



Green Loans Series, Part 1 – Green Loans and the Green Loan Principles

February 28, 2022



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In our January edition of *REF News and Views*, we discussed some key recent **ESG developments in Europe and the UK** in the financial markets. We want to follow this up over the coming months with a series of articles where we consider ESG further by delving deeper into the emergence of “green loans” and the Green Loan Principles – those principles that seek to form the framework of market standards, guidelines and methodology to be adopted across the green loan market.

Ultimately, as the world moves towards a greener, more sustainable future, lenders and corporates in the UK are becoming more conscious of their impact on climate change and the environment through their investments and lending activity. This is in part due to the greater levels of regulation and accountability being imposed by the government in respect of sustainability, as well as an overall increased awareness of the issues shrouding climate change and the environment. This has led to the inception of the concept of green loans and the Green Loan Principles to help act as a roadmap towards sustainable investing and to align the financial system with the UK's ambitious net-zero commitments.

What is a green loan?

A “green loan” is not a clearly defined or regulated term, but is often used in the financial markets as a general term to describe loans made with the view of green and sustainable lending. This can be reflected by way of the underlying green project investment, the management of the proceeds, and reporting, but is otherwise linked to the use of the proceeds of the loan towards an eligible green project.

It is worth noting that a sustainability linked loan (“SLL”) should be differentiated from a green loan. An SLL focuses on the behaviour of the borrower as opposed to the project itself, in which the loan will be designed to incentivise the borrower to meet certain key performance indicators that are based on sustainability and a commitment to reducing environmental impact. These could include commitments that relate to energy efficiency and the sourcing and use of sustainable materials and supplies. We will discuss SLLs in more detail in future articles.

The Green Loan Principles

In March 2018, the Loan Market Association (“LMA”) first published its Green Loan Principles (“GLP”), which seek to facilitate and support environmentally sustainable economic activity by providing a framework of market standards, guidelines and methodology that can be consistently adopted across the green loan market. The LMA continues to update the GLP, with the latest version being published in February 2021 where it included social risks as one of the categories to consider during project evaluation.

When should the GLP be applied?

Whilst the GLP are recommended for green loan products, they are currently still voluntary and for guidance only, aimed to be applied by market participants on a deal-by-deal basis depending on the underlying characteristics of the transaction. It is therefore incumbent on the lenders to define their internal standards with regards to eligibility criteria for what they would classify as a green project.

This being said, there are an increasing number of national and international measures and initiatives being discussed, created and imposed on corporate governance, climate change and sustainability that are starting to change how companies and the financial markets are operating and approaching their businesses. As such, with increasing socioeconomic pressures, we fully expect to see a continued growth in the use of GLP as the guiding core principle for green loan products, as well as an evolution and development in the GLP, over the coming years.

To qualify as a GLP-compliant green loan, such loan product must align itself with the following four core components:

- Use of proceeds
- Process for project evaluation and selection
- Management of proceeds
- Reporting

We will discuss each of the four core components in more detail in next month's edition of *REF News and Views*.