

SSE Response to the Consultation on Proposed Revisions to the UK Corporate Governance Code

Q1. Do you have any concerns in relation to the proposed Code application date?

See response to Q7.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

SSE is grateful for the opportunity to feed into this consultation and to explain why it opposes this proposed change to the UK Corporate Governance Code (“the Code”) which effectively limits the Chair’s tenure to 9 years from first appointment to the Board for the reasons outlined below.

Existing Code and practice

The existing Code takes the position that:

- the Chair needs to be independent on appointment and that thereafter, the test of independence is not appropriate; and
- at least half the Board, excluding the Chair, comprise of independent Non Executive Directors, who rotate after nine years.

We understood that this approach was historically taken by the FRC because it reflected the particular and unique position of the Chair, who might often be appointed from the existing Board and whose role, in contrast to that of the non-executive directors, requires a significant level of involvement with the executive directors. This still seems to us to be a sensible approach to take and we would be grateful if the FRC could explain what has changed to justify the proposed change. Furthermore, in practice, most Boards then go on to impose a time limit on the Chairman’s term which is nine years at the outside and, more likely five/six years where the Chair has previously been on the Board as a non executive Director for a number of years.

Skills, experience, independence and knowledge

It is key that the Chair has the right level of knowledge and experience to lead the Board and this may often be consistent with a longer tenure than other Board members. For complex businesses and those with specialised regulatory requirements non executive Directors will require time to fully understand the business and its operating environment. Should they then go on to be appointed as Chair, the time spent gaining knowledge and experience as a Board member is likely to increase their ability to challenge and question the executive team, and generally to lead the Board effectively. Furthermore, a range of tenures on the Board is not in conflict with other guidance in the Code; in fact, one could argue it is consistent with the Code’s guidance that Boards should have the right balance of skills, experience, independence and knowledge and be diverse.

Mitigating Code provisions

It is not clear what problem the proposed Code is trying to fix in applying the independence provisions to Chairs, and we would argue that any perceived lack of independence of Chairs is mitigated through other provisions in the Code which ensure that the Board is being effectively led and that there is appropriate challenge. For example, the requirement for an annual Board evaluation (externally sourced every three years), the requirement for evaluations of each Board member (including the Chair), the assessment of potential conflicts, the requirement of the Board continually to refresh its membership, and the weight of numbers of independent non executive Directors.

Possible unintended consequences

SSE believes that there may be unintended consequences of this proposal including:

1. In the short term, there is likely to be unnecessary disruption of carefully thought through succession plans already in place for well-functioning Boards with Chairs first appointed to the Board more than 9 years ago;
2. Contrary to the overall intent of the Code which encourages Boards to look to the long term, we believe this proposed change may disturb the capacity of a Board to initiate, oversee and be accountable for long term decisions including:
 - long-term investment decisions;
 - in a regulated business, the handling of the setting of important new regulatory regimes and the subsequent monitoring of those regimes; and
 - significant long-term re-organisations or corporate transactions.
3. Bias towards the assumption that businesses can be learned quickly and towards external or less experienced candidates for Chair appointments, even if they are not the best person for the role, when compared to candidates from within the Board. If a desirable term for a new Chairman is at least six years plus, then the proposed change disqualifies anyone from being a Chair candidate who has been on the Board effectively longer than two to three years.

Conclusion

Taking into account all of the above arguments, SSE would therefore oppose this proposed Code change which effectively limits the Chair's tenure to 9 years from first appointment to the Board. It would leave the current position regarding Chair appointments unchanged, or would recognise the special position of Chairs and the need to foster internal succession, and limit the term of the Chair to, say, six years where he or she has extended the nine year rule.

SSE recognises that the FRC have, in theory, designed in some flexibility by allowing companies (out with "normal circumstances") to explain why they believe a Chair continues to be the right person for the role, beyond a 9 year tenure from first appointment on the Board. However, experience would suggest that not all investors or proxy firms take the time to understand the reasons for "non-compliance" and will often take a black and white approach when it comes to voting or recommending votes on resolutions. It is SSE's view that this effectively makes the proposed approach unnecessarily inflexible and may lead to unwarranted disruption of Boards.

Should the proposed change be adopted despite the above, Boards should be allowed to put appropriate plans in place to address any Chair tenure issues. SSE would strongly advocate that there is provision for a transition period before the introduction of the requirement, and that this is expressly set out in the Code. SSE would recommend this allows a period of transition to accounting periods beginning on or after 1 January 2024. This would allow Boards time to make succession plans which might include bringing in new non executive Directors and allowing them a 3/4 year period of settling in.