

NEW GUIDANCE ON "GREEN" LOANS AND "SUSTAINABILITY LINKED" LOANS

BACKGROUND

Environmental, social and governance ("**ESG**") issues continue to be high on the agenda of most governments, businesses and industry bodies. The potential for businesses to have a positive impact on the environment and/or climate by operating and delivering their services and products in a responsible and environmentally positive manner has led to greater focus from governments as to how encourage such behaviour.

As noted in our previous REF updates, over recent years we have witnessed the signing of the 2015 Paris Climate Change Agreement, the launch in the UK of the Green Finance Institute, the publication of the UK Government's "Green Finance Strategy" and the issuance by various industry bodies of voluntary principles and guidelines relating to green and sustainable financing – all of which has increased pressure on the finance industry to integrate environmental concerns into decision-making.

The impact of Covid-19 on the economy has further intensified focus in this respect with the UK Government facing calls from royals, businesses and pressure groups alike to ensure that the UK's economic recovery is a "green" recovery. Most recently on 9 June 2020, over 150 business leaders signed an open letter to the UK Prime Minister emphasising the importance of sustainability to the UK's recovery and expressing their support for the UN Sustainable Development Goals. With businesses strongly supportive of such goals one of the side-effects of the Covid-19 pandemic may be an acceleration of the process of the finance industry as a whole going "green", this green drive lending itself particularly well to the development of modern, energy efficient and environmentally friendly buildings.

It seems quite timely in this context that the LMA, the APLMA and the LSTA¹ together launched in May 2020 new guidance documents to enhance market understanding of, and support, the Green Loan Principles launched in 2018 and the Sustainability Linked Loan Principles launched in 2019.

GREEN LOAN PRINCIPLES AND THE RELATED GUIDANCE

The Green Loan Principles (the "**GLP**") sought to set out a high-level framework of standards and guidelines with the aim of creating consistent methodology for the origination of "green" loans. Whilst the principles were deliberately drafted upon flexible terms to reflect that the green loan market is developing and in its relative infancy, the GLP did indicate certain core components. These components centred upon (i) use of proceeds of the relevant loan (ii) the process for evaluation and selection of green loans (iii) the ongoing tracking and management of loan proceeds and (iv) robust reporting and ongoing evaluation of a loan's "green" status.

The Guidance on Green Loan Principles (the "**GLP Guidance**") seek to provide further clarity in respect of certain areas of the GLP. In particular:

- the guidance clarifies that the nature of the borrower is not determinative of whether a loan is a "green" loan – instead any entity may borrow a green loan if it complies with the principles;
- the guidance confirms that the fundamental aspect of a loan being a "green" loan is the use of proceeds – absent use of proceeds for a green purpose a loan could still be a Sustainability Linked Loan but it would not be a green loan; and
- the guidance emphasises the need for transparency and robust information processes in order to maintain the integrity of the market – requiring lenders and borrowers to work collaboratively in order to establish loan processes and information reporting that supports the categorisation of loans as "green" and recognising the reputational impact of mislabelling loans.

Most practically, the GLP Guidance provides clear guidance on the nature of the clauses that should be incorporated into loan documents in order to support the analysis. This includes (i) a clear setting out of the relevant green project categories in the purpose/use of proceeds clauses (ii) information undertakings and covenants relevant to the green project and (iii) representations as to the accuracy of reporting.

The GLP Guidance also queries the impact that a breach of a "green" provisions should have under the relevant facility agreement. As a minimum, the guidance states that the relevant loan should cease to be considered to be "green" from the relevant breach (subject to any cure periods). It will be important for parties to consider whether a breach of a green provision has sufficient impact to trigger an event of default. The approach will likely depend upon the importance to the relevant lender of the loan being categorised as "green" and the impact of any declassification. Whilst the principles are voluntary and current perceptions may be that there is little negative implication of loans ceasing to be green, the landscape is continuing developing. We may see in the

¹ The Loan Market Association, the Asia Pacific Loan Market Association and the Loan Syndications & Trading Association.

not-too-distant future a landscape where lenders face greater incentives and/or penalties in connection with green loan originations and therefore are more concerned to see preservation of such classification.

SUSTAINABILITY LINKED LOAN PRINCIPLES AND THE RELATED GUIDANCE

Similarly to the GLP, the Sustainability Linked Loan Principles (the "**SLLP**") sought to set out a high-level framework of standards and guidelines with the aim of creating consistent methodology for the origination of "sustainability linked" loans.

In contrast to the GLP which require that the use of proceeds of the relevant loan is for a green purpose, the SLLP focusses on the incentivisation of borrowers to achieve sustainability linked performance objectives. This is intended to be achieved through the marrying of pre-determined targets with loan terms that provide economic and/or documentary benefits to borrowers that achieve (or improve) their sustainability goals.

The core principles of the SLLP focus upon (i) the overall sustainability strategy of the borrower (ii) the setting of targets and measuring of performance against such targets and (iii) the need for robust reporting and review of performance.

The Guidance on the SLLP (the "**SLLP Guidance**") provides similar useful general guidance on the SLLP as featuring in the GLP Guidance, however, one of the most significant aspects is again in respect of best practices for documentation. Although it is recognised that there is no industry standard wording for documentation the guidance emphasises the need for (i) clear identification of sustainability targets and, ideally, transparency on how/why such targets are anticipated to be achieved (ii) clear mechanisms for measurement of performance (iii) clear information sources that can be relied upon in connection with the relevant performance targets. As per the GLP Guidance the impact of a breach of SLLP related terms for borrowers / lenders is a point to be resolved by the parties although the SLLP Guidance suggests that benefits granted to borrowers for achievement of targets could be retracted upon a breach.

A GREEN FUTURE?

The GLP Guidance and the SLLP Guidance provide further shape to the interpretation of the GLP and SLLP that should assist lenders and borrowers in applying these principles and appropriately drafting finance documentation. Borrowers and Lenders increasingly recognise the benefits of incorporating green and sustainable approaches in their business strategies and, in view of the worldwide focus on ESG issues this trend is likely to increase. As this area develops a consistent approach will need to be adopted by market participants in order to maintain the integrity of the categorisation of such loans in the market. Participants in the real estate finance sector will therefore need to (i) positively and pre-emptively engage with the development of this market and (ii) consider its impact on their strategies, in order to deliver a green and sustainable future and avoid being left behind.

If you have any questions or require any support on these issues, please do not hesitate to get in touch with your usual AG contact or one of the lawyers listed below.



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