A Growing Focus on Sustainability - Recent Developments and the Sustainability Linked Loan Principles

Whilst the value of banking transactions falling under the 'sustainability' umbrella is difficult to determine, it is clear that financing with some form of sustainability focus is in the ascendancy. Various stakeholders have driven this change, resulting in a range of initiatives. Examples include the Paris Agreement, the UK Government's Clean Growth Strategy and the EU's Action Plan on financing Sustainable Growth, to name but a few. Social momentum has also featured prominently, as London was so aptly reminded by the Extinction Rebellion demonstrations in April 2019.

This shift in attitudes is reflected in polling and financial data. A recent YouGov poll reported that millennial savers are twice as likely as older generations to want their pensions invested in a sustainable manner[1], and the money has followed suit: according to figures from Hargreaves Lansdown, the fund broker, money held in ethical funds has risen from £4.5bn in 2008 to £16.7bn in 2018[2].

In light of such developments, and driven by the desire to create consistent standards in this emerging market, the Loan Market Association (LMA) has published, following its issue of the **Green Loan Principles**, the **Sustainability Linked Loan Principles** (SLLPs). This is in line with the LMA's desire to promote the development of sustainability linked loan products by providing a framework for application by lenders and borrowers.

SLLPs – What are they?

SLLP loans are loan instruments or contingent facilities which incentivise the borrower's achievement of ambitious, pre-determined sustainability performance targets (SPTs). These objectives will be "sustainable" if they facilitate and support objectives conducive to environmentally positive or socially sustainable economic growth and activity. A loan is deemed "sustainable" under the SLLPs if the borrower has established an overarching sustainability or social responsibility strategy at a corporate level and the facility is applied to achieving these objectives. It can be differentiated from the Green Loan Principles in this regard as the SLLPs focus on the on-going sustainability profile of a borrower over time rather than the delivery (and maintenance) of a specific green project.

[1] *More young savers 'want ethical pensions'*, BBC news, 8 October 2017
[2] *UK ethical funds surge in popularity*, Financial Times, 28 September 2018

Fundamentally, it is for the borrower to set SPTs (which are agreed with the lender) by reference to key performance indicators, external ratings and/or equivalent metrics by which the borrower's sustainability profile can be tracked for the purpose of the loan.

Core Components – what do the SLLPs require?

The four key elements which the LMA consider should feature in a sustainability linked loan are as follows:

1. **Relationship to Borrower's overall CSR strategy** – the borrower should have clear sustainability objectives and a CSR strategy that provides context to the SPTs that have been set.
2. **Target setting: measuring the sustainability of the borrower** – the SLLPs direct that the SPTs should be "ambitious and meaningful to the borrower's business", linked to an identified target benchmark and bring about "positive change". These benchmarks can either be identified internally by reference to a framework devised by the borrower or externally assessed using established rating criteria. Where validation of the benchmark is to be undertaken internally, the borrower must demonstrate that it has appropriate internal expertise and methodologies to perform this function.
3. **Reporting** – as would be expected with a loan, the borrower is expected to (a) keep information on its sustainability performance current, (b) available on request and (c) report on the same annually to the Lenders, and ideally, also publicly (subject to competition and confidentiality constraints).
4. **Review** – external reviews of the borrower's sustainability performance are likely to be periodically required where the borrower does not have the necessary internal expertise to do so. External reviewers may be auditors, sustainability consultants or rating agencies.

Benefits of Borrowing under SLLPs

The benefits to be derived from SLLP compliant loans are yet to be fully ascertained, however, the likely "advantage" for borrowers is the positive public profile associated with such products and the potential to attract sustainability-oriented capital. Margin ratchets may be another positive of sustainability compliant loan products, with some lenders offering 'positive incentive loans' that reduce margin in recognition of meeting sustainability targets (subject to the individual constraints and policies of each lender).

With the link between prospective economic growth, financial stability and the need for sustainability becoming ever more apparent, we expect sustainable loan products to continue expanding and the use of SLLPs and green loans to become more common.

CMS has taken an active role in championing and advising on the transition to sustainable finance & responsible investment, with insight and commentary on key developments published frequently. For more information, click here.

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