Banking Business in Germany

A practical guide for foreign banks establishing a subsidiary or a branch in Germany

5th revised edition

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Preface

Now in its fifth edition, “Banking Business in Germany” presents the legal and economic frameworks for the banking sector in Germany.

Internationally, Frankfurt is often seen as a synonym for Germany. Flying into Frankfurt, one of the major airport hubs of the world, you get an impressive view over the skyline of its banking towers. Indeed, its location on the Main River has led many locals to refer to Frankfurt as “Mainhattan”. The financial centre of Frankfurt, too, is of great international importance, serving as a flagship for both Hessen and Germany.

Some 182 credit institutions, of which more than three quarters are foreign institutions, have chosen the financial centre of Frankfurt as their base.

Despite the financial crisis and the consolidation in its wake, the still high number of foreign banks (160 banks in 2015) demonstrates continued interest in being represented in this financial centre, in the benefit of being in close proximity to other key players and that Frankfurt has earned an excellent worldwide reputation.

With the European Central Bank and the Bundesbank located here, Frankfurt is a leading location for international monetary and currency policy. And since the Single Supervisory Mechanism (SSM) has been placed under the auspices of the European Central Bank in November 2014, the financial centre of Frankfurt as a whole has become even more valuable and attractive for foreign institutions. And so, together with the European Insurance and Occupational Pensions Authority (EIOPA) and the European Systemic Risk Board (ESRB), Frankfurt is not only the centre of European monetary policy, but has also become a centre for regulatory authorities and supervisory agencies that can boast a competitive regulatory environment.

Over the last few years, the main objective of regulatory efforts at international, European and national level has been the rebuilding of trust in the financial markets. The creation of a Capital Markets Union and the implementation of new European requirements for financial market products are just two of the changes we will have to adapt to. I believe that Frankfurt should contribute
towards achieving a change of direction: after years with a focus on regulation, it is now time for the simplification and optimisation of framework conditions. If these challenges can be actively addressed, I am confident that Frankfurt will be able to successfully defend its market position among the competition provided by global financial centres.

The government of the federal state of Hessen is also playing its part by taking a clear position and supporting the current legislative process for financial regulation both at EU and national level. For the state government of Hessen, this includes the promotion of an evaluation and, if necessary, a modification of the existing regulation, not only at domestic level but also at European level. Moreover – and this holds especially true with regard to the debate surrounding the Capital Markets Union – regulatory differences must not lead to advantages or disadvantages for particular forms of financing.

In addition, the state government of Hessen considers it essential for financial market players to engage in an intensive exchange with one another. For this reason it is an active member of Frankfurt Main Finance, an initiative focusing on the marketing, interconnection and the future of the financial centre of Frankfurt, which forges a close relationship between political and commercial representatives among its members.

Growing internationalisation and the policy changes as a result of the financial crisis are increasing the pressure for innovation on financial institutions. Product life cycles are getting shorter and financial products are becoming increasingly complex, requiring professionals in the banking sector to be highly skilled. At the same time, credit institutions, too, will have to adapt their training programmes to meet the growing needs of their staff. This is being addressed by the Frankfurt School of Finance & Management and the House of Finance (Goethe University Frankfurt), among others. In particular the House of Finance – an excellent example of an effective public-private partnership – offers a specific focus in the field of financial industry research in Frankfurt which is unique in Europe. By pooling their expertise, researchers and financial institutions can achieve high levels of synergy.

The financial centre of Frankfurt can also pride itself on a professionally run tax administration. It is a reliable partner for taxpayers, and this is highly appreciated by foreign institutions. In order to ensure that this remains the case in future, the state government of Hessen will always strive to maintain its high quality standards in the training programmes within the Hessian tax administration.
We welcome all financial institutions coming to Germany and contributing to this financial market, thereby enabling customers to choose from a diverse range of financial products.

I hope you will enjoy reading this publication and I cordially welcome you to Germany.

*Dr Thomas Schäfer*
*Minister of Finance of the State of Hessen*
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<td>ABCP</td>
<td>Asset-backed Commercial Paper</td>
</tr>
<tr>
<td>AG</td>
<td>Aktiengesellschaft (public limited company)</td>
</tr>
<tr>
<td>AGV</td>
<td>Arbeitgeberverband (Employers’ association)</td>
</tr>
<tr>
<td>AGB</td>
<td>Allgemeine Geschäftsbedingungen (General Terms and Conditions)</td>
</tr>
<tr>
<td>AIFMD</td>
<td>Alternative Investment Fund Managers Directive (Richtlinie zur Regulierung von Managern alternativer Investmentfonds)</td>
</tr>
<tr>
<td>AMAs</td>
<td>Advanced Measurement Approaches</td>
</tr>
<tr>
<td>AML</td>
<td>Anti-money laundering</td>
</tr>
<tr>
<td>AO</td>
<td>Abgabenordnung (German Fiscal Code)</td>
</tr>
<tr>
<td>AOA</td>
<td>Authorised OECD Approach</td>
</tr>
<tr>
<td>APA</td>
<td>Advance Pricing Agreement</td>
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<td>ASCG</td>
<td>Accounting Standards Committee of Germany (Deutsches Rechnungslegungs Standards Committee, DRSC)</td>
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<tr>
<td>AT1</td>
<td>Additional Tier 1</td>
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<tr>
<td>ATMs</td>
<td>Automated teller machines</td>
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<td>AWG</td>
<td>Außenwirtschaftsgesetz (Foreign Trade and Payments Act)</td>
</tr>
<tr>
<td>AWV</td>
<td>Außenwirtschaftsverordnung (Foreign Trade Regulation)</td>
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<tr>
<td>B2B</td>
<td>Business to Business</td>
</tr>
<tr>
<td>B2C</td>
<td>Business to Consumer</td>
</tr>
<tr>
<td>BaFin</td>
<td>Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)</td>
</tr>
<tr>
<td>BAM</td>
<td>Business Activity Monitoring</td>
</tr>
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<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
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<td>BGBl</td>
<td>Bundesgesetzblatt (Federal Gazette)</td>
</tr>
<tr>
<td>BIA</td>
<td>Basic Indicator Approach</td>
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<tr>
<td>BIC</td>
<td>Bank Identifier Code</td>
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<tr>
<td>BilMoG</td>
<td>Bilanzrechtsmodernisierungsgesetz (German Act on the Modernisation of Accounting Law)</td>
</tr>
<tr>
<td>BISTA</td>
<td>Bilanzstatistik (Balance sheet statistic)</td>
</tr>
<tr>
<td>BMWi</td>
<td>Bundesministerium für Wirtschaft und Technologie (German Ministry of Economics and Technology)</td>
</tr>
<tr>
<td>BPM</td>
<td>Business Process Management</td>
</tr>
<tr>
<td>BeschV</td>
<td>Beschäftigungsverordnung (Employment Regulation)</td>
</tr>
<tr>
<td>BRRD</td>
<td>Bank Resolution and Recovery Directive</td>
</tr>
<tr>
<td>BsGiaV</td>
<td>Betriebsstättenzweckverordnung</td>
</tr>
<tr>
<td>BVI</td>
<td>Bundesverband Investment und Asset Management e.V. (German Association of Investment and Asset Management)</td>
</tr>
<tr>
<td>BVV</td>
<td>Versicherungsverein des Bankgewerbes a.G.</td>
</tr>
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Abbreviations

BZSt Bundeszentralamt für Steuern (Federal Central Tax Office)
CAGR Compound Annual Growth Rate
CCFs Credit conversion factors
CCP Central counterparties
CDO Collateralised Debt Obligation
CDU Christlich Demokратische Union (Christian Democratic Union)
CEO Chief Executive Officer (geschäftsführendes Vorstandsmitglied)
CET1 Common Equity Tier 1
CIP Continuous improvement process
CIR Cost-to-income ratio
COREP Framework for Common Reporting of the New Solvency Ratio
CRM Customer Relationship Management
CRS Common Reporting Standard
CRSA Credit Risk Standards Approach
CSU Christlich Soziale Union (Christian Social Union)
CV Curriculum Vitae
CVA Credit valuation adjustment
DAC Directive on Administrative Cooperation
DAX Deutscher Aktienindex (Blue Chip Index listing the 30 major German companies)
DK Deutsche Kreditwirtschaft (Joint Committee of German Banking Associations, formerly ZKA, Zentraler Kreditausschuss)
DM Deutsche Mark
D-SIBs Domestic systemically important banks
DTT Double Tax Treaties (Doppelbesteuerungsabkommen)
EBA European Banking Authority (Europäische Bankenaufsicht)
EBITDA Earnings before interest, taxes, depreciation and amortisation
ECB European Central Bank (Europäische Zentralbank)
ECJ European Court of Justice
EdW Entschädigungseinrichtung der Wertpapierhandelsunternehmen (Compensation Scheme of German Investment Firms)
EEA European Economic Area
e.g. exempli gratia (for example)
EIB European Investment Bank
EIOPA European Insurance and Occupational Pensions Authority (Europäische Aufsichtsbehörde für das Versicherungswesen und betriebliche Altersversorgung)
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<td>ELStAM</td>
<td>Elektronische Lohnsteuerabzugsmerkmale (wage tax deduction procedure)</td>
</tr>
<tr>
<td>ELStER</td>
<td>Elektronische Steuererklärung</td>
</tr>
<tr>
<td>EMU</td>
<td>Economic and Monetary Union (Europäische Wirtschafts- und Währungsunion)</td>
</tr>
<tr>
<td>ERP</td>
<td>Enterprise Resource Planning</td>
</tr>
<tr>
<td>ESCB</td>
<td>European System of Central Banks</td>
</tr>
<tr>
<td>ESMA</td>
<td>European Securities and Markets Authority (Europäische Wertpapieraufsichtsbehörde)</td>
</tr>
<tr>
<td>ESStG</td>
<td>Einkommensteuergesetz (Income Tax Act)</td>
</tr>
<tr>
<td>ETL</td>
<td>Extract, Transform and Load</td>
</tr>
<tr>
<td>EU</td>
<td>European Union (Europäische Union)</td>
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<tr>
<td>EUR</td>
<td>Euro</td>
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<tr>
<td>FAFMS</td>
<td>Federal Agency for Financial Market Stabilisation (Bundesanstalt für Finanzmarktstabilisierung, FMSA)</td>
</tr>
<tr>
<td>FATCA</td>
<td>US Foreign Account Tax Compliance Act</td>
</tr>
<tr>
<td>FATF</td>
<td>Financial Action Task Force on Money Laundering</td>
</tr>
<tr>
<td>FDP</td>
<td>Freie Demokratische Partei (Free Democrats)</td>
</tr>
<tr>
<td>FGO</td>
<td>Finanzgerichtsordnung (Code of Fiscal Procedure)</td>
</tr>
<tr>
<td>FinaV</td>
<td>Finanzinformationenverordnung (Financial Information Regulation)</td>
</tr>
<tr>
<td>FinAnV</td>
<td>Finanzanalyseverordnung (Regulation on Investment Research)</td>
</tr>
<tr>
<td>Fina-RisikoV</td>
<td>Finanz- und Risikotragfähigkeitsinformationenverordnung</td>
</tr>
<tr>
<td>FINREP</td>
<td>Framework for Consolidated Financial Reporting</td>
</tr>
<tr>
<td>FIU</td>
<td>Financial Intelligence Unit</td>
</tr>
<tr>
<td>FMSA</td>
<td>Bundesanstalt für Finanzmarktstabilisierung (see FAFMS)</td>
</tr>
<tr>
<td>FRG</td>
<td>Federal Republic of Germany</td>
</tr>
<tr>
<td>FSA</td>
<td>Financial Supervisory Authority</td>
</tr>
<tr>
<td>FSAP</td>
<td>Financial Services Action Plan</td>
</tr>
<tr>
<td>FSIB</td>
<td>Financial Stability Board</td>
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<tr>
<td>FTE</td>
<td>Full-time employee</td>
</tr>
<tr>
<td>FWB</td>
<td>Frankfurter Wertpapierbörse (Frankfurt Stock Exchange)</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>GAS</td>
<td>German Accounting Standards (DRS Deutsche Rechnungslegungs Standards)</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product (Bruttoinlandsprodukt)</td>
</tr>
<tr>
<td>GDR</td>
<td>German Democratic Republic (former East Germany)</td>
</tr>
<tr>
<td>GK</td>
<td>Gesellschaft für Konsumforschung</td>
</tr>
<tr>
<td>GmbH</td>
<td>Gesellschaft mit beschränkter Haftung (private limited company)</td>
</tr>
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<td>GL</td>
<td>Guideline</td>
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<tr>
<td>G-SIBs</td>
<td>Global systemically important banks</td>
</tr>
</tbody>
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Abbreviations

G-SII  Global systemic institution
GroMiKV  Groß- und Millionenkreditverordnung
GW  Geldwäsche (Money Laundering)
GWB  Gesetz gegen Wettbewerbsbeschränkungen (German Act against Restraints on Competition)
GWG  Geldwäschegesetz (Money Laundering Act)
GewStG  Gewerbesteuergesetz (German Trade Tax Act)
HR  Human Resources (Personalabteilung)
IAS  International Accounting Standards
IBAN  International Bank Account Number
ICAAP  Internal Capital Adequacy Assessment Process
IDW  Institut der Wirtschaftsprüfer (German Institute of Certified Public Accountants)
i.e.  id est (it is/that is)
IFRS  International Financial Reporting Standards
IIC  Industrial Investment Council
IMWF  Institut für Management- und Wirtschaftsforschung (Institute for Management and Economic Research)
Instituts-VergV  Instituts-Vergütungsverordnung (Remuneration Ordinance for Institutions)
IRB  Internal Ratings-Based
ISAE  International Standards on Assurance Engagements
ISD  Investment Services Directive
IT  Information Technology
ITS  Implementing Technical Standards
JST  Joint Supervisory Team
KAGB  Kapitalanlagegesetzbuch (German Investment Code)
KERT  Key entrepreneurial risk taking function
KIW  Kreditanstalt für Wiederaufbau
KG  Kommanditgesellschaft
KGaA  Kommanditgesellschaft auf Aktien
KPI  Key Performance Indicators
KStG  Körperschaftsteuergesetz (German Corporation Tax Act)
KWG  Kreditwesengesetz (Banking Act)
LCR  Liquidity coverage ratio
LGD  Loss given default
LiqV  Liquiditätsverordnung
LSI  Less significant institution
M  Maturity
M&A  Mergers and Acquisitions
MaComp  Mindestanforderungen Compliance (Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant to Sections 31 et seq. of the
Abbreviations

Securities Trading Act (Wertpapierhandelsgesetz - WpHG) for Investment Services Enterprises

MAD Market Abuse Directive

MaH Mindestanforderungen an das Betreiben von Handelsgeschäften der Kreditinstitute (Minimum requirements for the trading activities of credit institutions)

MaIR Mindestanforderungen an die Ausgestaltung der Internen Revision der Kreditinstitute (Minimum requirements for the internal audit function of credit institutions)

MaK Mindestanforderungen an das Kreditgeschäft der Kreditinstitute (Minimum requirements for the credit business of credit institutions)

MaRisk Mindestanforderungen an das Risikomanagement (Minimum Requirements for Risk Management)

MFI Monetary financial institution

MiFID Markets in Financial Instruments Directive (Finanzmarktrichtlinie)

NATO North Atlantic Treaty Organization

NFC Near field communication

NRW Nordrhein-Westfalen (North-Rhine-Westphalia)

NYSE New York Stock Exchange

OECD Organization for Economic Cooperation and Development (Organisation für wirtschaftliche Zusammenarbeit und Entwicklung)

OFAC US Office of Foreign Asset Control

oHG Offene Handelsgesellschaft (General Partnership)

O-SII Other systemically important institutions

OTC Over-the-counter

P&L Profit and Loss

para. Paragraph

PB Private Banking

PD Probability of Default

PDCA plan-do-check-act

PE Permanent Establishment

PEP Politically Exposed Person

PMI Post-merger Integration

PPI Process performance indicators

POS Point of Sale

PrüfBV Prüfungsberichtsverordnung (Federal Financial Supervisory Authority’s regulation on audit reports)

PSV Pensionssicherungsverein (Pension Security Association)

QE Quantitative Easing

RFI Request for Information

RFP Request for Proposal
ROE Return on equity
ROPO Research online and purchase offline
RTS Regulatory Technical Standards
RW Risk weight
SA Standardised Approach
SEPA Single Euro Payments Area
SGB Sozialgesetzbuch (Social Security Code)
SLA Service Level Agreement
SME Small and medium sized enterprises (Kleine und mittlere Unternehmen)
SPD Sozialdemokratische Partei Deutschlands (Social Democratic Party)
SolvV Solvabilitätsverordnung
SRB Single Resolution Board
SREP Supervisory Review and Evaluation Process
SRF Single Resolution Fund
SRMR Single Resolution Mechanism Regulation
SRP Supervisory Review Process (Bankaufsichtlicher Überprüfungsprozess)
SSC Shared Service Center
SSM Single Supervisory Mechanism (Einheitlicher Aufsichtsmechanismus)
SRM Single Resolution Mechanism (Mechanismus zur Bankenabwicklung)
StGB Strafgesetzbuch (Criminal Code)
STP Straight-through Processing
STPO Strafprozessordnung (Code of Criminal Procedure)
STS Simple, transparent and standardised
T2 Tier 2
TG Tarifgruppen (pay scale groups)
USA United States of America
US GAAP US Generally Accepted Accounting Principles
UStG Umsatzsteuergesetz (Value Added Tax (VAT) Act)
VAT Value Added Tax (Umsatzsteuer)
VBG Verwaltungsberufsgenossenschaft (Professional association for administrative employment)
ver.di Vereinte Dienstleistungsgewerkschaft (United Trade Union of the Services Industry)
WpD-VerOV Wertpapierdienstleistungs-, Verhaltens- und Organisationsverordnung (Investment Services Conduct of Business and Organisation Regulation)
WpHG Wertpapierhandelsgesetz (Securities Trading Act)
WpHMV Wertpapierhandel-Meldeverordnung (Securities Transaction Reporting Ordinance)
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<tr>
<td>WPO</td>
<td>Wirtschaftsprüferordnung (Law Regulating the Profession of Certified Public Accountants)</td>
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<tr>
<td>XML</td>
<td>Extensible Markup Language</td>
</tr>
<tr>
<td>ZAG</td>
<td>Zahlungsdiensteaufsichtsgesetz (Payment Services Supervision Act)</td>
</tr>
<tr>
<td>ZAV</td>
<td>Zentrale Auslands- und Fachvermittlung (International Placement Service)</td>
</tr>
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Germany in facts and figures

Dr Oliver Wagner, Association of Foreign Banks in Germany, Frankfurt am Main

The following chapter does not set out to provide a detailed picture of all relevant ‘environmental’ aspects that are encountered when setting up business in Germany and should therefore not be read as such. Instead, the primary goal of the following chapter is to provide a general introduction to some selected characteristics of Germany that will not be covered later in this book.

1 General information

The Federal Republic of Germany (FRG) is located in the heart of Europe and the EU. It is the third biggest EU Member State in terms of area after France and Spain, covering an area of around 357,000 square kilometres, stretching around 900 kilometres from north to south and around 600 kilometres from east to west. With more than 80 million inhabitants, Germany has the largest population of any EU Member State. There are 16 federal states (Länder) which enjoy their own powers in some areas, especially in the field of education.

Germany has direct borders with or is easily accessible from many EU Member States, among which are those European countries with the biggest economies and/or the leading financial centres in Europe; Germany’s central location therefore makes it a top choice for international companies planning to set up a business in Europe. Since the fall of the Iron Curtain in the late 1980s and early 1990s, Germany has also developed into one of the major hubs for conducting business in the transforming states of Central and Eastern Europe, most of which joined the EU in May 2004. It also enjoys excellent ties with Russia.

Climatic conditions in Germany are moderate. Summers can be hot in the lower regions. Winters in these areas, however, tend to be mild, with temperatures seldom falling below freezing point. Higher regions enjoy cooler temperatures in both summer and winter. Overall, rainfall and snowfall are moderate.

2 Population

With more than 80 million inhabitants, Germany has the largest population of all EU Member States, making up 17% of the EU population. It is followed by France (66 million), the United Kingdom (65 million) and Italy (61 million). The population is largely ethnic Germans, but there are according to the Central Foreigners Register about 9 million foreign residents (around 11.2 % of the
overall population) from a large number of different countries live permanently in Germany today. The largest group of foreigners living in Germany today are of Turkish origin, followed by Slavs. North Rhine-Westphalia is Germany’s most populated federal state (17.6 million inhabitants), followed by Bavaria (12.7 million) and Baden-Württemberg (10.7 million). The federal state of Hessen, which has the financial centre of Frankfurt, has almost 6.1 million inhabitants.

The overall size of the population together with the generally high purchasing power (average annual income currently around €32,000) is one of the main reasons why the potential of the German (consumer) market is generally perceived to be huge. Added to the market attractiveness is the fact that over 100 million consumers can be reached in neighbouring German speaking countries like Austria and Switzerland through a presence in Germany.

3 Language and education

The sole official language is German, and literacy is high for most Germans, many of whom speak one or more foreign languages. The most important foreign language is English, followed by French, Spanish and – especially in the eastern part due to historical reasons – Russian. Large international firms located in Germany, whether German or foreign owned, increasingly use English internally as an official company language.

The standard of the German educational system is high in schools, vocational education and universities. Highly skilled staff are available at all levels. German labour is perceived as being highly skilled and productive.

The educational system is regulated by the federal states, thereby leading to regional differences. Generally, education starts with pre-school education that is provided in kindergarten. Children usually enter primary school (Grundschule) at the age of six. After completing primary school, children attend secondary school: at this level, there are secondary general schools (Hauptschule), intermediate schools (Realschule), grammar schools (Gymnasium) and comprehensive schools (Gesamtschule). Whereas state schools are the most common form of school education, various private schools have also been founded in recent years.

A certificate of higher education entrance qualification (Abitur, Allgemeine Hochschulreife) or certificate of the University of Applied Sciences (Fachhochschule) entrance qualification (Fachhochschulreife) – the exams for both of which are passed at grammar school – are required for admission to a higher education institution.
The dual system of vocational training consists of education in schools and internships. This differs from the purely academic vocational education customary in other countries. Training within this system takes from two to three and a half years. The content is tailored to the demands that trainees will face in their later professional life.

The centres of academic education in Germany are universities and equivalent institutions, including the so-called 'Fachhochschulen', Universities of Applied Sciences, which are increasingly attractive types of higher education institutions, offering practical courses in the sciences. Following the European Bologna Process, universities and other institutions offer bachelor and master degrees instead of the degrees formerly known as Diplom or Magister. While a lot of universities are publicly run, a number of business run schools have been founded recently. Depending on the federal state, universities will ask for fees.

4 A very brief history

The FRG was founded after World War II in 1949. Almost immediately after the Second World War, the US and the UK moved to establish a future German government by creating a central economic council for their two zones, which later merged with the French zone. The western part of the country became the Federal Republic of Germany, while in the Soviet zone in the east, the German Democratic Republic (GDR), was founded in 1949. From this point onwards, Germany remained a divided country for just over 40 years.

Since its foundation, the Federal Republic has been integrated within international organisations and cooperations of the Western hemisphere including, first and foremost, what is now the EU (of which the FRG was one of the founding members in 1957), NATO, the UN and the OECD. The FRG's integration within the (now) EU has had a considerable impact on the German political and legal environment in which companies operate.

After the Wall came down in 1989, the FRG and the GDR were finally reunited on 3 October 1990, with this day now being a national holiday in Germany. In June 1991, the German Bundestag decided to move the seat of government from Bonn to Berlin. Today, Berlin is the capital of the Federal Republic of Germany and the location of Germany's core government functions. Nearly every ministry still has offices in Bonn, the former capital of the FRG.

5 Political system

As the name suggests, the Federal Republic of Germany is a federation consisting of several individual federal states (Bundesländer) that are organised
Germany in facts and figures

according to democratic principles. These 16 federal states – the larger of which are (measured by number of inhabitants) North-Rhine Westphalia, Bavaria, Baden-Württemberg, Lower Saxony and Hessen – are not dependent provinces, but rather self-governing states. The federal states have their own constitutions, which must be consistent with the same principles as the Basic Law of the Federal Republic (Grundgesetz). The Basic Law ensures a republican, democratic and socially responsible constitutional state in which all Germans can enjoy uniform rights and duties and comparable living conditions. Within this framework, the federal states have a free hand in setting their own constitutional priorities. This specific form of federalism is one of the core principles of the Basic Law (Grundgesetz), which was enacted on 23 May 1949.

At both federal level and state level, systems of checks and balances are in place with their own executive, legislative and judicial branches. At federal level, the executive branch includes:
- the Federal President (Bundespräsident) as the highest representative of the country but with only marginal executive power, and
- the Federal Government (Bundesregierung) headed by the Chancellor who is elected by the lower house of parliament (Bundestag).

The legislature consists of:
- the Bundestag (lower house of parliament), which is directly elected by the German citizens and holds the main legislative power at federal level, and
- the Bundesrat (upper house of parliament) consisting of representatives of the federal state governments.

The third and final component of the checks and balances system is the independent judicial system, which consists of District Courts (including Amtsgericht and Landgericht), Appellate Courts (including Landgerichte, Oberlandesgerichte/Kammergericht and the Bundesgerichtshof) and the Constitutional Court (Bundesverfassungsgericht). Issues of constitutional importance are brought before the Bundesverfassungsgericht as the court of last resort.

In recent years with European integration proceedings, the decisions of the European Court of Justice, the supreme decision-making body for issues relating to the fundamental freedoms guaranteed in the European Union Treaty, have significantly gained importance domestically and are likely to become even more important in the future. A significant number of national political issues have already been influenced by the rulings of the European Court.
The cooperation between the federal and state level functions operates as follows:

- The federal states are responsible for those areas of legislation not explicitly granted to the federal government in the Basic Law, which are education (schools and universities), cultural policy, the press, police law, and local government.
- Direct federal administration is limited to the foreign service, customs, the border agency, the armed forces, and the labour office. All other administration is provided by the states independently, even if legislation in these areas is developed at federal level.
- In fact, the power vested in the federal states within the German political system mainly derives from their administrative functions and their participation in the legislative process at federal level through the Bundesrat. The federal states are responsible for all internal administration matters. They also implement most federal laws and regulations. In this respect, federal state administration performs three tasks: it handles matters that fall exclusively within its own jurisdiction; it implements federal law in its own right and on its own responsibility; and it implements federal law on behalf of the federal government.
- The federal scope within the judicial system is granted by Federal Courts, mainly the Federal Constitutional Court and the Federal Supreme Court (Bundesverfassungsgericht, Bundesgerichtshof). These courts ensure uniform interpretation of the law throughout Germany. All other courts come under the jurisdiction of the individual federal states.

6 Some structural aspects of the legal system

The body of German federal laws encompasses more than 2,000 Acts and 3,500 Statutory Instruments. These are complemented by the Acts and regulations at federal level.

The Bundestag passes laws enacted at federal level, and the federal government enacts regulations on the basis of these laws. Laws regulating certain industries such as the financial services industry and tax laws are normally passed at federal level.

In the field of European financial regulation a clear shift can be detected from national implementation of European Directives to directly binding European Regulations. As these rules are accompanied by technical standards, guidelines and FAQs of the EBA and ESMA, national laws are being replaced more and more by European regulation aiming to adhere the “Single Rulebook”, this being a set of harmonised rules which are to be respected throughout all EU institutions. In the medium term this will have an effect on the legal system, not
least in the financial sphere. In addition, the European Central Bank (ECB) as well as the Single Resolution Board (SRB) are increasingly developing in the direction of standard setters, not only for their supervised SSM banks but also for the other European banks as well due to the model function.

The judicial administration in the Federal Republic can broadly be set out as follows:

- **Ordinary courts** (ordentliches Gericht) are responsible for criminal matters, civil matters (such as disputes arising from contracts under private law, e.g. sale or rental agreements), family proceedings and non-contentious legal proceedings. There are four levels: the local court (Amtsgericht), the regional court (Landgericht), the higher regional court (Oberlandesgericht/Kammergericht) and the Federal Court of Justice (Bundesgerichtshof).

- **Labour courts** (Arbeitsgericht) are responsible for disputes arising from employment contracts or between management and the labour force as well as matters covered by the Works Constitution Act (Betriebsverfassungsgesetz). There are two levels of appeal (Landesarbeitsgericht, Bundesarbeitsgericht).

- **Administrative courts** (Verwaltungsgericht) are responsible for legal protection against all administrative acts and other administrative proceedings. There are two levels of appeal (Oberverwaltungsgericht, Bundesverwaltungsgericht).

- **Social security courts** (Sozialgericht) rule on disputes arising from all areas of social security. There are also two levels of appeal.

- **Financial courts** (Finanzgericht) are responsible for matters of taxation and other various related matters.

Amongst the different branches of jurisdiction mentioned above, the most important one for foreign companies is the civil division of the different levels of ordinary courts and, in fewer cases, the administrative courts.

7 Business geography and infrastructure

Business in general is not concentrated in one specific region but rather scattered all over the country with some industry-specific clusters in certain regions. As with the other industries, the financial industry is not exclusively concentrated in one specific area. Nonetheless, Frankfurt am Main and the Rhine-Main region rank as the leading financial centre in Germany and in continental Europe, coming second to London within the EU. Other financial centres are Munich, Düsseldorf and Hamburg. There are also local stock exchanges in some federal capitals. Below are some of the reasons why Frankfurt is the biggest financial centre:
• Traditionally, Frankfurt has been the headquarters for a large majority of German banks like Deutsche Bank, Commerzbank, KfW, DZ Bank, Deka Bank and Helaba.
• Practically all other banks and other financial services companies located elsewhere in Germany have set up large regional offices in the area.
• Some major domestic and international insurance companies are located in Frankfurt am Main and the neighbouring city of Wiesbaden.
• Deutsche Börse Group, operating some of the leading exchanges worldwide for both equities (Frankfurt Stock Exchange; FWB) and derivatives (Eurex), is located in the Frankfurt area. Through Xetra, its electronic trading platform, FWB is today one of the largest electronic cash stock markets worldwide.
• The German Federal Bank (Bundesbank) is located in Frankfurt am Main.
• Frankfurt am Main is the host city of the EU insurance supervisory body known as the European Insurance and Occupational Pensions Authority (EIOPA).
• Finally, the European Central Bank (ECB) has its premises in Frankfurt am Main. Not only due to its monetary policy for the eurozone but especially against the backdrop of the role of the ECB as the banking supervisory authority for the large banks (balance sheet of more than €30 billion) of the eurozone, the city is the centre of monetary and supervisory policy for this area.

As a result of this agglomeration of financial institutions, the vast majority of foreign financial firms – about 80% of foreign institutions with a presence in Germany – have also decided to set up operations in Frankfurt am Main; a fitting indication of the importance of this city and region from an international perspective.

The second most important financial centre in Germany is Munich, which has been the domestic centre of the insurance industry with two of the world’s biggest insurance companies located there. Also, one of the big German banks, HypoVereinsbank, which now is owned by UniCredit, is headquartered in Munich. Over recent years quite a few foreign banks from Austria, Switzerland and Italy have established their offices in Munich and to some extent other regions in the federal state of Bavaria. HSBC Trinkaus & Burkhardt AG is located in Düsseldorf as well as a majority of the Japanese banks and some from Turkey, while Hamburg hosts most of the foreign banks who have their headquarters in Scandinavia or in Iran.

The transportation infrastructure in Germany is highly developed, with a tight network of around 13,000 kilometres of motorways throughout the country and 21 international airports, the most important ones being located in Frankfurt am Main, Munich and Düsseldorf. Some of the major seaports worldwide offer easy access to the North Sea and the Baltic Sea. A close network of connections
via plane and high-speed trains connect the major business centres not only within Germany, but also between Germany and other European countries. The technical infrastructure for data transfer is also highly developed.

8 Economy

Germany has a so-called ‘social market economy’, which is a system based on free market principles such as competition and free enterprise. It is supplemented by some strong social elements, especially an extensive pay-as-you-go system of social security organised and partially financed by the State.

Since the foundation of the FRG after World War II in 1949 and well into the 1970s, Germany experienced dynamic and almost uninterrupted economic growth. This development that built the basis for economic prosperity of large parts of the German population became known as the internationally renowned Wirtschaftswunder, which largely transformed German society into a typical middle class society. As a result of this success story, the German economy and the underlying ‘social market principle’ were soon regarded as a model for the successful development of transitional economies.

Today, Germany is one of the leading industrialised nations, the world’s fourth largest economy after the US, Japan and China and by far the largest in Europe with an annual nominal GDP of almost €3.03 trillion in 2015, which is about 20% of the EU’s GDP and 30% of the eurozone’s GDP. Traditionally, the German economy has been highly export oriented. Nowadays many German companies, as well as many medium sized entities (the ‘Mittelstand’), are international market leaders in their respective fields of business.

9 Currency

The official currency in Germany and in other Member States of Economic and Monetary Union (EMU) is the euro. When the euro was first issued in January 1999, the third stage of EMU was implemented, and the exchange rates between the domestic currencies of Member States and the euro were fixed (the exchange rate between the former Deutschmark (DM) and the euro was fixed at DM 1.95583 for one euro). Monetary policy, which is primarily aimed at guaranteeing price stability, is conducted by the so-called European System of Central Banks (ESCB), which is headed by the ECB and comprises the former independent central banks of the Member States participating in EMU. The Bundesbank is part of the ESCB.
Influence of the EU

As with all EU Member States, the influence of the EU on German domestic legislation has increased substantially in recent years – notably since the emergence of the single European market and the implementation of the Maastricht Treaty in 1993. This is especially true in the case of legislation governing the financial services sector.

Today, an estimated 80% of domestic legislation has already been driven by EU initiatives in the financial services industry. One of the main drivers of this development has been the so-called Financial Services Action Plan (FSAP) introduced in 1999, which stipulated a total of 42 legislative measures that were to be applied in each EU Member State by 2005. The purpose of the FSAP has been to harmonise the regulatory framework of financial services in Europe and thus to make financial services the model industry for further harmonisation and to create a common market in Europe. One of the outcomes of the financial crisis was a new European regulation and supervisory set-up. The implementations of Basel III, the Alternative Investment Fund Managers Directive (AIFMD), the European Market Infrastructure Regulation (EMIR), the Market Abuse Regulation, the Regulation on short selling, MiFID II, UCITS V and quite a lot of further regulations lead to a much more harmonised rule book than before the beginning of the crisis. The famous “Single Rulebook” for the financial industry is becoming a reality, especially as a lot of new regulation is implemented by directly applicable European Regulations instead of Directives as in the past. In line with this trend, national options and discretion are therefore gradually being eroded.

Furthermore, in establishing 2011 the European Banking Authority (EBA) in London, the European Securities and Markets Authority (ESMA) in Paris and the European Insurance and Occupational Pensions Authority (EIOPA) in Frankfurt am Main, a new chapter in European supervision was opened. This was consequently promoted when in 2012 the decision was taken to shift the power of the supervision of the largest banking groups from the eurozone from the national authorities to the ECB (see Chapter C Supervisory authorities, p. 51).

On 4 November 2014 this new era of banking supervision in Europe had begun when the ECB became the competent authority for the 120 biggest banking groups of the eurozone. For all other 3,500 banks the ECB will also set and monitor the supervisory standards, working closely with the national competent authorities in the supervision of these banks. The ECB directly supervises around 130 significant banks of the participating countries. These banks hold almost 82% of banking assets in the eurozone.
A still non-harmonised area is taxation. Tax legislation is still left to the domain of the national legislators of EU Member States. However, in recent years the rulings of the European Court of Justice have increasingly forced national governments to introduce non-discriminatory tax treatment of foreign companies compared to domestic enterprises in order to bring harmonisation of corporate taxes to all companies, both foreign and domestic.

11 Further information

Further general information on the matters discussed above may be found on the following websites:

- www.invest-in-germany.de (website of the official German Investment Agency)
- www.bmwi.de (website of the Federal Ministry of Economics and Technology)
The banking industry in Germany

B The banking industry in Germany

Dr Oliver Wagner, Association of Foreign Banks in Germany, Frankfurt am Main

1 Specific characteristics of the German banking system

The German financial system has unique characteristics that differentiate it from other financial systems both in the US as well as in certain European countries. In a nutshell, the banking system is fairly fragmented and is highly competitive, especially in the field of retail. Some voices see this fragmentation as one of the main reasons why only a few banks have brushed with insolvency since the outbreak of the crisis in 2007, though some doubt this especially due to the crucial situation in some publicly owned banks which were stabilised by the Länder and the Federal State.

1.1 Universal banking system

Germany has traditionally had a universal banking system where the vast majority of German banks are typically active in the full range of banking activities rather than being (voluntarily) specialised or (legally) restricted to certain activities. While legislation has not changed with respect to the financial sector, there has, however, been some movement towards greater specialisation on core competencies in most of the big German banking groups.

1.2 Bank based financial system

Germany has been widely characterised as having a bank based (compared to a market based) financial system. Although there has been a certain trend during the financial crisis towards firms using the capital markets more frequently for funding purposes, bank loans are still the predominant form of funding for firms and will remain so for now. One of the main reasons for this is the famous ‘Mittelstand’ of which only a few are beginning to access to the capital market by issuing corporate bonds.

1.3 House bank principle

An important characteristic of the German banking system is the close bank-customer relationship, which is commonly referred to as the ‘house bank principle’. Until now, German enterprises and individuals had concentrated on a close relationship with one dominant credit institution in all financial matters. However, this close relationship is beginning to loosen and German companies
are now likely to maintain close relationships with two or three banks instead of merely one bank, with one being foreign. Increasing competition from abroad has been one of the significant factors in relation to this recent development as well as the stepping back of German banks from abroad. Furthermore, in the retail business quite a few online banks also offer accounts as well as internet brokerage and are quite successful when it comes to offering the classic branch services.

1.4 Fragmentation

With around 1,800 independent banks and 35,000 branches at the end of 2015, the German banking system is still one of the more fragmented banking systems in Europe, and is often described as being 'overbanked' and 'over-branched'. Nonetheless, the German banking industry has shown a steady trend towards consolidation over the last few decades. This trend has intensified in recent years. For example, 15 years ago there were around 3,500 independent banks with 47,000 branches. The main deficiency of this development is, however, that it has only taken place within but not yet between the traditional 'pillars' of the German banking industry. It is likely that there will be further mergers especially in the area of the savings banks and the cooperative banks due to the increased and costly regulatory requirements resulting from the new banking and financial regulation following the financial crisis as well as from higher contributions for the banking levy and the deposit guarantee schemes.

1.5 Three pillars

One of the more prominent issues of German banking is the division of existing institutions into three pillars – private banks, cooperative banks and public sector banks (Landesbanken and Sparkassen) – and the difficulties in overcoming this 'pillarisation' via consolidation. The traditional pillars are defined along the legal structure and ownership of the respective institutions. Mergers between institutions from different pillars are difficult since some mergers are blocked due to legal barriers protecting the pillars.

2 Structure of the German banking industry

As already highlighted in the previous chapter, the German banking system is characterised by a number of structural specifics that differentiate it from other significant banking systems around the world. Without repeating the points already made earlier, the following paragraphs will deal with the underlying structure in more detail.