A practical discussion of the drafting and negotiation of sustainability-linked loan terms

Environmental Social Governance in Finance

Presented by Ellis Lawson, Partner and Maria Capocci, Associate, Sullivan & Worcester UK LLP

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What this talk will cover

- What are environmental social governance loans
- Current market position
- Key Concepts in LMA draft Sustainability-Linked Loan (**SLL**) provisions, including:
  - Key Performance Indicators
  - Sustainability Performance Targets
  - Margin impact
  - Reporting and disclosure
  - Declassification
- Where the market is heading
- Questions

Hot Topic: Sustainability

Environmental

- Climate Change mitigation
- Pollution Prevention
- Preservation of biodiversity

Social

- Inequality
- Investing in human rights issues
- Inclusiveness

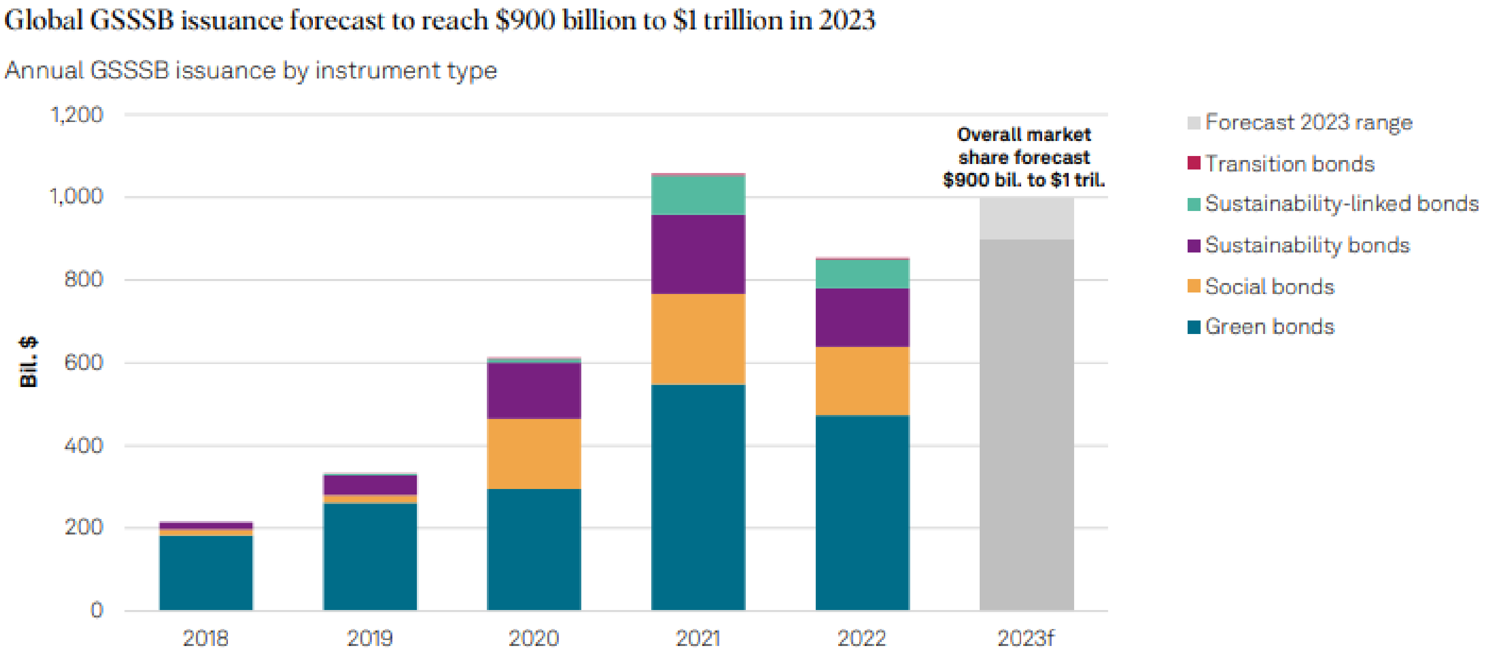
Governance

- Management structures
- Employee relations
- Executive renumeration

Types of ESG Loans

	Green Loans	Blue Loans	Social Loans	Sustainability – Linked Loans
Use of Proceeds	Only to finance, re-finance or guarantee eligible green projects	Only to finance, re-finance or guarantee eligible blue projects	Only to finance, re-finance or guarantee eligible social projects	No restrictions
Pricing Characteristics	No margin adjustments or incentives	No margin adjustments or incentives	No margin adjustments or incentives	Margin adjustment to incentivise borrowers to achieve agreed sustainability performance targets
Reporting	Ongoing reporting to monitor use of proceeds	Ongoing reporting to monitor use of proceeds	Ongoing reporting to monitor use of proceeds	Ongoing reporting to benchmark performance against agreed sustainability performance targets

Market growth graph



Note: Excludes structured finance issuance. f--S&P Global Ratings forecast. GSSSB-Green, social, sustainability, sustainability-linked bonds.
Sources: Environmental Finance Bond Database, S&P Global Ratings.

Key elements of the LMA drafting

- Borrower endeavours to achieve ambitious sustainability performance targets (**SPTs**) for relevant and material key performance indicators (**KPIs**).
- Borrower reports periodically on performance against the SPTs for each KPI and such reporting is reviewed by an independent external reviewer.
- Margin is adjusted periodically by reference to the number of SPTs achieved.
- Loan may be declassified as a sustainability linked loan in certain circumstances.

KPIs: Selection and Credibility

Consider SLLP and SLLP Guidance

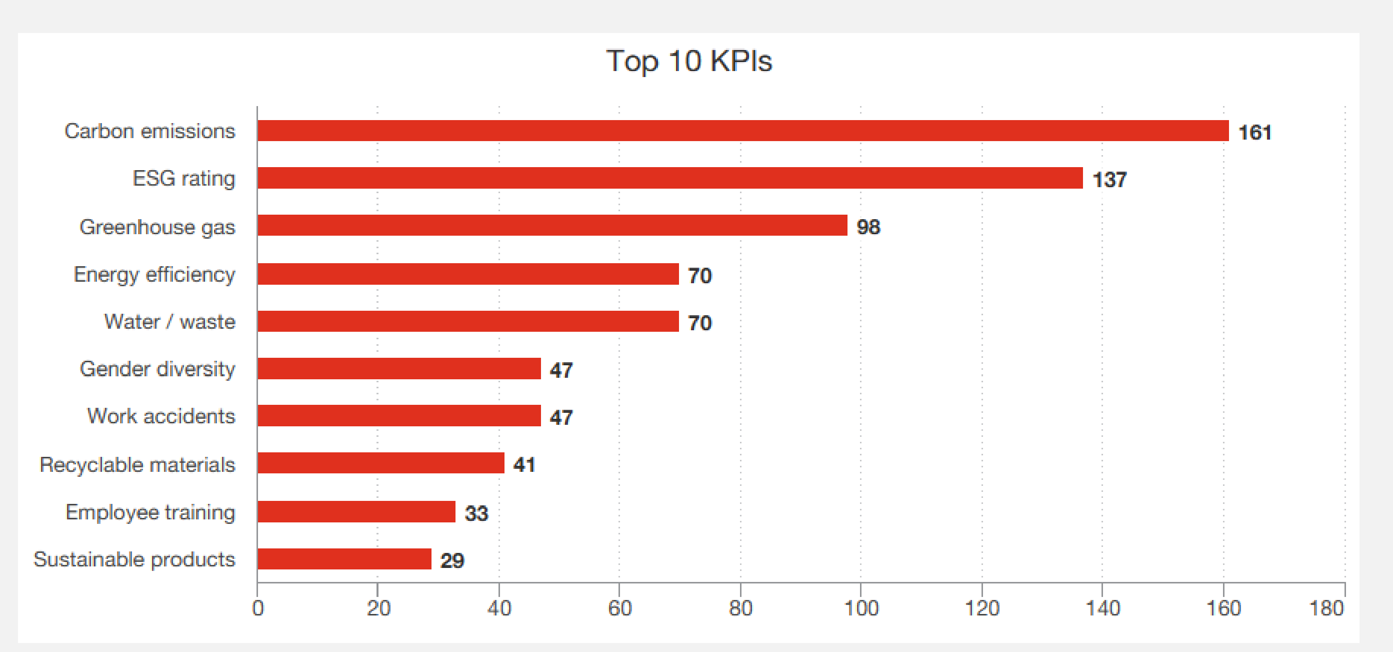
Selection of KPIs

- Borrower's Sustainability Report/Framework
- Lender as "Sustainability Coordinator"

Credibility for KPIs

- Relevant, core and material to the Borrower's overall business
- KPIs should be measurable and quantifiable
- Benchmarkable against peers and the wider industry

KPIs: what is the most popular?



- Environmental KPIs are expanding and evolving
- Social areas are increasing in popularity
- Governance related KPIs are limited
- Numbers of KPIs per loan increasing
- Drive to consider KPIs outside of environmental factors

https://www.pwc.co.uk/services/business-restructuring/insights/financing-sustainable-growth-emerging-opportunity.html

Calibration of SPTs

Relevance and ambition are key

Must be relevant, ambitious and beyond the "business as usual" trajectory and regulatory requirements

Where possible, should be compared with an external reference or benchmark, e.g. own historic performance, performance of peers and science-based targets

Ongoing ambitiousness

Structure

Expressed as an absolute value or percentage reduction

Annual SPTs should usually be set per KPI for **each** year of the loan term (unless strong rationale for why this is inappropriate)

Calibration of SPTs cont.

Rendez-vous clauses

- Creates a framework for adjusting KPIs and SPTs if circumstances change
- Not always seen but should be considered if the circumstances around the initial loan could be subject to change
- Negotiation and consent between Lender(s) and Borrower(s) is required

Sleeping SLLs

- Loans that become SLLs after signing, and KPIs and SPTs are finalised at a later date
- It is not a shortcut to avoid negotiations and detailed consideration
- There are specific circumstances that these would be considered acceptable (e.g. where there is significant time pressure and the borrower already has a clear sustainability strategy in place)

Loan Characteristics: Margin Rachet

SPTs not achieved

ESG controversy clauses

=

Margin Rachet Increase

SPTs are achieved

=

Margin Rachet Decrease

Reporting Requirements

- Frequency: Typically once per year
- Key deliverables to lenders:
  - Sustainability Compliance Certificate
  - Sustainability Report
  - Verification Report (we'll get to that next)
- Contents:
  - up-to-date information to allow for monitoring of SPT performance and ambitiousness
  - Compliance with SPTs and margin adjustment
- Other reporting requirements: Broader reporting obligations, e.g. to provide additional information on request and to notify the agent of inaccuracies in the Sustainability Compliance Certificate

Verification

- Independent and external assessment of the borrower's performance against each SPT for each KPI
- Aim should be to obtain the necessary verification with minimum additional work and expense (where possible) – e.g. it may be possible to use an ESG report that the borrower already obtains
- Borrower should be careful to ensure that it can in fact procure what it commits to in the credit agreement
- Lender approval of changes to External Reviewers typically not required (provided they meet the agreed requirements)
- May need different External Reviewers for different KPIs
- Typically lenders are not permitted to rely on the verification reports

Declassification Clauses

- Provides the Lender(s) with the right to declassify the loan as a sustainability-linked loan

- Not entitled to future publicity of the facility as sustainability-linked

- Borrowers will want to ensure the triggers and consequences are set appropriately

Declassification Clauses cont.

Once declassified a Loan cannot be reclassified

Declassification Date → Should there be a grace period?

Lender voting requirements → Majority Lender or all Lender?

Impact of declassification decision → Margin ratchet falls away

Sustainability Coordinator and protective provisions

- Sustainability Coordinator not a party, which is a change to previous market practice
- Sustainability Coordinator benefits from protective provisions under the Contracts (Rights of Third Parties) Act 1999
- Provisions protect the Sustainability Coordinator in the same way as the other administrative parties and include an indemnity in favour of the Sustainability Coordinator
- Protections in relation to sustainability aspects also extend to the agent and arrangers – e.g. no duty to monitor sustainability matters, no responsibility for sustainability information and no responsibility for whether the facility complies with the Sustainability-Linked Loan Principles or other sustainability matters

Future and concerns

Application of sustainability linked principles to trade finance loans

Focus on green-washing

More regulations and disclosure standards

Green loan and social loan drafting

FCA scrutiny

Rise in sustainable financing disputes

Recap – a quick summary

- Sustainable financing continues to be at the forefront of boardroom discussions
- Greenwashing and reputational risks or concerns
- What kind of KPIs and SPTs should be used?
- Regulations are on the rise

Questions?

Suggestions for future topics and webinar dates

Please feel free to send any suggestions for future topics to London Events (londonevents@sullivanlaw.com)

Webinar dates for 2023

- 26 October
- 23 November

Ellis Lawson

Ellis has extensive experience across a wide range of finance products and geographies, having spent significant portions of his career based both in London and in the Middle East and having advised on transactions across Europe, the Middle East and Africa.

He has regularly acted for all commercial parties to financings, including arrangers, syndicate lenders, borrowers, sponsors and export credit agencies across finance categories including syndicated corporate lending (conventional and Shari'ah compliant), acquisition finance, project finance and real estate development finance. In addition Ellis has significant experience acting on debt restructurings and in connection with financial distress.

Ellis joined Sullivan & Worcester from a Magic Circle law firm in 2023 after spending 12 years working in their London, Dubai and Abu Dhabi offices.

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Maria advises on a range of cross-border trade finance transactions in a variety of jurisdictions, including syndicated and bilateral pre-export commodity financings, letter of credit facilities, commodity repo structures, receivables financings, including supply chain finance, structured trade and commodity finance.

Maria also advises clients in relation to sanctions matters connected to trade and export finance, together with other regulatory and compliance issues and in relation to professional negligence and commercial litigation matters.

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Global Trade Review (GTR) “Best Export Finance Law Firm”, 2023
GTR named Sullivan “Best Export Finance Law Firm” at the GTR Leaders in Trade Awards, 2023

Trade Finance Global “Legal Innovation in Trade” 2023
Sullivan recognised for “Legal Innovation in Trade" 2023 by *Trade Finance Global* (in connection with BAFT) at its Trade, Treasury and Payment Awards 2023

The Legal 500 UK, 2023
Sullivan ranked in Tier 1 for Trade Finance by *The Legal 500 UK, 2023* for the ninth year running
Partner Geoffrey Wynne is included as a Leading Individual for Trade Finance in the “Hall of Fame”
Partners Simon Cook and Mark Norris are recognised as Leading Individuals
Partner Sam Fowler-Holmes is recognised as a Next Generation Partner and Managing Associate Hannah Fearn as a Rising Star

Chambers UK, 2023
Chambers UK, 2023 ranked Sullivan for Commodities: Trade Finance (UK-wide)
Geoffrey Wynne and Simon Cook are both ranked in Tier 1, with Mark Norris included in Tier 3
Sam Fowler-Holmes is recognised as an “Up and Coming” lawyer

IFLR1000 Banking and Finance Guide, 2023 (32nd edition)
Sullivan recognised for Banking Lending - Lender Side, United Kingdom, in *IFLR1000’s Banking and Finance Guide, 2023*
Partner Geoffrey Wynne is ranked as a Leading Lawyer – Highly Regarded in the United Kingdom

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Best Lawyers included five London partners — Marian Boyle, Simon Cook, Sam Fowler-Holmes, Mark Norris and Geoffrey Wynne — in the 2024 edition of *The Best Lawyers in the United Kingdom®*

Receivables Finance International (RFIx) Annual Awards, 2023 and 2022
Geoffrey Wynne named “Industry Ambassador of the Year” in 2023, and Hannah Fearn was named joint "Industry Ambassador of the Year" in 2022, at the Receivables Finance International (RFIx) Annual Awards

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Geoffrey Wynne named a recipient of the *Lexology* “Client Choice” Award 2021 for Banking, United Kingdom

Trade Finance Global “Best Trade Finance Law Firm” 2019
Sullivan named “Best Trade Finance Law Firm” 2019 by *Trade Finance Global* at its International Trade Finance Awards, 2019

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