

The Lead Independent Director

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With increasing independence requirements, more and more companies are appointing a Lead Independent Director (LID) if the board chair is not (or no longer) regarded as independent by a large majority of investors and proxy advisors or in case of other concerns surrounding the board. The LID originates from the one-tier board system, in which an independent ordinary member of the board of directors is given special powers to compensate for the disadvantages of a non-independent chair.

Origins in the US, now also common in Europe

The LID concept has mainly existed in the US for some time because, in the US market, it has long been a common practice to combine the functions of CEO and chair. After increasing criticism of this combination, since 2011, US companies with a one-tier board structure have had to justify why they have decided for or against a combined CEO and chairperson.



This has led to a significant increase in the role of the LID, which is widely considered a compromise solution in the US market.

European markets with a one-tier board structure where a Lead Independent Director (also known as Senior Independent Director) is well established include the UK, France, Switzerland, and Ireland. In Germany, where the two-tier board system is predominant, the LID has found its way onto the supervisory boards of three listed companies for the first time in the last three years. In all three cases, the board chairs were largely considered non-independent. In the past, the appointment of a LID appeared less suitable and not a natural fit for the German two-tier board system as the roles of CEO and chair were already separate, but this view has changed. Meanwhile, a LID can be positioned in both prevailing board systems if the chairperson is not independent.

The role of a Lead Independent Director

The LID advises the board chair and adequately considers all shareholders' interests in the board's actions, discussions, and decisions. Notably, a LID:

- Acts as an independent board member with sufficient time to fulfill his/her role.
- Is authorized to convene board meetings and to place items on the meeting agenda.
- Preferably acts as the chair of the board's nomination committee and optionally is also a member of other key committees (but is at least entitled to attend committee meetings as a guest if not a member of a committee).
- Is responsible for the self-assessment of the board's performance regarding its duties; he/she is also authorized to analyze the results and take measures to improve the board's effectiveness in relation to the self-assessment results.
- Assesses the board chair's performance and leads the process of nominating and installing a successor (unless he/she is the obvious candidate).
- Is dealing with the company's environmental, social, and governance aspects and is authorized to develop measures relating to such ESG topics.
- Maintains an understanding of the issues and concerns of shareholders (and other stakeholders) and is available for investor engagement.
- Is an independent contact person for other board members, executives, and investors who may not wish to discuss issues directly with the chair.
- Acts as a mediator in the event of disagreements between (1) the CEO and board chair, (2) the board chair and (an)other member(s) of the board, and (3) between the board chair or the board as a whole on the one hand and investors on the other hand.
- Has all other rights and obligations the board decides by mutual agreement.

An independent person with special skills

Considering the critical task that the LID performs, it is essential that a LID remains independent in every respect at the time of appointment and throughout the whole term of office. The LID must be independent of the entire board, but especially of the board chair, and free of any conflicts of interest that could arise if the LID must challenge the board chair at a later date. Therefore, the LID should not be appointed by the board chair. Instead, the LID should be elected by all shareholder-elected board members in an independent role that complements the board chair.

Once the LID has been elected, investors expect a clear and transparently disclosed division of responsibilities between the two positions, as the LID does not replace the board chair. The LID has additional powers and responsibilities in the interests of the company and its investors and must have independent judgment, know when to support the board chair, and know when to assume specific tasks and responsibilities. He/she is also expected to have strong interpersonal skills. The LID must be able to acquire more knowledge about the company, the market environment, and its stakeholders than the other directors. Given the high demands on knowledge and understanding of the company, he/she should preferably be an existing board member.

In regular times, the LID is an essential point of contact for the company's investors to raise questions and concerns. Talking to the LID is also crucial if the dialog with the board chair has not led to a satisfying solution or if contact with the board chair would be inappropriate. Under challenging situations for the company, the board chair may have assumed a position that is perceived as too closely linked to the strategic decision-making of the executive board and is, therefore, not independent. In such cases, the LID can provide for good communication between executive and non-executive board members as well as institutional investors.

Investors value a Lead Independent Director

Established in the one-tier board system for many years, the LID concept is still new for companies subject to the two-tier system. In both governance systems, the LID is generally appointed if the board chair is not independent and lacks independent control. The appointment of a LID does typically not entail any significant disadvantages (provided that the chair's and LID's responsibilities are separated and disclosed). In fact, investors highly value a LID for communication purposes. In this respect, one can only agree that companies with a non-independent board chair should generally opt for the appointment of a LID to add value and improve or emphasize the independence of the board's leadership.

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