

Insight:

Board observers – a pragmatic solution in a covenant light world



In previous periods of financial difficulty, strong covenants have helped lenders keep abreast of a company's financial performance and identify potential issues ahead of time. However, in the current covenant light world, lenders need to look at other tools available to them to ensure they get the required information.

One potential solution is to introduce a board observer to enhance the lenders position, monitor performance and in certain situations help the board.

Rights and appointment

A board observer is not a member of the board and has no rights to vote or any fiduciary duties to shareholders.

The appointment of a board observer is a contractual agreement and will often be requested by a lender in a distressed situation. As it is a contractual arrangement, it will be subject to negotiation as no two scenarios will be the same. It will detail amongst other things, the rights to which meetings can be attended, what information is provided and the whether there is the ability to participate in discussions.

A spectrum of scenarios

Historically, board observers were just that – observers – listening and updating lenders. This still works at one end of the spectrum as it enhances any existing reporting, providing additional information to the lender which is not usually covered by the covenant framework.

However, in more distressed situations, the board observer appointed may be someone with experience of restructuring and having greater participation in board meetings. But to be clear, this is not a CRO.

One other key consideration in where the board observer sits on this spectrum is good corporate governance. This is critical to the board who need to be able to openly discuss all matters in board meetings.

Therefore, the board observer needs to be pragmatic, constructive and personable with a strong understanding of corporate governance. Being trusted by both the lender and the company will allow the board observer to be alive to any potential conflict of interests.

Further, where multiple lenders are involved, the board observer can be seen as a neutral amongst the group.

The benefits of a board observer

Treading this fine line can offer lenders improved communications and understanding to optimise the outcome of any potential situation that has required the introduction of a board observer.

Benefits include:

- **Insights into decision making:** the opportunity to gain firsthand insight into the decision-making processes of the company's board, understanding the rationale behind strategic decisions and financial choices
- **Lender representation:** representing the interests of lenders ensures that their concerns and perspectives are considered during discussions and decisions
- **Open communication:** providing a channel for open communication between the board and the lender, relaying important information, asking questions, and providing feedback to the board on behalf of the lender
- **Easier information sharing:** facilitating the flow of information between the board and the lender, particularly when sensitive or strategic information needs to be conveyed
- **Monitoring performance:** closely monitoring the company's performance helping the lender to stay informed about the progress being made and whether the company is adhering to the agreed-upon strategies
- **Protection of interests:** safeguarding the interests of the lender, ensuring that plans align with their goals and that their rights are being respected
- **Mitigating risks:** keeping the lender informed about the company's financial health and prospects giving transparency to allow them to make informed decisions

Finally, it is important to remember that to achieve these benefits from appointing a board observer there needs to be openness, good communications and a strong governance framework.

Managing the dynamics between the board and lender are critical, as is having a clear framework setting out the issues and strategies to deliver the ultimate goals and outcomes.



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