

Sustainability Linked Loan Principles

Supporting environmentally and socially sustainable economic activity



Introduction

Sustainability linked loans aim to facilitate and support environmentally and socially sustainable economic activity and growth. The Sustainability Linked Loan Principles (SLLP) have been developed by an experienced working party, consisting of representatives from leading financial institutions active in the global syndicated loan markets.

The goal of the SLLP is to promote the development and preserve the integrity of the sustainability linked loan product by providing guidelines which capture the fundamental characteristics of these loans. In doing so, the purpose of the SLLP is also to promote sustainable development more generally. The SLLP are voluntary recommended guidelines, to be applied by market participants on a deal-by-deal basis depending on the underlying characteristics of the transaction.

The sustainability linked loan product enables lenders to incentivise the sustainability performance of the borrower.

The SLLP are intended for broad use by the market, providing a framework within which the flexibility of the loan product can be maintained, and will be reviewed on a regular basis in light of the development and growth of sustainability linked loans.

Sustainability Linked Loan Definition

Sustainability linked loans are any types of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) which incentivise the borrower's achievement of ambitious, predetermined sustainability performance objectives. The borrower's sustainability performance is measured using sustainability performance targets (SPTs), as set against key performance indicators, external ratings and/or equivalent metrics¹ and which measure improvements in the borrower's sustainability profile.

The use of proceeds in relation to a sustainability linked loan is not a determinant in its categorisation and, in most instances, sustainability linked loans will be used for general corporate purposes. Instead of determining specific uses of proceeds, sustainability linked loans look to improve the borrower's sustainability profile by aligning loan terms to the borrower's performance against the relevant predetermined SPTs. For example, sustainability linked loans will often align the borrower's performance to margin redetermination over the life of the sustainability linked loan. In some instances, a loan may be structured to allow for its categorisation as both a green loan, aligned with the Green Loan Principles², and a sustainability linked loan.

Sustainability Linked Loan Principles – Core Components

The SLLP set out a framework, enabling all market participants to clearly understand the characteristics of a sustainability linked loan, based around the following four core components:

1. Relationship to Borrower's Overall Sustainability Strategy
2. Target Setting – Measuring the Sustainability of the Borrower
3. Reporting
4. Review



1. Please see Appendix 1 for a list of examples of common categories of SPTs in relation to sustainability linked loans.

2. The Green Loan Principles are available at: <https://www.lma.eu.com/documents-guidelines/documents/category/green-loan-principles>.

1 Relationship to Borrower's Overall Sustainability Strategy

The borrower of a sustainability linked loan should clearly communicate to its lenders its sustainability objectives, as set out in its sustainability strategy, and how these align with its proposed SPTs. Borrowers are encouraged to position this information within the context of their overarching objectives, strategy, policy and/or processes relating to sustainability. Borrowers are also encouraged to disclose any sustainability standards or certifications to which they are seeking to conform.

2 Target Setting – Measuring the Sustainability of the Borrower

Appropriate SPTs should be negotiated and set between the borrower and lender group for each transaction. A borrower may elect to arrange its sustainability linked loan product with the assistance of one or more “Sustainability Coordinator(s)” or “Sustainability Structuring Agent(s)” and, where appointed, they will assist with negotiating the SPTs with the borrower.

The SPTs should be ambitious and meaningful to the borrower's business and should be tied to a sustainability improvement in relation to a predetermined performance target benchmark. Market participants recognise that any targets should be based on recent performance levels (often data from the previous 6-12 months, but this will vary). SPTs may be either internal (defined by the borrower in line with their global sustainability strategy) or external (assessed by independent providers against external rating criteria).

As mentioned above, sustainability linked loans look to improve the borrower's sustainability profile. They do so by aligning loan terms to the borrower's performance against pre-determined SPT benchmarks. For example, the margin under the relevant loan agreement may be reduced where the borrower satisfies a pre-determined SPT threshold or vice versa.

By linking the loan terms to the borrower's sustainability performance, borrowers are incentivised to make improvements to their sustainability profile over the term of the loan.

Borrowers may be encouraged to seek a third party opinion as to the appropriateness of their SPTs as a condition precedent to the relevant sustainability linked loan product being made available. In cases where no third-party opinion is sought, it is strongly recommended that the borrower demonstrates or develops the internal expertise to verify its methodologies.

The SPTs should be meaningful and apply over the life of the loan – one of the aims of sustainability linked loans is to encourage ambitious, positive change through incentives and this should form the basis of target setting.³

3. Borrowers should also note the existing and ongoing work on environmental and social impact metrics by the Green Bond Principles (GBP) that may help identify relevant SPTs and calculation methodologies. Impact metrics guidance of the GBP is available at: <https://www.icmagroup.org/green-social-and-sustainability-bonds/resource-centre/>.

3 Reporting

Borrowers should, where possible, make and keep readily available up to date information relating to their SPTs (such as any external ESG⁴ ratings), with such information to be provided to those institutions participating in the loan at least once per annum.

As transparency is of particular value in this market, borrowers should be encouraged to publicly report information relating to their SPTs and this information will often be included in a borrower's annual report or its sustainability report. However, this will not always be the case and, where appropriate, a borrower may choose to share this information privately with the lenders rather than making this publicly available. Borrowers are also encouraged to provide details of any underlying methodology and/or assumptions.

4 Review

The need for external review is to be negotiated and agreed between the borrower and lenders on a transaction-by-transaction basis.

For loans where information relating to SPTs is not made publicly available or otherwise accompanied by an audit/assurance statement, it is strongly recommended that a borrower should seek external review of its performance against its SPTs. For publicly traded companies, it may be sufficient for lenders to rely on the borrower's public disclosures to verify its performance against its SPTs. With respect to certain SPTs, even if data is publicly disclosed, verification of the borrower's sustainability performance by independent external review may still be desirable.

In transactions where a borrower seeks external review, the borrower should have its performance against its SPTs independently verified by a qualified external reviewer, such as an auditor, environmental consultant and/or independent ratings agency, at least once a year. Any such external reviewer should be agreed by those institutions participating in the loan. Furthermore, it is also recommended that external reviews be made publicly available where appropriate.

In cases where no external review is sought, it is strongly recommended that the borrower demonstrates or develops the internal expertise to validate the calculation of its performance against its SPTs. Borrowers are recommended to thoroughly document any such expertise, including the related internal processes and expertise of their staff. This documentation should be communicated to all lenders participating in the loan. When appropriate, and taking into account confidentiality and competition considerations, borrowers should also make publicly available, via their website or otherwise, the description of the internal expertise they have in relation to the SPTs for their sustainability linked loan(s).

Once reporting has been completed and external review (if any) has taken place, the lenders will evaluate the borrower's performance against the SPTs based on the information provided.

4. Environmental, social and governance.

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Appendix 1 – SPTs

This list sets out some common categories of SPTs together with an example of the improvements which an SPT in this category might seek to measure. The categories listed are intended to be indicative only and are listed in no specific order. Whilst the examples provided are commonly used examples, please note that there are a large variety of SPTs and, as a result, it is not possible to refer to all categories of SPTs in this Appendix.

Category	Example
Energy efficiency	Improvements in the energy efficiency rating of buildings and/or machinery owned or leased by the borrower.
Greenhouse gas emissions	Reductions in greenhouse gas emissions in relation to products manufactured or sold by the borrower or to the production or manufacturing cycle.
Renewable energy	Increases in the amount of renewable energy generated or used by the borrower.
Water consumption	Water savings made by the borrower.
Affordable housing	Increases in the number of affordable housing units developed by the borrower.
Sustainable sourcing	Increases in the use of verified sustainable raw materials/supplies.
Circular economy	Increases in recycling rates or use of recycled raw materials/supplies.
Sustainable farming and food	Improvements in sourcing/producing sustainable products and/or quality products (using appropriate labels or certifications).
Biodiversity	Improvements in conservation and protection of biodiversity.
Global ESG assessment	Improvements in the borrower's ESG rating and/or achievement of a recognised ESG certification.