

Brexit and the fate of German dismissal protection

Frankfurt first, A legislative move to attract UK banks to relocate top talent to Germany's financial hub

A Guest contribution by Michael Magotsch, LL.M. (Georgetown)

On March 15, 2019, the German Parliament passed the Act on Tax-Related Provisions Regarding the UK Withdrawal from the EU (*Brexit-StBG/Steuerbegleitgesetz*). The new legislation introduces a first inroad on Germany's otherwise strict dismissal protection. The move is designed by the German government to attract UK banks to relocate to Frankfurt, rather than one of the other financial centers in the remaining 27 member states of the European Union.

The strict rules under the German Dismissal Act (*Kündigungsschutzgesetz/KSchG*) are the core of termination protection in German employment contracts. For the first time, the act provides for a specific relaxation of these rules. Since German law does not recognize the concept of employment “at will,” in principle, if the German Dismissal Act applies, employment in Germany can only be terminated for a stipulated cause.

The Brexit Transition Act will allow banks located in Germany—provided they



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qualify as “significant institutions”—to terminate employment contracts with their high-paid employees (as long as their jobs qualify them as “risk takers”)

without following the usual strict requirements imposed by German labor law.

Nevertheless, the public outcry—mainly stemming from union representatives, such as the German Federation of Trade Unions (*DGB*) and the public-service →

union (ver.di), as well as former Federal judges—seems excessive. Raising concerns regarding potential discrimination and violation of the constitution, the Confederation of German Employers' Associations (the counterpart of the German unions under German collective autonomy) has argued that the act is too narrow and its scope should be broadened to include non-significant institutions as well. The group has especially stressed the specific limitation to top earners at major banks and compared it with the broader approach taken for financial institutions, including the insurance industry.

Political background

One potential consequence of Brexit is that financial institutions currently based in London may consider relocating to other European financial centers. In Germany, this generated concern that Frankfurt, the German financial metropolis, faced a major disadvantage compared with competing cities such as Paris, Zurich and Barcelona. German employment protection laws were at the top of the list of concerns. The key issue revolved around how employers would be able to terminate employment contracts with highly paid investment bankers under Germany's strict labor laws.

Legal background

It is first necessary to consider the background of German dismissal protection. As previously mentioned, Germany does not provide for employment termination "at will." On the contrary, if an employer fails to prove at least one of the three legally recognized grounds for dismissal, the former employee must be re-employed if he or she files suit with a local labor court. Unless the employer succeeds in negotiating severance pay during mediation, re-employment is indeed the usual result. Except for executive employees (*leitende Angestellte*) and members of the management board (C-level executives), these strict termination protection rules apply to all employees, regardless of salary level.

The solution proposed by the new act is not surprising: The new provisions provide banks with the right to end employment without giving any reason or presenting any justification (section 9 paragraph 1 2 of the German Dismissal Act), thus deviating from the standard German termination protection proceedings. Banks may benefit from the simplified termination proceedings and opt for an application to end employment (*Auflösungsantrag*) provided the following prerequisites are met:

- the employee qualifies as a "risk-taker" (*Risikoträger*), pursuant to section 25a of the German Banking Act (section 25a paragraph 5a *KWG*);
- the employee's annual fixed salary is three times higher than the pension contribution limit, currently €241,000 per annum; and
- the bank terminating the contract (that is to say, the employer) qualifies as a "significant financial institution" pursuant to section 25n of the German Banking Act/*KWG*, meaning over the course of the last three years, its balance sheet total reached or exceeded €15 billion on average.

Consequences: Severance pay instead of re-employment risk

If a bank has applied for a termination of contract without providing any justification, the labor court must sentence the bank to pay severance pay before ending the employment contract with the risk-taker. This will result in a statutory limitation of severance payments for risk-takers, the maximum severance sum in the event of separation constituting 12 to 18 months' gross salary, depending on age and seniority. Thus, the financial risk

associated with dismissal litigation will be drastically reduced.

Risk-takers do not have to be executive employees (*leitende Angestellte*) as per section 14 paragraph II 1 of the German Dismissal Act. It is therefore irrelevant under the new act whether the risk-takers are entitled to independently hire and/or fire staff (which is seldom the case), as exempted employees normally must be under the German Dismissal Act. Furthermore, the act does not apply to insurance companies—it is limited exclusively to banks. It will, however, apply to all banks doing business in Germany and not only to London or UK-based banks planning to transfer staff to Germany.

All that said, highly-paid top bankers will eventually lose their German termination protection. This may leave major banks faced with a difficult task when trying to attract top talent. Alternative options could include adding exit clauses to contractual agreements made with candidates with high potential, such as fixed severance amounts and/or longer termination notice periods. Combining these with post-contractual non-compete clauses may be useful. On the positive side, this means banks' HR divisions will enjoy much more flexible staffing at →

the higher end of the pay scale, and costly, time-consuming litigation in the event of separation will no longer be a concern.

When will the act come into force?

The act will enter into force on the same day the EU withdrawal agreement between the UK and the EU enters into force — which is still expected to be March 29, 2019. Very recent news, however, could result in a

substantial delay compared with the original Brexit date. The terms of the act that simplify termination will, however, only become effective as of November 29, 2019—or eight months after the act enters into force, pursuant to section 64m of the German Banking Act/KWG.

As a result, the act will only apply to employment terminations or separations served after the effective date, currently November 29, 2019. ←



Michael Magotsch, LL.M. (Georgetown)
Rechtsanwalt, Of Counsel
Bryan Cave Leighton Paisner
Frankfurt am Main

michael.magotsch@bclplaw.com

www.bclplaw.com

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