

# Employment Brief

## Summer 2010



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## Welcome

### Introduction

On 28 May 2010 the Financial Reporting Council (**FRC**), which is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance, published the UK Corporate Governance Code (**the Code**). This was previously known as the Combined Code. The Code is the product of the FRC's 2009 and 2010 review of the Combined Code which began in March 2009 following a call for evidence on the impact and effectiveness of the Combined Code in light of the events of the banking crisis.

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# New UK Corporate Governance Code

The Code consists of 18 Main Principles of good governance, most of which have their own set of Supporting Principles and more detailed Code Provisions. The Supporting Principles are drafted in general terms to allow companies the flexibility of deciding their own method of implementation.

The Code's Main Principles, Supporting Principles and Code Provisions set out standards of good practice on issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. In this brief, we focus on the Code's approach to executive remuneration including the key changes it has introduced. Although the Code applies to all companies with a premium listing whether incorporated in the UK or elsewhere, listed corporate governance standards are influential for other companies looking at best practice on good governance.

and individual performance. In so doing, it has introduced a new Supporting Principle, namely that performance-related elements of executive remuneration should be 'stretching and designed to promote the long-term success of the company'. This represents a much stronger statement about the linkage of executive directors' rewards with performance.

The Code Provisions state that where a company is looking to design performance related remuneration for executive directors, the remuneration committee should follow the provisions set out in Schedule A to the Code. Schedule A contains some significant changes to the Combined Code, most importantly excluding non-executive directors from these principles reinforcing a recommendation from the review that they should not receive any performance related remuneration. Briefly it states that a remuneration committee should take the following into consideration:

*“...listed corporate governance standards are influential for other companies looking at best practice on good governance.”*

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## Executive Remuneration

The Code has two Main Principles on executive remuneration. The first governs the level and components of remuneration and the second governs the procedure for fixing levels of remuneration.

### The remuneration package

The main changes introduced by the Code suggest an increased importance to linking executive directors' rewards with long-term corporate performance.

The first Main Principle states that levels of remuneration should be sufficient to attract, retain and motivate directors but a company should avoid paying any more than necessary. This reflects what was in the Combined Code. It goes on to state that a significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate

- Whether or not executive directors should be eligible for annual bonuses and if so, performance conditions should be relevant, stretching and designed to promote the long term success of the company
- Whether or not executive directors should be eligible for benefits under long term incentive schemes and, if so, any long term incentive scheme plan should be approved by shareholders.
- Payments or grants under incentive schemes should be subject to challenging performance criteria reflecting the company's objectives, including non-financial performance metrics where appropriate.
- Remuneration incentives should be compatible with risk policies and systems. This new statement reflects the major conclusions of the review of corporate governance into

large financial institutions and national and international regulatory responses to the banking crisis: in short, excessive risk-taking should not be encouraged.

- Consideration should be given to claw back provisions where there is evidence of exceptional circumstances of misstatement or misconduct. Again, this supports the review carried out but unfortunately does not address the practical and legal difficulties that may be involved with this.
- In general, only basic salary should be pensionable.

It should also be noted, that under the Combined Code, performance related remuneration should be designed to align executive directors' interests with those of shareholders. This has now been deleted from the Code. It has been suggested that this is because a short term focus on growth in share value, and dividends paid, may not produce sustainable gains.

## Policies on remuneration

The Second Main Principle states that companies should have in place a formal and transparent procedure for developing policy on executive remuneration and that no director should be involved in deciding his own remuneration. In support of this, the remuneration committee should have delegated responsibility for setting the remuneration for all the executive directors and the chairman.

The Code Provisions deal with the constitution of the remuneration committee and state that the board must establish a committee of at least three or (in the case of smaller companies) two independent non-executive directors. This can include the chairman, although he or she cannot chair the remuneration committee.

The FRC's next review of the Code will take place in 2013.

## Sick Notes Now Replaced by Fit Notes

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From 6 April 2010, when an employee is absent from work due to illness for a period of 8 days or more, he will no longer be provided with a sick note from his GP. Sick notes have now been replaced by a 'Statement of fitness for work', otherwise known as a 'fit note' under the Social Security (Medical Evidence) and Statutory Sick Pay (Medical Evidence) (Amendment) Regulations 2010 further to a government consultation.

In contrast to sick notes, fit notes place the emphasis on what the employee can do rather than what they cannot. In this brief we look at what this means for employers dealing with the absent employee.

### What has changed?

Rather than GPs stating that an employee is or is not fit for work, they now have the option of stating that the employee 'is not fit for work', or 'may be fit for work taking into account the following advice'.

This should enable an employee to return to work where an employer puts in place measures which, for example could include implementing a phased return to work, altering the employee's working hours, amending the employee's duties, and/or making workplace adaptations.

GPs should then state the period for which this advice covers. A note issued in the first six months of a medical condition cannot last more than three months.

### What remains the same?

As before, the information provided on the fit notes is only advice for the employee. It is not binding on the employer.

The requirements for the payment of Statutory Sick Pay have not changed and neither have the employer's obligations under the Disability Discrimination Act.

## How fit notes may affect businesses

The objective behind the new regime is that fewer employees will stay signed off work when they may be able to return to work earlier with support. There is space on the fit notes for the doctor to provide information about how the employee's condition will affect what they do. This will enable employers to have more informed discussions with the employee to help them return to work.

Employers should continue what they already do by way of best practice by having regular discussions with the employee about when they are able to return to work and what adjustments would help them in their return to work. A return-to-work plan should be put together and once this is agreed on, a risk assessment should be carried out to consider the plan in more detail. The situation should then be monitored and adjusted if necessary once the employee has returned to work.

Employers should update their sick leave policies to make reference to the fit notes.



## Government's Emergency Budget: Employment Related Measures

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On 22 June 2010, George Osborne announced the government's emergency budget which contained a number of employment related measures. We have set these out briefly below:

- National insurance rates will increase by 1 per cent in April 2011. The threshold for employer National Insurance Contributions (NICs) will be increased by £21 a week above indexation - this is intended to reduce the negative impact of the employer rate rise. Therefore, the number of employees for whom employers pay no NICs will rise by 650,000.
- The income tax personal allowance for under 65s will increase by £1,000 to £7,475 in 2011-12.
- From April 2011, the government will use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) for the indexation of benefits. Although not specifically stated, this will presumably cover maternity pay, sick pay etc.
- There is some discrepancy between the published Budget documentation and the Chancellor's Budget speech regarding Default Retirement Age (DRA). Whereas the Budget documentation states that the government will consult on how it will phase out the DRA from April 2011, the Chancellor's speech says that the consultation will look at whether DRA should be phased out.
- The government will review when the State Pension Age will rise to 66.
- From April 2011, the basic State Pension will be uprated by a triple guarantee of earnings, prices or 2.5 per cent, whichever is highest. CPI will be used as the measure of prices in the triple guarantee but the basic State Pension will be uprated by the equivalent of RPI in April 2011.

- An independent commission will undertake a fundamental structural review of public service pension provisions by Budget 2011 and consider the case for short-term savings in the Spending Review period by September 2010.
- There will be a two year pay freeze for those workers in the public sector who earn more than £21,000. Those who earn less than this will receive a pay rise of £250 in both years.
- Plans will be put in place to ensure that those at the top of public sector organisations are paid no more than 20 times the salary of those at the bottom.



## The Bribery Act 2010: What it Means for Employers

On 8 April 2010, the Bribery Act 2010 received Royal Assent. It was anticipated that the Act would come into force in October 2010. However with the advent of the new coalition, this is now uncertain.

The UK's current law on bribery is considered to be unsatisfactory because it is inconsistent with the OECD Bribery Convention ratified by the UK in 1998. The OECD highlighted many of the problems with UK current law when it reported on the UK application of the OECD Bribery Convention in October 2008.

In line with the criticisms from the OECD, the Act is intended to reform the criminal law on bribery by consolidating bribery offences and creating a new offence where a commercial organisation fails to prevent bribery. In this brief we outline the offences covered and look at what employers should put in place to ensure they do not leave themselves open to proceedings under the Act.

### The offences

#### *Bribing another person*

Under the Act, X is guilty of an offence where X offers, promises or gives financial advantage to Y in exchange for Y's improper performance of a relevant function or activity.

#### *Being bribed*

It is also an offence under the Act to be bribed by another person. This offence occurs where Y requests, agrees or accepts a financial advantage in exchange for Z performing a relevant function or activity improperly.

What amounts to a 'financial advantage to another person' has not been defined and is being left to be determined by the courts.

#### *Function or activity to which the bribe relates*

For both of these offences, the definition of "relevant function or activity" is wide-ranging and

covers all functions of a public nature, all activities connected with a business, any activity performed in the course of a person's employment and any activity performed by or on behalf of a body of persons (whether corporate or unincorporated).

Both of these offences can be committed by an organisation.

#### *Failure of commercial organisations to prevent bribery and the adequate procedures defence*

The Act has introduced a new offence where a "commercial organisation" commits an act where someone "associated with" it bribes someone else with the intention of obtaining or retaining business or advantage for the organisation. A "commercial organisation" is any body incorporated under UK law.

A person is associated with a commercial organisation if they perform services for or on behalf of it e.g. an employee, agent or subsidiary. In defending itself, the organisation can show that it had

some cases both the company and the senior officer can be subject to criminal proceedings.

#### **Practical implications for employers**

Employers should therefore be looking to put in place measures to ensure they are equipped to deal with the Act. Subject to further guidance from the government on "adequate procedures", all employers should consider the following:

- Carrying out risk assessments to identify where/how bribery could be committed – for example, in respect of those involved in issuing contracts
- Ensuring that systems and internal procedures, including internal controls and oversight, counter the risk of bribery, for example checks on payments
- Making clear how allegations of bribery can be raised – for example under a Whistleblowing Policy
- Staff training and guidance

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'adequate procedures' in place designed to prevent bribery. Further guidance is to be issued on what will constitute "adequate procedures"

#### **Penalties**

An individual convicted of a bribery offence can be sentenced to up to 12 months in prison and/or fined up to £5,000 (on summary conviction) or up to 10 years in prison and/or a fine (if convicted on indictment).

A company convicted of a bribery offence can be fined up to £5,000 (on summary conviction) or an unlimited fine (if convicted on indictment). A company can also be debarred from tendering for public-sector contracts. A "senior officer" of the company can also be personally liable if they have consented to or connived in the commission of an offence by the organisation which means that in

- Carrying out due diligence before entering into arrangement with other parties
- Reviewing standard contract terms to include anti-corruption provisions
- Establishing a process for how any allegation of bribery made within the organisation or in public would be dealt with

Public sector employers should ensure that contracts relating to supply of goods, works or services to the public sector contain provisions to prevent corruption and should be ready to update these when the Act comes into force. Whilst the new offence of failure of commercial organisations to prevent bribery does not apply to public sector organisations, they may wish to update their contracts to refer to it to avoid, at the very least, public embarrassment if a public sector contractor was found to have committed an offence on behalf of a public authority.