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The Impact of Brexit on Talent and Rewards in Germany

Banks, insurers, and other financial services institutions are in a race against the clock to clinch licenses and bolster their continental workforces before Britain leaves the EU. Without a comprehensive trade deal between the UK and EU that covers financial services, companies risk having no replacement for lost passporting rights, which currently allow firms to serve clients across the bloc.

The proposed Brexit withdrawal agreement has yet to gain parliamentary approval, putting in doubt a transition period that would extend cross-border access for banks until December 2020. This leaves firms with little choice but to shift employees, assets, and clients from the UK in preparation for a no-deal and no-transition scenario. According to Frankfurt Main Finance, estimate numbers are expected to range between €750bn and €800bn in transfer of assets from London to Frankfurt, the majority of which will be transferred in the first quarter of 2019.

Since the referendum on 23rd June 2016, 25 foreign banks have chosen to move operations and staff from London to Frankfurt. While on one hand, the German economy will benefit from this, the movement of staff can also lead to rising concerns among established firms in Germany, as it places increased pressure on the sensitive topic of compensation and competitive rewards.

For management and human resource professionals, this translates into some key questions—What does this mean for our existing people? What are the size and dynamics of the employment market in Germany? How many people do we need to hire and at what cost? What is the appropriate rate to pay people in the German market?

As the leading provider of pay and headcount data for the largest global, European, and regional banks, we have set out to answer some of these questions and leave firms with valuable insights on pay trends in the German market.

What is the size of the talent market in Germany?

A challenging economic environment, cost saving provisions, and continued institutional restructuring have all left their mark on the talent pool in the German financial market. Over the last 18 years, the headcount in banking has decreased from 775,000 employees to 586,000 by end of 2017. Nevertheless, by end of 2017, the main metropolis had approximately 63,000 bank employees—a number that is predicted to increase over the next two years due to Brexit.

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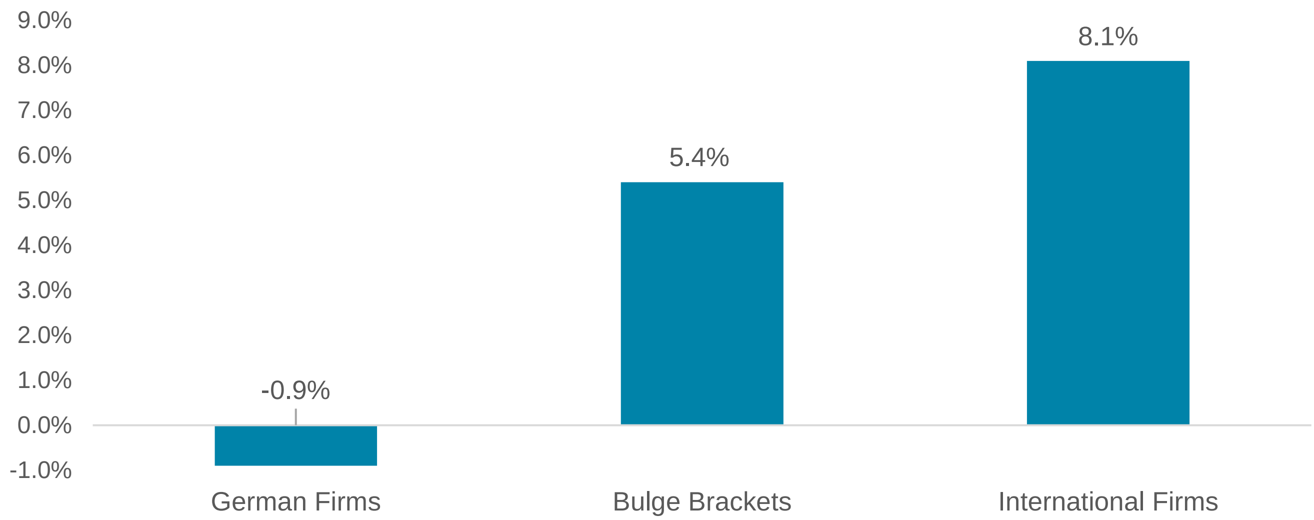
As per the McLagan database, from 2017 to 2018, the overall number of employees in the German financial market increased by 2.4%, whereby international firms have grown by 8.1% (albeit on a smaller base), followed by bulge brackets with an increase of 5.4%. German firms, on the other hand, have reduced their workforce in the same period by 0.9%.

YoY Headcount Change



Over the next two years, it is likely that this trend will continue. Most new hires, the majority middle and senior level employees, will come from international firms moving to Germany. Senior level hires could be particularly challenging given the limited talent pool available, as well as the additional Vorstand responsibilities that senior managers in Germany are required to have.

Did Brexit cause pay levels to increase in 2018?

While there is plenty of noise around Brexit driving firms to increase pay, the market does not yet fully reflect this. McLagan data shows that firms made very selective decisions over the last few quarters. Higher than market increases were typically seen when hiring for key senior management roles like Head of Businesses, Chief Operating Officers, or Chief Risk Officers.

Since the talent pool at international firms tends to be smaller compared to local German banks, it should come as no surprise that the larger increases in compensation were found at these highly competitive institutions.

McLagan survey data for 2018 further supports this trend, showing that employees at international firms experienced an average pay increase of 2% more compared to their peers at German firms. These results were driven by a significant salary increase in markets businesses including equity and debt, which reached double digits for international firms, as well as functions like risk and treasury on the support side (6% international firms vs. 0% German headquartered firms).

Based on 30 of the largest firms in the McLagan database (of approximately 150 firms in Germany), the below table illustrates a year on year comparison of increases at international and German HQ firms for front and back office business. Front office employees at international firms received an average salary increase of 4.5%, while their peers at local German banks took home 2.9%. A similar picture, but with a lower spread, shows the development of back office salaries. International firms increased salaries by an average of 1.2%, while salaries at German firms increased by only 0.75%.

YoY Comparison of Front and Back Office Average Salary Increases at International and German HQ Firms

Salary	Front Office / Revenue Roles	Back Office
German HQ	2.9%	0.75%
International Firms	4.5%	1.2%
Total Compensation		
German HQ	3%	1%
International Firms	5.5%	2.60%

The delivery of pay also tends to be different across firms. German HQ firms have a stricter regulatory guideline, delivering compensation predominantly through fixed pay, while international firms have a larger proportion delivered by variable pay across senior and middle management levels.

% Delivered by Fixed Pay

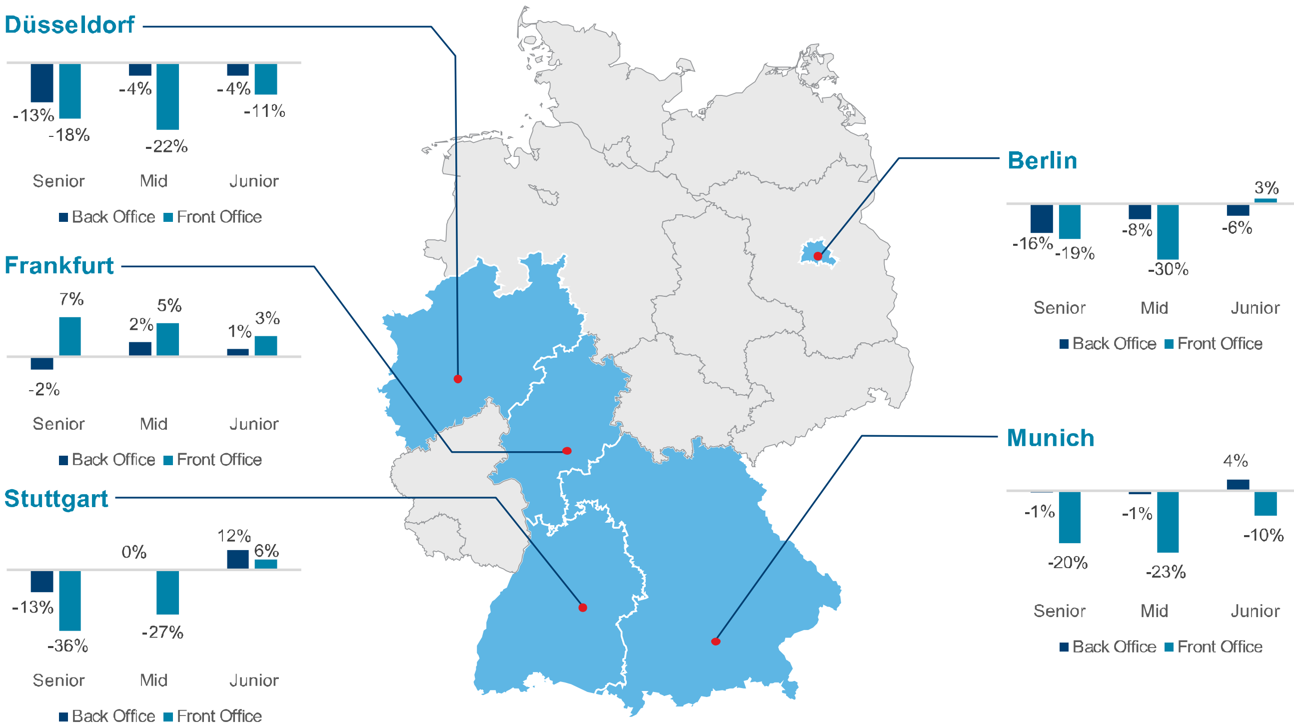
Type of Firm	Senior Levels	Middle Management Levels
German HQ	78%	90%
International Firms	71%	85%

Where in Germany are people moving and at what rates?

Frankfurt serves as the HQ location for some of the largest German banks. To add to this, most firms moving into Germany post Brexit have chosen Frankfurt as their base, thus making it the largest financial centre in Germany, followed by Munich.

The figure below shows the 2018 salary variance of five major financial locations in Germany. Based on our database, McLagan has analysed the front and back office business in these cities compared to the entire German market for employees in senior, middle, and junior levels.

2018 Salary Variance of Five German Financial Locations



Our data clearly shows that employees in front office positions for senior and mid-level positions receive the highest salaries in Frankfurt, while junior levels in Stuttgart beat Frankfurt by 3 percentage points. Back office roles reveal a mixed picture. Employees in Frankfurt and Munich are rewarded on a similar level, while Düsseldorf and Berlin lag.

What role do benefits play?

From an employee benefits perspective, after re-visiting the current benefit communication materials, we are starting to see some adjustments to the benefits package due to Brexit transfers. These areas include:

- Reviewing the level of death and disability lump sum benefits provided, which are generally much lower in Germany than those provided by banks in London.
- Ensuring that pension plans have an upper salary cap (with the expectation of more high earners and a desire to limit additional cost impacts).
- Negotiating preferred terms with one or more of the public health funds and offering individual advice from an external advisor or broker in this area. This is due to the complications associated with new arrivals choosing whether to remain in the public healthcare system or opt out for private coverage.
- Reviewing any company car policy.

There is no doubt that benefits, coupled with the larger employee value proposition (EVP), will play a key role in attracting and moving people to new markets in the EU.

What to expect over the next few months

The next few months will be a critical phase in the political history of the UK and European Union. Banks are waiting to see what agreement is reached and how it will impact their strategic decisions going forward.

Given the much smaller scale of banking and markets professionals on the continent vs. UK, a conservative estimate of 5% of jobs leaving the UK would increase headcount by approximately 20% in Germany. Typical pay levels for internal transfers are expected to be above local levels, driving higher average compensation costs in these countries. Based on our internal Brexit reward modelling, an equal split of internal transfers and hires in Germany will raise salary levels by 2-3% and total compensation by 3-5%.

However, institutions are cautious, global cues are worrying, and firms will be keeping a keen watch on the following:

- **Global pressures:** Downward revisions of current and future global growth in October / November are weighing heavily on business planning and expectations for 2019, with a growing consensus that 2020 could see a correction, if not a broader recession in pockets of the global economy.
- **European uncertainty:** The current market is driven by uncertainty. The deadline of 29th March 2019 is imminent, yet there is still no clear sign that the British parliament is close to agreement on Brexit terms.
- **Domestic uncertainty:** It has been in the press on a regular basis over the last few years, but it seems that the likelihood of a potential merger between Deutsche Bank and Commerzbank has never been higher.

These are only some of the factors increasing pressure on HR and the upcoming reward decision. The industry will enter the year-end pay cycle, balancing affordability with temperance. For areas where performance lags, banks will concentrate on maintaining market position. Most firms will be focused on how to best spend the allocated incentive pool with an eye on key roles aligned to “change the bank” vs “run the bank.”

It is, no doubt, a challenging time for banks—and rewards professionals will play a key role in shaping these new strategic locations that are emerging post Brexit.

For further details on talent and rewards in Germany or assistance with planning people moves post Brexit, please reach out to McLagan colleagues Marcus Dammann at marcus.dammann@aon.com in Munich or Adithi Jagannathan at adithi.jagannathan@aon.com in London.

For advice on pensions and benefits, please reach out to Ian Hinton at ian.hinton@aon.com.

McLagan has supported firms through their Brexit people strategies with detailed pay reviews, executive compensation benchmarking, structuring of executive pay, pay differential analysis, benefits structuring, and benefits communication. Our database in Germany, combined with our insights from the UK, France, and other European markets, gives us insight into the size of the available population, pay levels, and pay differentials that help firms make strategic people decisions.

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About McLagan

McLagan provides tailored talent, rewards, and performance expertise to financial services firms across the globe. Since 1966, we have partnered with the largest and smallest financial services firms to help them make data-driven decisions to hire, retain, and engage the top talent for keeping the global economy running. Our compensation surveys are the most comprehensive, in-depth source of rewards data covering over 150 countries from more than 2,500 clients. Our consultants work with hundreds of firms annually to design total rewards programs and benchmark financial performance for boards of directors, executives, employees, and sales professionals. McLagan is a part of Aon plc (NYSE: AON). For more information, please visit mclagan.aon.com.

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