GENERAL GUIDANCE NOTE
Independence of directors

Purpose

The following information should be considered as general guidance from the IoDSA on assessing the independence of non-executive directors.

King III references as background

Principle 2.18 of King III – *The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent.*

Chapter 2, paragraph 67 of King III
An independent non-executive director is a non-executive director who:

67.1 Is not a representative of a shareholder who has the ability to control or significantly influence management or the board;

67.2 Does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group's total number of shares in issue;

67.3 Does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his personal wealth;

67.4 Has not been employed by the company or the group of which it currently forms part in any executive capacity, or appointed as the designated auditor or partner in the group's external audit firm, or senior legal advisor for the preceding three financial years;

67.5 Is not a member of the immediate family of an individual who is, or has during the preceding three financial years, been employed by the company or the group in an executive capacity;

67.6 Is not a professional advisor to the company or the group, other than as a director;

67.7 Is free from any business or other relationship (contractual or statutory) which could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner, such as being a director of a material customer of or supplier to the company; or

67.8 Does not receive remuneration contingent upon the performance of the company

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General opinion

Independence of directors is in essence a state of mind, and although the independence criteria, as listed in the King III Report provide useful guidance, these independence criteria are external criteria that serve as an indication of how likely or unlikely it will be that the director will act in an independent manner. It is however, not the complete answer to assessing directors' independence

Paragraph 66 of the Report summarises it well:
An independent director should be independent in character and judgement and there should be no relationships or circumstances which are likely to affect, or could appear to affect this independence. Independence is the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company rather than any particular fact such as length of service or age.

It is for this reason that paragraph 76 requires the board to do an independence assessment:
Every year, non-executive directors classified as 'independent' should undergo an evaluation of their independence by the chairman and the board. If the chairman is not independent, the process should be led by the LID. Independence should be assessed by weighing all relevant factors that may impair independence. The classification of directors in the integrated report, as independent or otherwise, should be done on the basis of this assessment.

Important to note also, that independent non-executive directors should be independent in fact and in perception of a reasonably informed outsider. Although independence of mind is essential, perceptions of independence are also important.

The independence criteria in paragraph 67 should therefore not be used as a strict formula for the board to determine a director's independence or lack thereof.

Selected specific guidance

Interpreting 67.1

For example, one of the independence criteria is that the individual director will only be regarded as independent if that director *is not a representative of a shareholder who has the ability to control or significantly influence management or the board*. It is a moot point whether directors who are part of a BEE deal do or do not have this influence. It will depend on the strategic importance of the BEE deal to the company and also the role that the BEE directors play in this relationship with the company. In circumstances where the sustainability of the company is dependent upon the success of the BEE deal; and where one of the BEE directors holds sway over the other BEE directors, it could be argued that that director has the ability to control or significantly influence management or the board. This is a question of fact that has to be assessed by the board.

Interpreting sections 67.2 and 67.3

Another of the criteria for independence is that the director does not have a direct or indirect interest in the *company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group's total number of shares in issue* OR *does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his personal wealth.* "Direct or indirect interest" should be widely defined to encompass not only shares, but also options, loans and guarantees. It may therefore be that the shareholding does not constitute 5% of the number of the total shares in issue, but that shareholding together with a loan or guaranteed amount may very well reach this threshold either in relation to the company's issued share value or the director's personal wealth.