The power of growth
Guide to sustainability-linked loans
Sustainability-linked loans (SLLs), also known as ESG (environmental, social and governance) loans, are general corporate purpose loans and revolving credit facilities which have an additional intention of facilitating and supporting environmental and/or socially sustainable economic activity and growth. Importantly, SLLs are non-sector specific, so can apply to any corporate, regardless of sector or underlying asset class. They also do not require the purpose of the lending to be for specific ESG projects.

The borrower’s sustainability performance is measured using sustainability performance targets, as set against key performance indicators, external ratings and/or equivalent metrics and which measure improvements in the borrower’s sustainability profile.

The purpose of the Eversheds Sutherland guide to SLLs is to provide a quick reference point on the main drivers for both lender and borrower clients on entering into a SLL and summarises four key points which we think are crucial to consider when parties are discussing sustainability or ESG loans. If you would like any further advice in relation to SLLs, please ask one of our team members listed.
Most financial institutions are now under pressure from and have made various commitments to their stakeholders to be sustainable. With government, regulators and the wider market now increasingly looking towards improving sustainability and focusing on wider societal impacts, SLLs and ESG related loans are becoming more and more attractive.

Entering into a SLL is just one way lenders can evidence their commitment to sustainability as it incentivises and supports material sustainability improvements by actively directing capital towards borrowers implementing robust sustainability strategies. It also brings the added benefits of being able to clearly report to stakeholders on what borrowers are doing as part of their own sustainability commitments, and can improve a lenders own ESG ratings and compliance requirements, not to mention have a huge positive impact on reputation and credibility.
Main drivers for borrowers

Whilst the above comments hold true for lenders and borrowers alike, there are additional points to consider from a borrower perspective:

- SLLs incentivise increased sustainable performance by offering a reduction to the cost of finance, usually by way of a discount to the margin.
- Credit committees and rating agencies are now embedding sustainability as a method of selecting assets and opining on credit risk, in a similar way as to how they assess other factors such as management, sector risk or the quality of financials.
- Companies who see sustainability as an important part of their personal and working lives are reporting an increased ability to attract and retain staff.
The sustainability targets should be both ambitious and meaningful and should go beyond what the borrower would have achieved in the ordinary course of business. Traditionally, targets were focused around environmental factors, such as increased energy efficiency or a reduction in greenhouse gas emissions. More recently, we are seeing an increase in the number of social and governance related targets, such as placing people into work, training and education programmes and targets linked to decreasing the gender pay gap and increasing diversity on management boards. SLLs, by their nature, can be used by any entity which has a sustainability strategy and therefore the types of targets which can be considered are purposely broad, provided that they are suitably meaningful, measurable, core to the overall business, externally verifiable and able to be benchmarked.
The potential reductions to the cost of financing are relatively modest, starting around 5-10 basis points for investment grade borrowers and up to circa 5-10% of the overall interest margin for borrowers with a higher cost of capital. Two way pricing (a margin reduction if targets are achieved but a corresponding margin premium if targets are missed) is now market standard. We are seeing a number of SLLs adopt stepped-pricing techniques, allowing borrowers to gain advantages by firstly achieving a base target and then exceeding this target by certain pre-agreed levels, and also incorporating a number of, what can be very different, sustainability targets into the same loan agreement. Finally, the parties should consider where the funds from any margin adjustment should be directed towards; it can be stipulated that any margin benefit should be put towards an ESG project or a sustainable purpose, but whether this is decided by the lender or the borrower is a point for negotiation.
There is, currently, no generally accepted methodology for reporting on targets. Borrowers should be reporting on targets at least once per annum and are encouraged to provide details of any underlying methodology and/or assumptions. The information should be publicly reported, if possible, through an annual report or a separate, specific sustainability report. Similarly, reporting on each target should be verified by a third party at least once a year and such verification publicised along with the reporting. While the form of verification will vary on transaction by transaction basis as a commercial decision, it is increasingly common for limited assurance to be provided.
These are terms to describe situations where claims on sustainable credentials are misleading, inaccurate or inflated and may occur when some elements of an SLL are absent and the loan is publicised or marketed as an SLL, targets are not challenging or meaningful enough or are not disclosed or monitored correctly. When considering whether to enter into a SLL, it is important that all elements, in particular the targets, are considered in detail and sufficient importance is placed, not only on the targets set at the outset of the loan, but also on how these targets are monitored and validated and the requisite ambition maintained over the life of the loan.
How can we help?

The legal landscape on green and sustainable investment is constantly evolving, which means considered legal advice is vital. With years of experience helping corporates with their environmental, social and governance performance, our ESG lawyers can help enable you to deliver your own sustainability strategies with significant positive outcomes. We are regularly advising both borrower and lender clients on SLLs and would be happy to discuss your sustainable financing requirements with you.

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