



Sustainability Linked Loan Principles Snapshot

Why?

Following its development of the Green Loan Principles (GLPs), the Loan Market Association (LMA) has identified a need to create a similar methodology to develop consistency in the granting of sustainability linked loans. The goal of the Sustainability Linked Loan Principles (SLLPs) is to promote the development and preserve the integrity of sustainability linked loan products by providing a framework for application by lenders and borrowers.

What?

Sustainability linked loans are loan instruments or contingent facilities which incentivise the borrower's achievement of ambitious, pre-determined sustainability performance objectives. These objectives will be sustainable, for these purposes, when they facilitate and support environmentally and socially sustainable economic activity and growth.

How?

The SLLPs envisage that the borrower has established an overarching sustainability or social responsibility strategy at a corporate level and that the loan/facility will be applied to achieving these objectives. The borrower is to set itself sustainability performance targets (SPT) by reference to key performance indicators, external ratings and/or equivalent metrics by which the borrower's sustainability profile can be tracked.

Incentivising General rather than Specific Use of Proceeds

Unlike green loans where proceeds must be clearly identified and applied to a specified green project, the use of proceeds for a sustainability linked loan are most likely to be applied to general corporate purposes which improve the borrower's sustainability profile. The SLLPs envisage that borrowers may be financially incentivised to achieve the SPTs and but necessarily penalised where SPTs are not met.

Core Components

The 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 for itself 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 required where the borrower does not have the necessary internal expertise to do so. External reviewers may be auditors, sustainability consultants or rating agencies. Alternatively, if the borrower is set up to publicly release the relevant information, this may satisfy the review requirement. Considering the framework in the round it can be concluded that this review process is to be undertaken periodically during the term of the loan.

Sustainable Performance Targets Categories

The SLLPs list ten different categories in which SPTs can be set. The first four of these might be regarded as “green” or falling within the “E” of the ESG agenda e.g. energy efficiency and water consumption, and so would equally be eligible to fall within the GLPs. The categories also include social themes e.g. affordable housing and activities promoting sustainable behavioural change e.g. sustainable sourcing, global ESG assessments and the circular economy.

Differences between the SLLPs and the GLPs

1. The GLPs only relate to the environmental agenda whereas the SLLPs comprise environmental, social and governance issues and the promotion of positive behavioural change.
2. 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.
3. The SLLPs envisage that the borrower has espoused a general corporate strategy which comprises sustainability or social responsibility goals whereas a green loan borrower could theoretically only have one green project which may or may not align with its core operational approach.
4. Whilst the GLPs do not require that non-compliance with the GLPs should be an event of default, they do suggest that there should be a consequence of non-compliance. Certain banks have taken the view that non-compliance with the GLPs will result in the declassification of the loan as green loan. A similar suggestion is not made in the SLLPs.

Conclusion

The SLLPs introduce a methodology for a more generic sustainable debt product which will not in all cases be “green”. This will enable companies to source products specifically designed to support a demonstrable corporate level sustainable or CSR strategy which can meet the requirements set out by the SLLPs. In our experience each lender will take a slightly different approach to determining eligibility for, and the documentation of, these principles and this will continue to be the case in as sustainable finance seeks to establish itself as a mainstream banking theme.

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