

Brexit and German Employment Law – A New Type of Interaction

IN SHORT

The Background: In an effort to benefit from Brexit, Germany is looking at ways to attract financial institutions and reduce their fears of excessive employee termination protections in Germany.

The Situation: The German government coalition has plans to reduce termination protection standards for certain groups of bankers.

Looking Ahead: Once implemented, the liberalization of the labor market for bankers might pave the way for comparable steps for employees in other industries, although it is likely that only high-earners would be affected.

While it's no wonder that continental Europe's financial centers benefit from Brexit, it still was noteworthy that Frankfurt ranked 10th worldwide in the most recent Global Financial Centres Index, as of September 12, 2018. This is an advance of no less than 10 positions compared to the previous survey. Frankfurt is ahead of Luxembourg (rank 21), Paris (rank 23), and Geneva (rank 27), and just one position behind Zurich. New York City ranks first, having replaced London, which still holds second place.

What does this have to do with German employment law? The survey was based on several indices, including human capital and the flexibility of the labor market as one of the sub-factors. From an international point of view, Germany is traditionally seen as inflexible in this respect and considered to have excessive termination protection; in fact, some joke that it is easier to get divorced in Germany than to terminate an employee there. No wonder that foreign companies were reluctant to situate operations in the country.

In the wake of Brexit, however, 26 major financial institutions (so far) have announced an intention either to move to Frankfurt or significantly increase their operations there. In the hope of more such moves, changes to termination protection in the banking sector are coming.



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The February 2018 coalition agreement between Germany's conservative parties and the social democrats provided that the German coalition government would take steps to create "attractive framework conditions for Germany as a financial center," perhaps to benefit from Brexit. This goal was to be achieved by equating "risk takers" in the banking industry to so-called "management employees," as defined in the German Termination Protection Act (*Kündigungsschutzgesetz* or "KSchG"). The change would apply only to individuals earning above €234,000 gross per year (i.e., three times the contribution ceiling for statutory pension contributions of currently €78,000 per year).

Equating the two employee groups means that quite a significant change in German employment law is on the horizon. "Risk takers" are further defined in the Remuneration Ordinance for Institutions, which is based on EU Directive 2013/36/EU; the term "risk taker" covers individuals whose professional activities influence the risk profile of their financial institution. "Management employees" under the KSchG are those individuals below managing director level who are in a position to independently hire or dismiss other employees.

If management employees are terminated, they can contest the validity of the termination (as can all other employees). But what makes the situation with management employees distinct is that if the termination is invalid, the employer can apply to the labor court to "dissolve" the employment relationship in exchange for a severance payment. It does not require any specific justification, and the amount of the severance is, within certain limits, within the court's discretion. This option does not exist with regular employees; it requires such a specific justification that for normal employees, it plays no practical role.

This option can be a game changer for employers. Without it, an employee who has won a termination protection case might triumphantly return to work and/or demand unpaid salaries far beyond the intended end of the notice period (and could do so legitimately because the employment relationship did not terminate and continues indefinitely). Alternatively, the employee could ask for excessive severance amounts in a settlement negotiation that the employer might feel compelled to accept, to avoid the

aforementioned disadvantages.

In contrast, with the possibility of dissolving the employment relationship, employers can better calculate their risk: They may win the case, but even if they do not, a "dissolution" entails only reasonable, hardly exaggerated severance pay. An invalid termination may bear a cost, but the employee certainly has less leverage and clearly will no longer be employed at the company. Most employers would consider this as "more flexibility in the labor market." In the banking sector, it seems to be becoming a reality.

While the plan is to equate bankers with management employees, the "management employee," in the sense of the KSchG, does not exist in practice. German case law requires such a high degree of "independence" in decisions of hiring or dismissing other employees that few managers meet the criteria. In contrast, bankers falling under the planned regulation actually exist and could be safely identified by their earnings rather than shaky decision-making criteria.

Interestingly, trade unions are strongly against this intended change in law, but not out of concern for high-earning bankers. Unions fear that reducing termination protection for bankers opens the floodgates for a general reduction of termination protection in Germany—and they may be right. The plan to make Germany a more convenient place for banking institutions looking for post-Brexit continental Europe headquarters could indeed be the beginning of further liberalization of the labor market.

A speech of Chancellor Merkel at the Frankfurt Stock Exchange on September 4, 2018, was generally interpreted to reveal a stronger-than-ever political commitment to strengthen Frankfurt as a financial center. Accordingly, the above-described changes to the Termination Protection Act are likely to take form quite soon. It remains to be seen whether other business sectors will follow suit.

THREE KEY TAKEAWAYS

1. In the German banking industry, termination protection for high-earners most likely will be deregulated in such way that employers may apply at the labor court to dissolve the employment relationship in exchange for a severance payment.
2. By German standards, this is a significant change and may assuage employer fears that employing bankers in Germany is too risky in view of the country's historic termination protections.
3. It seems possible that termination protection in other business areas will be reduced in a similar way.



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