CADWALADER

REF news and views

Sustainability-Linked Loans Series, Part 4 – SLLP Core Components in Detail (Continued)


By **William Lo**
Associate | Real Estate


By **Carl Hey**
Associate | Real Estate

In our July edition of *REF News and Views* we began our deep dive into the Sustainability-Linked Loan Principles ("SLLP") core components ("Core Components").

As a reminder, the SLLP set out a framework, with the aim to enable all market participants to clearly understand the characteristics of a SLL. The framework is based around the five Core Components, namely:

1. selection of key performance indicators ("KPIs"),
2. calibration of sustainability performance targets ("SPTs"),
3. loan characteristics,
4. reporting progress against SPTs, and
5. verification.

In this next article in our Sustainability-Linked Loans Series, we will continue our examination into the Core Competencies and look at loan characteristics, reporting progress against SPTs, and verification.

Loan Characteristics

A key characteristic of a SLL is that an "economic outcome" is linked to the borrower's performance against its predetermined KPIs/SPTs.

In practice, the economic outcome will usually take the form of a margin ratchet where the pricing of the loan changes according to the borrower's ESG performance. In contrast to other forms of ESG loan products (such as green loans), the focus for a SLL is not based on the purpose for which the loan is made available.

Reporting Progress against SPTs

The SLLPs recommend that borrowers should report at least once per year with up-to-date information sufficient to allow lenders to monitor progress and confirm that targets remain ambitious and relevant to the borrower's business.

Given the value of transparency in the SLLP market, the SLLPs recommend that where possible borrowers should be encouraged to publicly report the underlying calculations and methodologies (such as in a borrower's integrated annual report or sustainability report). To the extent that this is not possible, where appropriate, a borrower may choose to share this information on a private basis only with lenders. Borrowers are also encouraged to provide lenders with details of any underlying methodology of SPT calculations and/or assumptions.

It will be interesting to track evolving market practice in relation to the type of detail and information that lenders expect to receive to enable them to accurately assess the ongoing relevance of the KPIs and SPTs over the duration of the loan.

Verification

The SLLPs encourage borrowers to obtain independent and external verification of their performance level against its SPT for each KPI by a "qualified external reviewer with relevant expertise, such as an auditor, environmental consultant and/or independent ratings agency at least once a year." The SLLPs recommend that verification of the borrower's performance against the SPTs is made publically available where appropriate, which we note is not limited to publicly traded corporates.

It is important to point out that transactions without independent external verification of performance will not meet the requirements of the SLLP to be classified as a SLL.

Once reporting by the borrower has taken place, the lenders will be able to assess the borrower's performance against the agreed SPTs and KPIs.

On March 3, 2022, the Loan Market Association, Asia Pacific Loan Market Association and Loan Syndications and Trading Association published "Guidance for Green, Social and Sustainability-Linked Loans External Reviews." This seeks to provide guidance on best practice on the external review process for borrowers, lenders, external reviewers and other stakeholders in the ESG loan market. It is voluntary and aims to provide information and transparency on the external review processes for borrowers, lenders, external reviewers and other stakeholders in the loan market.

Final Words

In the next article in this Sustainability-Linked Loans Series, we will discuss the application of the SLLPs to real estate finance transactions.