

Banking Business in Germany

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

5th revised edition



Verband der
Auslandsbanken
in Deutschland e.V.

Association of Foreign
Banks in Germany

Published by
Fachverlag Moderne
Wirtschaft GmbH

Fachverlag
Moderne Wirtschaft

Banking Business in Germany

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

5th revised edition



Verband der
Auslandsbanken
in Deutschland e.V.

Association of Foreign
Banks in Germany

Published by
Fachverlag Moderne
Wirtschaft GmbH

Fachverlag
Moderne Wirtschaft

Banking Business in Germany

Edited by Jens Rönning (PwC) and Dr Oliver Wagner (Association of Foreign Banks in Germany)

By Yaprak Akyol, Nina Bartholmes, Sascha Demgensky, Dr Nicole Elert, Markus Erb, Christina Grulke, Eva Handrick, Julia Karlstedt, Andreas Kastl, Dr Holger Kern, Marco Libudda, Dr Angelika Meyding-Metzger, Martina Rangol, Jens Rönning, Hiltrud Thelen-Pischke, Wolfgang Vahldiek, Dr Oliver Wagner, Christine Wicker, Maxi Wilkowski, Elke Willy, Herbert Zerwas

5th revised edition, October 2016, 428 pages, 43 figures, 48 tables, softcover

ISBN 978-3-934803-82-4

Fachverlag Moderne Wirtschaft GmbH, Frankfurt am Main

© October 2016 PricewaterhouseCoopers Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft. All rights reserved.

This material may not be reproduced in any form, copied onto microfilm or saved and edited in any digital medium without the express permission of the editor.

This publication is intended to be a resource for our clients, and the information therein was correct to the best of the authors' knowledge at the time of publication. Before making any decision or taking any action, you should consult the sources or contacts listed here. The opinions reflected are those of the authors.

Druck:
Xerox GmbH, Neuss

In this document, "PwC" refers to PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

Printed in Germany.

Bibliographic information published by the Deutsche Nationalbibliothek

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data are available on the internet: <http://dnb.ddb.de>

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

Table of Contents

Preface	3
Figures	17
Tables	20
Abbreviations	23
A Germany in facts and figures	31
1 General information	31
2 Population	31
3 Language and education	32
4 A very brief history	33
5 Political system	33
6 Some structural aspects of the legal system	35
7 Business geography and infrastructure	36
8 Economy	38
9 Currency	38
10 Influence of the EU	39
11 Further information	40
B The banking industry in Germany	41
1 Specific characteristics of the German banking system	41
1.1 Universal banking system	41
1.2 Bank based financial system	41
1.3 House bank principle	41
1.4 Fragmentation	42
1.5 Three pillars	42
2 Structure of the German banking industry	42
2.1 Commercial banks	43
2.2 Savings banks (Sparkassen) and Landesbanken	44
2.3 Cooperative banks ('Volks- und Raiffeisenbanken')	44
2.4 Mortgage banks	45
2.5 Development banks	45
2.6 Building and loan associations	46
2.7 Non-bank financial intermediaries	46
3 Foreign banks in Germany	46
3.1 Presence of foreign banks in Germany	47
3.2 Business model	47
3.3 Market shares	48
4 Recent developments	49
5 Further information	49

C	Supervisory authorities	51
1	The new European supervisory environment	51
2	The SSM banking supervision.....	51
3	German banking supervision.....	53
3.1	The Federal Financial Supervisory Authority	54
3.2	The Bundesbank	55
4	The Resolution Agencies	56
D	Deposit guarantee and investor compensation schemes	57
1	Two schemes for foreign banks.....	57
2	Access to the schemes.....	57
3	Scope of protection.....	58
3.1	Claims protected.....	58
3.2	Creditors protected.....	58
3.3	Amounts protected.....	59
4	Contributions.....	59
5	Additional obligations of banks	60
6	Scheme for foreign investment firms	60
E	Market access to Germany – legal and regulatory implications.....	61
1	Subsidiary – make or buy?.....	62
1.1	Establishment of a subsidiary	62
1.1.1	Legal forms	62
1.1.2	‘Banking’ licence	62
1.1.2.1	Banking business.....	63
1.1.2.2	Financial services.....	64
1.1.2.3	Payment services	65
1.1.2.4	E-money business.....	66
1.1.2.5	General remarks	66
1.1.2.6	Exceptions.....	66
1.1.2.7	Competent authorities: Federal Financial Supervisory Authority, the Bundesbank and ECB.....	67
1.1.2.8	Preconditions for granting the licence.....	68
1.1.2.9	Application for the licence.....	72
1.1.2.10	Refusing the licence by the Federal Financial Supervisory Authority.....	73
1.1.2.11	Start of business.....	74
1.2	Acquisition of an institution.....	74
1.2.1	Notification procedure	74
1.2.2	Possibilities available to the regulatory authorities	76
1.2.3	Additional notification requirements for the holders of a major participating interest	78
1.2.4	Breach of the notification requirements.....	79
1.3	Pros and cons.....	79

2	Branches	80
2.1	Concept of a branch.....	80
2.1.1	Commercial law.....	80
2.1.2	Banking Act	80
2.2	Under the European Passport	80
2.2.1	Requirements	81
2.2.2	Obligations in Germany – Banking Act.....	81
2.3	Branches of non-EEA Member States	82
2.3.1	Licensing procedure	82
2.3.2	Supervision.....	83
2.3.3	Privileges for the USA, Japan and Australia	83
2.4	Specifics of the Payment Services Supervision Act.....	84
3	Cross-border activities	84
3.1	Under the European Passport	84
3.2	Third country.....	85
4	Representative office.....	85
5	Pros and cons	86
6	Summary	87
F	Strategy and operations	91
1	The retail banking market in Germany	91
1.1	Framework conditions in Germany.....	91
1.2	Characteristics and recent developments of the retail banking industry in Germany	92
1.3	Product portfolio in retail banking.....	98
2	Business model and strategy	101
2.1	Bank formation and market entry approach.....	101
2.2	Mergers and acquisitions	104
2.3	Business model.....	110
2.4	Outsourcing	115
3	Organisation and process management	118
3.1	Trends.....	118
3.2	Business process management	121
G	Outsourcing	123
1	Introduction	123
2	Legal sources and definition of outsourcing	124
3	Conditions and special requirements.....	125
4	Notification and reports.....	128
5	The German outsourcing market for financial institutes	128
6	Right steps towards successful outsourcing.....	133
6.1	Sourcing Requirement Assessment.....	133
6.2	Request for Information and Proposal.....	135
6.3	Setting up Service Level Agreements	136

6.4	Preparation for the transition	138
6.5	Successful management of providers	138
H	Prudential Supervision in Germany	141
1	Introduction.....	141
2	Scope of application of prudential requirements and definitions.....	145
2.1	CRR Institutions.....	146
2.2	Credit institutions and financial services institutions according to the Banking Act.....	147
2.3	Financial holding companies and other relevant entities.....	149
2.4	Trading book (business).....	151
3	The Capital Requirements Regulation (CRR)	152
3.1	Own funds.....	153
3.1.1	Own funds requirements for institutions and groups.....	153
3.1.2	Capital elements	159
3.2	Capital requirements.....	164
3.2.1	Credit risk.....	165
3.2.1.1	Standardised Approach	165
3.2.1.2	Internal Ratings Based Approaches.....	168
3.2.1.3	Securitisations and requirements for transferred credit risk	171
3.2.2	Operational risk.....	175
3.2.3	Market risk.....	176
3.2.4	CVA risk and counterparty credit risk	180
3.3	Large exposures.....	182
3.3.1	Excursus: EBA Guidelines on limits on exposures to shadow banking entities	184
3.4	Liquidity.....	185
3.4.1	EU branches.....	188
3.4.2	Non-EU branches	188
3.5	Leverage	188
3.6	Disclosure	189
3.7	Reporting requirements	191
4	The German Banking Act	192
4.1	Capital buffers.....	193
4.2	Loans exceeding €1 million and loans to related parties	195
4.3	Information required of debtors.....	196
4.4	Notifications and reporting requirements.....	197
4.5	Submission of annual accounts.....	198
4.6	Organisational duties and corporate governance	198
4.7	Remuneration policies	202
5	Outlook: Further Reforms induced by the Basel Committee	203

I	Minimum Requirements for Risk Management (MaRisk)	205
1	Overview of MaRisk	205
2	Risk-bearing capacity.....	206
3	Strategies	207
4	Internal Control System.....	207
5	Special functions	208
6	Operational and organisational structure.....	209
7	Latest revision of MaRisk under consultation	210
J	Prevention of money laundering, terrorist financing and other crimes	213
1	Laws to be observed and materials to be used	213
2	The role of the German supervisor	214
3	Scope of application	215
4	Internal security measures	215
4.1	AML officer and Central Office.....	215
4.1.1	Outsourcing	216
4.1.2	Reliability verification.....	216
4.1.3	Data protection laws and conflicts of interest.....	216
4.2	Threat analysis	217
5	Elements of money laundering.....	218
6	Elements of terrorist financing.....	218
7	Elements of other crimes	219
8	Diligence requirements.....	219
8.1	General diligence requirements.....	219
8.1.1	Identifying customers	220
8.1.2	Identifying the purpose of the business relationship	220
8.1.3	Identifying beneficial owners.....	220
8.1.4	Monitoring the business relationship.....	221
8.2	Simplified diligence requirements	222
8.3	Enhanced diligence requirements	222
8.3.1	Politically exposed persons.....	222
8.3.2	Physically non-present customers.....	223
8.3.3	Other high risk scenarios	224
9	Documentation and record keeping.....	224
10	Suspicious activity reports.....	224
K	Securities Trading Act	227
1	Scope of the Securities Trading Act (STA)	227
2	Reporting requirements.....	227
3	Rules of conduct.....	228
3.1	Client classification	228
3.2	Suitability and appropriateness tests	229
3.3	Client information.....	230

3.4	Inducements	230
3.5	Best execution	231
3.6	EEA branches and foreign service providers.....	232
4	Organisational requirements	232
4.1	General requirements.....	232
4.2	Managing conflicts of interest and staff transactions	233
4.3	EEA branches and foreign service providers.....	233
5	Other provisions	234
5.1	Insider Dealing and Market Abuse	234
5.2	Notification of shareholders' voting rights	234
L	Reporting requirements	235
1	Banking statistical reporting.....	235
1.1	Balance sheet statistics – BISTA.....	236
1.2	External positions of banks.....	237
1.3	MFI interest rate statistics	237
1.4	Statistics concerning the issuance of bonds	238
1.5	Borrowers' statistics	238
1.6	Securities holdings statistics	239
1.7	OTC derivatives statistics	239
1.8	Payment statistics.....	240
1.9	Statistics on the money markets	240
2	Prudential supervisory reporting.....	241
2.1	Regular prudential supervisory reporting.....	242
2.1.1	Financial information.....	242
2.1.1.1	Financial information according to the CRR (FINREP)	242
2.1.1.2	Financial information according to the Banking Act	243
2.1.2	Reporting regarding the institution's own funds	244
2.1.3	Leverage ratio	245
2.1.4	Reporting regarding the institution's liquidity and stable funding	245
2.1.5	Reporting concerning loans	245
2.1.5.1	Reporting of large exposures.....	245
2.1.5.2	Reporting of loans of €1 million or more.....	246
2.1.6	Submission of annual accounts, management report and auditor's reports.....	246
2.1.7	Further regular reports.....	247
2.1.8	Specifics with respect to EEA branches.....	248
2.2	<i>Ad hoc</i> prudential supervisory reporting.....	248
2.2.1	Notification of a qualified participating interest	248
2.2.2	Further notification duties	249
2.3	Exemptions	251
2.4	Prudential supervisory reporting with respect to payment service institutions and e-money institutions	251

3	External sector statistics reporting.....	252
3.1	Monthly reporting of incoming and outgoing payments.....	253
3.1.1	General reporting obligations.....	253
3.1.2	Exemption from reporting obligations.....	254
3.1.3	Reporting forms.....	254
3.1.4	Special reporting obligations for institutions.....	255
3.2	Reporting of positions of claims and liabilities.....	256
3.2.1	Monthly reporting of positions of claims and liabilities.....	256
3.2.2	Quarterly reporting of positions of claims and liabilities.....	257
3.3	Annual reporting of direct investment stocks.....	257
3.3.1	Residents' assets in foreign economic territories.....	257
3.3.2	Non-residents' assets in the economic territory.....	258
3.4	Submission of reports and reporting deadline.....	258
4	Further reporting obligations.....	259
5	Penalties.....	260
M Accounting Requirements.....		261
1	Overview of the legal framework.....	261
2	Financial statements.....	265
2.1	Components of financial statements.....	265
2.2	Recognition regulations.....	267
2.2.1	General remarks.....	267
2.2.2	Special requirements for banks.....	267
2.3	Valuation.....	268
2.3.1	General remarks.....	268
2.3.2	Special requirements for banks.....	270
2.4	Notes.....	272
2.5	Management report.....	273
2.6	Disclosure requirements.....	274
3	Consolidated financial statements.....	276
3.1	Overview.....	276
3.2	Exemption from the preparation of consolidated financial statements.....	278
3.3	Reporting entity (Commercial Code i.e. non-listed bank).....	278
3.4	Components of the consolidated financial statements.....	279
4	Interim financial reporting.....	279
5	Disclosure requirements pursuant to the Commercial Code for foreign credit institutions.....	280
5.1	Subsidiaries of foreign credit institutions.....	280
5.2	Branches of foreign credit institutions.....	280
5.2.1	Documents required.....	281
5.2.2	Language requirements.....	281
5.2.3	Deadline for disclosure.....	282
5.2.4	Recipient of the data.....	283

5.2.5	Responsibility for the disclosure.....	283
5.2.6	Costs and Penalties.....	283
N	Audit.....	285
1	Overview	285
1.1	Annual audit requirements	285
1.2	Branches of banks domiciled outside the European Economic Area	285
1.3	Branches of banks domiciled in another State of the European Economic Area.....	286
1.4	Timeframe.....	286
1.5	Legal framework.....	287
1.6	Audit subject.....	287
1.6.1	Economic condition.....	288
1.6.2	Audit of the reporting system.....	288
1.6.3	Audit of the equity situation and regulatory capital.....	289
1.6.4	Disclosure of financial situation of debtors.....	289
1.6.5	Implementation of a risk management system	289
1.6.6	Auditor specific reporting requirements	290
1.6.7	Regulatory reporting requirements	290
1.6.8	Special audit focus as defined by the Federal Financial Supervisory Authority	291
1.7	Reporting and communication	292
1.7.1	Auditor's long form report	292
1.7.2	Specific reporting obligations for auditors.....	295
2	Custodian business and investment services audit.....	295
2.1	Custodian business audit	295
2.2	Investment services audit.....	296
2.3	Branches of banks domiciled in another State of the European Economic Area.....	298
3	Special audits.....	298
3.1	Special audits for regulatory purposes	298
3.2	Special audits initiated by the deposit guarantee scheme	299
3.3	Special audits of commercial transactions or corporate actions	300
4	Auditors.....	300
O	Taxation on corporations	303
1	Sources of tax law	303
2	Principal taxes	305
2.1	Corporation Tax Act	305
2.1.1	General income determination	305
2.1.2	Thin capitalisation rules (interest deduction ceiling/interest barrier)	307
2.1.3	Income from dividends and capital gains.....	308

2.1.4	Loss deduction.....	309
2.2	Trade Tax Act	310
2.2.1	Tax liability and assessment procedure	310
2.2.2	Trade tax income	311
2.3	Tax group.....	314
2.4	Overall tax burden on income	316
3	Value Added Tax Act	316
3.1	Tax liability.....	316
3.2	Value Added Tax group.....	318
3.3	Place of supply of services.....	319
3.4	Invoice requirements	320
3.5	Obligation to file VAT returns	320
3.6	Electronic input VAT refund procedure (EU)	322
4	Withholding taxes	322
4.1	Withholding tax for capital investments	322
4.2	Other withholding taxes.....	324
5	Transfer pricing.....	324
6	Special features of permanent establishments.....	326
6.1	Obligation to keep records.....	327
6.2	Income determination	327
6.3	Endowment capital	329
6.4	VAT	331
7	Tax procedure.....	332
7.1	Disclosure requirements.....	332
7.2	Competence	332
7.3	Additional charges	334
7.4	Appeals	334
7.5	Tax audit.....	334
8	Taxation of partnerships.....	335
9	Bank levy (<i>Bankenabgabe</i>).....	335
10	Tax compliance.....	338
P	Taxation on individuals and the social security system	339
1	Income tax	339
1.1	Basis of taxation	340
1.1.1	Sum of net income.....	340
1.1.2	Dependent personal services (Employment)	341
1.1.3	Investment of capital.....	342
1.1.4	Other earnings.....	343
1.1.5	Loss offsetting.....	344
1.2	Special deductions.....	344
1.2.1	Overview	344
1.2.2	Children	345
1.2.3	Personal allowances for extraordinary financial burdens	346

1.2.4	Tax reduction for household related employment as well as tradesman's and other services	347
1.3	Income tax calculation	347
2	Ancillary taxes on income	348
3	Tax procedures	349
3.1	Income tax returns	349
3.2	Payment of income tax	350
3.2.1	Wage tax	350
3.2.2	Quarterly prepayments.....	353
3.2.3	Definitive withholding tax (<i>Abgeltungsteuer</i>)	353
3.3	Interest on tax payments.....	355
4	Gift and inheritance tax.....	355
5	Other taxes.....	356
6	Expatriates.....	357
7	Social security system.....	358
7.1	Overview	358
7.2	Pensions.....	359
7.3	Health insurance	360
7.4	Statutory nursing care insurance.....	362
7.5	Unemployment insurance.....	362
7.6	Occupational accident insurance.....	363
7.7	Foreign employees.....	363
7.8	Employer's obligations and costs.....	365
Q	Employment relations.....	367
1	Principles of employment law	367
1.1	Players.....	367
1.1.1	Employees and employers.....	367
1.1.1.1	Full time and part time employees	367
1.1.1.2	Freelancers.....	368
1.1.1.3	Temporary employees	368
1.1.2	Works council	369
1.1.3	Trade unions.....	370
1.1.4	Employers' association.....	370
1.1.5	Supervisory board.....	370
1.2	Legal sources.....	371
1.3	Impact of the number of employees	374
1.4	Hiring employees.....	376
1.4.1	Application and selection	376
1.4.2	Prohibition of discrimination.....	377
1.4.3	CV and references	377
1.4.4	Form and content of employment agreements	378
1.5	Dismissals	379
1.6	Minimum working conditions	383

Table of Contents

1.6.1	Minimum salaries, fixed salaries	383
1.6.2	Additional benefits	385
1.6.3	Sick pay	385
1.6.4	Working hours.....	385
1.6.5	Vacation entitlement	386
1.7	Specific provisions for managing directors.....	387
1.7.1	Statutory personnel requirements concerning the position.....	387
1.7.2	Legal limitations for bonuses and disclosure obligations.....	388
2	Work and residence permits for foreigners	390
2.1	Citizens from EU Member States	390
2.2	Third country nationals	391
2.3	Blue Card EU	392
3	Mergers and acquisitions of a bank or a business unit – employment law aspects	393
3.1	Share deal/asset deal	393
3.2	Transfer of business undertakings	393
3.2.1	Precondition	394
3.2.2	Passing of the employment relationships as a legal consequence	395
3.2.3	Information requirements and right of the employee to object.....	395
3.2.4	Liability of the seller and the acquirer.....	396
3.2.5	Impact on the works council and works council agreements.....	396
3.2.6	Impact on collective bargaining agreements.....	397
3.3	Transformations.....	397
	References	399
	Index	405
	Glossary	415
	Authors and contacts	425
1	PwC	425
2	Association of Foreign Banks in Germany	427

Figures

Fig. 1	Balance sheets total by banking groups.....	48
Fig. 2	Market shares of different banking groups in Germany at the end of Oct 2015.....	93
Fig. 3	Regulations' effect on retail banking ROE in Germany.....	97
Fig. 4	Earnings development of products in European retail banking.....	98
Fig. 5	Factors of bank formation.....	101
Fig. 6	Stages of market entry approach (first and second phase).....	103
Fig. 7	Stages of market entry approach (third and fourth phase).....	104
Fig. 8	European FS M&A total deal value 2003–2014, in € billions.....	105
Fig. 9	Typical deal process on buy-side.....	108
Fig. 10	Index capacity need by function (in %).....	112
Fig. 11	Opportunities in FinTechs (in %).....	113
Fig. 12	Customer facing roles and non-customer facing roles.....	120
Fig. 13	Make or buy decision.....	134
Fig. 14	Overview regulatory frameworks.....	141
Fig. 15	CRR & CRD IV go far beyond simple implementation of Basel III.....	143
Fig. 16	Hierarchy of supervisory rules in the banking sector.....	144
Fig. 17	Powers of the European Banking Authority (EBA).....	144
Fig. 18	Extension of scope of CRR through German Banking Act.....	146
Fig. 19	Activities falling within the scope of CRR.....	147

Figures

Fig. 20	Extension of scope of CRR according to Section 1a of the Banking Act.....	149
Fig. 21	Relevant groups according to the Banking Act	154
Fig. 22	Consolidation methods according to Article 18 of the CRR	157
Fig. 23	Qualitative criteria of CET1 capital instruments.....	160
Fig. 24	Qualitative criteria of AT1 and AT2 capital instruments	161
Fig. 25	Components of own funds	162
Fig. 26	Capital ratios.....	163
Fig. 27	Calculating the risk weight (RW) for securitisation exposures	174
Fig. 28	Risk drivers in banking book and trading book.....	177
Fig. 29	Calculation methods for market risk.....	179
Fig. 30	EMIR, CVA risk capital charge and CCP	181
Fig. 31	Calculation of liquidity coverage ratio (LCR).....	185
Fig. 32	Overview reporting templates for own funds and capital requirements	192
Fig. 33	Overview capital ratios and capital buffers	194
Fig. 34	Requirements for executive board members Section 25c of the Banking Act	200
Fig. 35	Obligations of executive board members Section 25c of the Banking Act.....	201
Fig. 36	Requirements for non-executive management Section 25d Banking Act.....	201
Fig. 37	Overview of “Basel IV” issues.....	204
Fig. 38	Overview MaRisk.....	206

Fig. 39 Conversion of items into foreign currency 270

Fig. 40 Three categories of securities 271

Fig. 41 Parent/subsidiary relationship 276

Fig. 42 Consolidated financial statements: IFRS or German
Commercial Code.....277

Fig. 43 Hierarchical structure of the various legal sources of
German employment law 374

Tables

Tab. 1	The 10 biggest banks in Germany.....	43
Tab. 2	The pros and cons regarding the establishment of a subsidiary or the acquisition of an institution	79
Tab. 3	The pros and cons of the European Passport.....	86
Tab. 4	Establishment of local premises	87
Tab. 5	Acquisition of a major participating interest (directly or indirectly at least 10% of the capital or voting rights)	89
Tab. 6	Cross-border services.....	90
Tab. 7	Own Funds – Overview of the final RTS	159
Tab. 8	Capital Requirements – Overview of the final RTS and ITS	165
Tab. 9	Assignment of credit quality steps to risk weights (in %).....	167
Tab. 10	Risk weights independent of creditworthiness	167
Tab. 11	The four phases of the regulatory review of the IRB Approach.....	170
Tab. 12	Credit risk – Overview of the final RTS.....	171
Tab. 13	Risk weights for securitisation exposures in %.....	173
Tab. 14	Securitisation – Overview of the final Guidelines.....	174
Tab. 15	Exposures to Transferred Credit Risk – Overview of the final RTS and ITS.....	175
Tab. 16	Operational Risk – Overview of the final RTS and Guidelines	176
Tab. 17	Specific risk own funds requirements of debt instruments in the trading book	178
Tab. 18	Market Risk – Overview of the final RTS and ITS	180

Tab. 19	Counterparty Credit risk – Overview of the final RTS	181
Tab. 20	Credit Valuation Adjustment Risk – Overview of the final RTS	181
Tab. 21	Large Exposures – Overview of the final RTS, ITS and Guidelines	184
Tab. 22	Liquidity – Overview of the final ITS and Guidelines.....	187
Tab. 23	Leverage - Overview of the final ITS.....	189
Tab. 24	Disclosure - Overview of the final ITS	190
Tab. 25	Reporting deadlines: Banking statistical reporting.....	241
Tab. 26	Reporting deadlines: Prudential supervisory reporting	252
Tab. 27	Reporting deadlines: External sector statistics reporting.....	259
Tab. 28	Overview of legal requirements.....	262
Tab. 29	Overview of application requirements of IFRS	264
Tab. 30	Balance sheet of a bank	266
Tab. 31	Extract of recognition regulations.....	267
Tab. 32	General principles of valuation	269
Tab. 33	Carrying amount of loans and advances.....	272
Tab. 34	Overview of the deadlines for preparation and for disclosure of financial statements	275
Tab. 35	Disclosure obligations for branches pursuant to the Commercial Code.....	282
Tab. 36	Deadline for the German branch's submission	283
Tab. 37	Structure of a long form report for a bank – Volume I.....	292
Tab. 38	Structure of a long form report for a bank – Volume II.....	294

Tables

Tab. 39	Municipal factors.....	311
Tab. 40	Examples of the effects of the interest related add-backs	312
Tab. 41	Free Float Clause	313
Tab. 42	Total tax burden on income (in %)	316
Tab. 43	Assessment period for preliminary VAT returns	321
Tab. 44	Other withholding taxes.....	324
Tab. 45	VAT competence.....	333
Tab. 46	Annual contribution of small institutions	337
Tab. 47	Income tax rates	348
Tab. 48	Wage tax categories.....	351

Abbreviations

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

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 Demokratische 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)

ELStAM	Elektronische Lohnsteuerabzugsmerkmale (wage tax deduction procedure)
ELStER	Elektronische Steuererklärung
EMU	Economic and Monetary Union (Europäische Wirtschafts- und Währungsunion)
ERP	Enterprise Resource Planning
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority (Europäische Wertpapieraufsichtsbehörde)
EstG	Einkommensteuergesetz (Income Tax Act)
ETL	Extract, Transform and Load
EU	European Union (Europäische Union)
EUR	Euro
FAFMS	Federal Agency for Financial Market Stabilisation (Bundesanstalt für Finanzmarktstabilisierung, FMSA)
FATCA	US Foreign Account Tax Compliance Act
FATF	Financial Action Task Force on Money Laundering
FDP	Freie Demokratische Partei (Free Democrats)
FGO	Finanzgerichtsordnung (Code of Fiscal Procedure)
FinaV	Finanzinformationenverordnung (Financial Information Regulation)
FinAnV	Finanzanalyseverordnung (Regulation on Investment Research)
Fina- RisikoV	Finanz- und Risikotragfähigkeitsinformationenverordnung
FINREP	Framework for Consolidated Financial Reporting
FIU	Financial Intelligence Unit
FMSA	Bundesanstalt für Finanzmarktstabilisierung (see FAFMS)
FRG	Federal Republic of Germany
FSA	Financial Supervisory Authority
FSAP	Financial Services Action Plan
FSB	Financial Stability Board
FTE	Full-time employee
FWB	Frankfurter Wertpapierbörse (Frankfurt Stock Exchange)
GAAP	Generally Accepted Accounting Principles
GAS	German Accounting Standards (DRS Deutsche Rechnungslegungs Standards)
GDP	Gross Domestic Product (Bruttoinlandsprodukt)
GDR	German Democratic Republic (former East Germany)
GfK	Gesellschaft für Konsumforschung
GmbH	Gesellschaft mit beschränkter Haftung (private limited company)
GL	Guideline
G-SIBs	Global systemically important banks

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
KfW	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

	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

Abbreviations

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)

WPO	Wirtschaftsprüferordnung (Law Regulating the Profession of Certified Public Accountants)
XML	Extensible Markup Language
ZAG	Zahlungsdiensteaufsichtsgesetz (Payment Services Supervision Act)
ZAV	Zentrale Auslands- und Fachvermittlung (International Placement Service)

A 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

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, legislature 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.

10 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)

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.