of coal by 2030 remains open. With coal and nuclear on the out, the new German government envisions that renewable energy sources will grow to meet 80% of electricity demand, up from a previous target of 65%. Major investment in new and upgrading existing wind and solar power projects are planned.

The coalition government has also agreed to speed up its hydrogen policy during 2022 so as to become a leading market by 2030. Germany’s hydrogen policy was set under the previous Merkel chancellorship as a means to advance hydrogen-based decarbonization. On the path to 2030 natural gas fired plants are expected to be “indispensable for the transition period” until new hydrogen-powered plants are available.

As part of this move on hydrogen as well as stepping up the shift to other renewable energy sources, the coalition is seeking to secure more private capital for domestic transformation projects. In order to deliver that transition, the German State-owned development bank, KfW will have its mandate strengthened so as to support innovation and investment, notably in those projects that qualify under the EU’s program to support “Important Projects of Common European Interest”.

[2] An overview of the various pledges in the electoral manifestos on Climate Policy is available here:

SPD	Greens	FDP
• Carbon neutrality target by 2045 • Germany should move to being entirelys on renewable energy by 2040 and a leader in hydrogen technology by 2030 • Make rail travel cheaper than flying in the EU • Aim for 15mln + fully electric cars in German roads by 2030 • Introduce a 130km/h speed limit • Low income residents should be compensated for increases in carbon taxes	• Carbon neutrality target by 2040 • Exit from coal to be completed 2030 and not 2038 • Reduce emissions by 70% by 2030 and be fully running on renewable energy by 2035 • Invest EUR 100bln in railways and stations by 2035 • Improve rural public transport • Have 15 mln electric vehicles by 2030 • Limit vehicle registrations only to emission-free cars • Introduce speed limit to 130 km/h • Carbon tax revenues should be paid to residents	• Carbon neutrality target by 2050 • Extend emissions trading to all sectors • Support hydrogen strategy • Privatize train operations with railways remaining state owned • No ban on fossil fuel vehicles, no speed limit and no subsidies for electric cars • Pay residents a climate dividend from CO2 revenues

[3] In 2020, it was estimated that about 25% of Germany´s electricity production came from thermal coal. Germany´s exit plan from coal was agreed in 2020 and included compensation and support payments for existing operators and regions worth about EUR 400 billion.

[4] The full version of the decision is available here.

Furthermore, the coalition agreement’s chapter on broader climate protection priorities evidences how far-reaching and multi-layered the topic is and that it affects almost all areas of modern life. Examples include digitalization, nutrition, mobility and all areas of the economy. This also highlights once again the structural change that society is facing.

Financing change as a foundation: Sustainable Finance

One of the biggest challenges associated with the sustainable transformation in society is the issue of how to finance such change both within in Germany but equally across the EU-27 and indeed globally. Without the involvement of the financial sector, combatting climate change will also be impossible to manage because there is simply a lack of financial resources.

As a result, the topic of investing in the future plays a special role in the coalition agreement. This also includes the shift of Germany’s financial market participants toward sustainable investments. The coalition agreement dedicates quite some focus to setting out how, post-COVID-19, Germany’s economy needs a new focus and one on sustainability and digitalisation. The aim of the German government is to press forward projects and (legislative and non-legislative) means to build a more “socio-ecological” market economy (*sozial-ökologische Marktwirtschaft*) that also serves to support the aims and objectives of the EU’s Green Deal.

According to the paper, Germany is to become a leading location for sustainable finance. The decision by the new global policy and standard-setting body, the International Sustainability Standards Board to set-up its headquarters in Frankfurt, and thus in close proximity to the European Central Bank and other EU and German authorities whose mandates now include a focus on climate finance, ESG and sustainability, aims to provide a foundation for Frankfurt as a “sustainability hub” inasmuch as for Germany, at the heart of the EU’s economy, to further press forward climate finance and the EU’s Green Deal.

In terms of legislative efforts, the significance of climate and sustainability risks is to be strengthened in such a way that they are explicitly designated as financial risks. The European minimum requirements in the market for ESG ratings and the mandatory inclusion of sustainability risks in credit ratings of the major rating agencies are also to be included and feature prominently in the aims of the coalition agreement. The aim is to create a uniform transparency standard for sustainability information at European level and also to support the project for the EU’s Corporate Sustainability Reporting Directive. In addition, ecological and, where appropriate, social values are to be integrated into existing accounting standards, starting with greenhouse gas emissions. This is to be carried out in dialogue with the business community both in Germany as well as further afield.

Lastly, the new German government is looking to press ahead, and thus support German industry through its transition to greater sustainability, by finalizing the introduction of carbon contracts for difference (**CCfDs**). CCfDs are a key policy instrument and aim to incentive key industrial sectors including steel, cement and ammonia production, by closing profitability gaps that may arise compared to alternative carbon intensive processes and thus support the demand for green hydrogen across relevant sectors. CCfDs aim to support the EU’s efforts on “Fit for 55” as well as the new Carbon Border Adjustment Mechanism (**CBAM**). CBAM puts a carbon price on imports of a targeted selection of products to limit “carbon leakage”.

Lastly, Germany’s Sustainable Finance Strategy, as the basis for all the above-mentioned projects at the national level, is to be revised and develop an international scope – again going hand-in-hand where desirable with the EU’s Green Deal efforts.

Outlook

At first glance, sustainability and climate protection in particular are genuinely valued in the new coalition agreement. Compared with previous legislative periods, the issue is gaining significantly in importance and coming to the fore. However, as is so often the case, the devil is in the detail. The many plans, actions and goals represent real and welcome progress on the road to sustainable transformation, also with regard to the financial sector. But the question remains whether these projects will be enough to meet the major goal of adhering to the 1.5-degree Celsius path. There is reason to doubt this, as compliance with this path will require far more drastic measures than those currently planned.

Looking at the international community, it is clear that climate change is not a national but an international problem in need of international solutions. Multilateral cooperation is the focus and deserves this place, otherwise all national efforts will miss their target. Policymakers must continue to keep a close eye on developments in the EU, because it is urgently necessary to work hand-in-hand with future national regulations and those at EU level, such as the Taxonomy Regulation[5] or the Disclosure Regulation[6]. It is therefore necessary to strike a balance between further national development, EU and international cooperation.

The basis for transformation has now been laid with the coalition agreement, but it is now important that Berlin ensures that what is well intended is also well done. Instead, a real, continued delivery is needed to meet the challenges and, in line with the title of the paper, 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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[5] The full version is available here.
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