Guidance on Green Loan Principles

1 Introduction

The Green Loan Principles (GLP) were originally published in 2018 and provide a framework to what is recognised as an increasingly important area of finance. In order to promote the development of this product, and underpin its integrity, the APLMA, LMA and LSTA considered it appropriate to produce Guidance on the GLP, to provide market practitioners with clarity on their application and promote a harmonised approach.

This Guidance note should be read alongside the GLP. Guidance is also available for the Sustainability Linked Loan Principles (**SLLP**). Both sets of Guidance are intended to highlight the differences between, and suitability of application of, the GLP and SLLP to any particular deal.

2 Fundamentals

A. Is there a definition of green loans?

The GLP define green loans as follows:-

Green loans are any type of loan instrument made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible Green Projects. Green loans must align with the four core components of the GLP, as set out in the GLP.

This definition will be reviewed on a regular basis in light of the development and growth of Green Loans. Whilst it is recognised that definitions of green and green projects may vary depending on sector and geography[1], the GLP do contain a non-exhaustive list of indicative categories of eligibility for Green Projects (Appendix 1 of the GLP).

B. What are the advantages of entering into a green loan?

The UNFCCC Climate Agreement, ratified in 2016 (known as the "**Paris Agreement**"), and the publication of the UN Sustainable Development Goals (**SDGs**) in 2015 are important drivers behind sustainable financing solutions. Companies are increasingly devising green and sustainable strategies, incorporating them into their business strategy and aligning their funding mechanisms to their sustainable development commitments. Entering into a green loan in this context has a number of wide ranging advantages for borrowers and lenders.

These benefits could potentially include, but are not limited to:

- positive impact on the environment and/or climate change mitigation and/or adaptation;
- positive impact on reputation and credibility;
- building stronger, values-based relationships with stakeholders;
- gaining access to new markets, providing greater resilience to market disruption caused by climate change and decreasing risk across portfolios;[2]
- gaining access to a wider/more diverse pool of investors, particularly those seeking investment with a positive environmental or environmental, social and governance (**ESG**) focus;
- meeting regulatory and policy targets/commitments; and
- increasing ability to attract and retain staff who see SDG contribution as an important part of their personal and working lives.

C. Who can borrow a green loan?

Subject to any applicable law, regulation and credit assessment, any entity that may borrow in the bilateral or syndicated loan market may borrow a green loan provided it is aligned with the four core components of the GLP.

D. What is the difference between green loans and sustainability linked loans (SLLs)?

The fundamental determinant of a green loan is the utilisation of the loan proceeds for Green Projects. Whilst use of proceeds is the key determinant, the other core criteria set out in the GLP must also be met, i.e. the criteria for project evaluation and selection, management of proceeds and reporting.

Under the SLLPs, the focus is on incentivising the borrower's efforts to improve its sustainability profile, by aligning loan terms to the borrower's performance against mutually agreed, material and ambitious, pre-determined sustainability performance targets (**SPTs**). Use of proceeds is not a key determinant in the categorisation of a SLL.

E. Can a loan follow both the GLP and SLLP?

Technically, a loan can follow both the GLP and the SLLP, although such transactions are rare in the market.

1 See ICMA's Compendium of international policy initiatives at https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/ICMA-Sustainable-finance-Compendium-of-international-policy-initiatives-best-market-practice-February-2020-200220.pdf for examples of international and national initiatives taxonomies

2 The potential for green and sustainable finance to mitigate against long term risks associated with climate change has encouraged regulatory authorities in many countries to promote policy initiatives which encourage and incentivise green and sustainable finance strategies, of which green loans form a key component.

3 See Appendix 1 of the GLP for a non-exhaustive list of indicative categories of eligibility for Green Projects.

F. How do the GLP incorporate ESG considerations?

The GLP explicitly recognise several broad categories of eligibility for green loans with the objective of addressing key areas of environmental concern such as climate change, natural resources depletion, loss of biodiversity, and air, water and soil pollution. This non-exhaustive list is set out in Appendix 1 of the GLP. Furthermore, it is recommended that the borrower of a green loan clearly communicate to its lenders its environmental sustainability objectives and position this information in the context of its overarching objectives, strategy, policy and/or process relating to environmental sustainability.

A green loan could have related social and governance considerations, but these considerations alone will not qualify the loan as green.

G. How do the GLP fit with their bond counterparts?

The GLP build on and refer to the Green Bond Principles (**GBP**) administered by ICMA with a view to promoting consistency across financial markets. The GBP are internationally recognised voluntary issuance guidelines that promote transparency, disclosure and reporting in the green bond market.

H. What is greenwashing? How should the market seek to avoid it?

In the context of green loans, greenwashing is a term that has been used to describe situations where a borrower or project is held out to have green credentials but where these claims are misleading, inaccurate or inflated. All market participants should seek to preserve the integrity of the product at all times, as any accusation of greenwashing in connection with green loans undermines the product and may impact investor confidence and cause serious reputational fallout for the institutions involved, as well as the potential for future litigation. In addition, accusations of greenwashing may impact investor confidence, as the product's integrity is called into question.

The GLP are drafted so as to give a clear framework of the processes to be followed in order to maintain the integrity of green loans. By closely adhering to all the core components with a view to being as open and transparent as possible, the market can take steps to avoid any allegations of greenwashing.

Borrowers of green loans should set out whether the use of proceeds will still be considered green, as set out in Appendix 1 of the GLP, for the duration of the loan and not just at the outset of the loan period. During the life of a loan, should an eligible project become subject to a major ESG controversy, or no longer be categorised as green because, for example, of new information or change in circumstances (e.g. updated technology), the parties can agree to exclude such project from being categorised as green. However, the application of use of proceeds is a key determinant of a green loan and any breach of the use of proceeds provisions should be taken seriously. See section 3.D.II for more information on "What will constitute a "green" breach?"

3 Green Loan Principles

A. Green loan definition

I. Can a revolving credit facility be green?

Green loans are any type of loan instrument which align with the four core components of the GLP, including revolving credit facilities. Appendix 2 of the GLP specifically relates to the application of the GLP to revolving credit facilities.

II. Can a revolving loan be recognised as green if the borrower does not have a designated eligible Green Project at the time of entering into the loan?

Where the borrower does not have a designated eligible Green Project at the time of entering into the loan, it may be possible to designate a revolving credit facility as a green loan provided the eligible category (or categories) of Green Projects for which the loan proceeds may be utilised is sufficiently identifiable in the relevant facility agreement and the loan satisfies all four core components of the GLP. The parties may agree a green finance framework for the purposes of identifying what amounts to an eligible Green Project on such transactions.

Lenders and borrowers will need to determine on a case-by-case basis how best to document the use of proceeds requirement in relation to the relevant revolving credit facility agreement, and agree whether any additional reporting requirements and/or other conditions will apply at the point of drawdown under the revolving credit facility.

III. Refinancing of Projects

Green loans include those made to re-finance new or existing eligible Green Projects. Borrowers should clarify which projects are to be refinanced and (re)evaluate and confirm the continuing environmental benefits of the project. It may be appropriate to have this confirmed through an external review.

B. Core components

I. Use of proceeds

a) If a tranche of a loan is green, is the whole loan deemed green?

No – only the green tranche will be classified as green.

Where a facility includes a green tranche, the green tranche must be clearly designated, with proceeds of the green tranche credited to a separate account or tracked by the borrower in an appropriate manner.

b) Is disclosure of use of proceeds required?

Borrowers are required to provide, and keep readily available, up to date information on the use of proceeds to the lenders. This information should be updated at least annually until the loan is fully drawn, and as necessary thereafter in the event of material developments.

This information should include:

- a list of the Green Projects to which the green loan proceeds have been allocated and the basis on which they have been designated as Green Projects;
- a brief description of the projects;
- the amounts allocated; and
- the expected environmental impact, if possible.

The borrower and the lender(s) may agree that this information should be reviewed by an external reviewer. They may also agree that additional reporting in relation to use of proceeds be carried out to ensure that the use of proceeds criteria continues to be met.

II. Process for project evaluation and selection

Green Projects should be consistent with the sustainability strategy of the borrower and in line with local policies and lenders' lending criteria/policies.

As stated in the GLP, borrowers are encouraged to position the information within the context of their overarching objectives, strategy, policy and/or processes relating to environmental sustainability.

a) What standards might be referred to in determining whether a loan is green?

It is noteworthy that there are several current international and national initiatives to produce definitions, standards and catalogues (sometimes referred to as "taxonomies"), as well as to provide mapping between them to ensure comparability. These may give further guidance to green loan borrowers as to what may be considered green and eligible by lenders and investors. These taxonomies are currently at various stages of development. Issuers and other stakeholders can refer to examples contained in ICMA's Compendium of international policy initiatives at https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/ICMA-Sustainable-finance-Compendium-of-international-policy-initiatives-best-market-practice-February-2020-200220.pdf.

b) The GLP states that a borrower should clearly communicate "the related eligibility criteria, including, if applicable, exclusion criteria or any other process applied to identify and manage potentially material environmental and social risks associated with the proposed projects". What is expected of borrowers in this regard?

Borrowers should seek to clarify any related eligibility and exclusion criteria, as well as any other policies or processes by which the borrower identifies, and manages perceived environmental and social risks associated with the proposed projects. The borrower's processes should seek to mitigate adverse environmental and social impacts associated with the proposed projects, and should communicate its analysis, any mitigation measures enacted and the monitoring to be undertaken where the borrower assesses the potential risks to be meaningful.

c) Would a project be eligible for inclusion in a green loan if it were to improve energy efficiency on projects associated with fossil fuel production or industrial processes linked to fossil fuel production?

Projects that significantly improve the efficiency of utilisation of fossil fuels are potentially eligible, as long as the loan funding such projects is aligned with the four core components of the GLP, and the borrower has committed to an ambitious decarbonisation pathway reasonably considered to be aligned to the Paris Agreement. Observed market practice is that such projects may be labelled as "light green" or "transition".

The GLP recommend that a borrower clearly communicate to its lenders its environmental sustainability objectives and how it will identify and manage potentially material environmental and climate risks associated with the proposed projects. An external review may be appropriate in such circumstances.

Market participants will likely consider green loans against their own environmental assessment standards and lending criteria that may set target thresholds for energy efficiency improvements and include broader ESG requirements.

d) Can a green loan be made to a borrower that has low ESG ratings, exposure to controversial issues or controversial sectors/ technologies (such as fossil fuels or nuclear energy)?

The focus of green loans is on the eligible projects rather than on the borrower itself. It should nonetheless be noted that the GLP recommend that borrowers clearly communicate to lenders their environmental sustainability objectives overall, and how they will identify and manage potential environmental and climate risks associated with proposed projects.

In the presence of controversial issues, such as fossil fuel, extractive or nuclear based activities, or limited overall sustainability credentials, lenders may require additional transparency from borrowers, particularly around the strategic importance of sustainability for the business and/or sustainability benefits from the underlying projects that go beyond established sector norms and business as usual.

III. Reporting

a) How are metrics chosen to report on the environmental impact or efficiency of projects?

The GLP recommend the use of qualitative performance indicators and, where feasible, quantitative performance measures (for example, energy capacity, electricity generation, greenhouse gas emissions reduced/avoided, resource efficiency etc.) and disclosure of the key underlying methodology and/or assumptions used in the quantitative determination.

For the calculation of indicators, where there is no single commonly-used standard, borrowers may follow their own methodologies while making these available to lenders. Reporting data based on a uniform, consistent and published methodology remains a challenge as on-going efforts to harmonise accounting methodologies for relevant sectors take place. Borrowers are therefore encouraged to provide full transparency on the applicable accounting methodology and assumptions they have applied, which can be referenced.

The borrower and lender(s) should agree at the outset whether an external review is required to assess the performance and impact measures to be reported by the borrower during the life of the loan.

b) How often should a borrower report?

Borrowers should make and keep readily available up-to-date information on the use of proceeds. This information should be updated at least annually until the loan is fully drawn, and as necessary thereafter in the event of material developments. The borrower and the lender(s) may agree that reporting should take place more regularly.

Where the proceeds are used to finance more than one eligible Green Project, the borrower's report must clearly set out the proceeds being applied to each project and the project's resulting environmental benefits. Where portfolio level reporting is agreed between the borrower and lender(s), information on proceeds allocation and aggregated impact at the portfolio level should be clearly reported.

C. Review

I. What is an external review and is it required?

The borrower and lender will need to agree at the outset whether an external review is required.

Given that the loan market is traditionally a relationship-driven market, lenders are likely to have a broad working knowledge of the borrower and its activities and, consequently, self-certification may be appropriate where the borrower has demonstrated or developed the internal expertise to confirm alignment of the green loan with the key features of the GLP.

Where lenders do not have a broad working knowledge of the borrower, or the borrower is not able to demonstrate sufficient internal expertise to satisfy the lenders that self-certification would be appropriate, external review is recommended. Similarly, if the lenders do not have sufficient internal expertise on the subject matter, external review is recommended. The GLP provide further information about the possible levels and types of review that are available in the market. These examples are not exhaustive.

II. Does a new external review need to be issued on a refinancing?

When refinancing an existing green loan, parties should consider whether it may be appropriate to obtain a new external review. This may assist, in particular, where minimum qualitative and/or quantitative thresholds have been set so as to ensure that the eligibility criteria are in line with the best practices prevailing at the time of the (re)financing.

It will also ensure that the integrity of the product is maintained.

III. Do self-certified loans need to be externally reviewed before they are compared/ranked against other loans (e.g. league tables)?

Neither the APLMA, LMA nor LSTA determine which loans can be included in green loan league tables, nor whether they need be externally reviewed. We are aware that the GLP are often used as screening criteria by data providers.

D. Documentation

I. What green clauses should be included in loan documents?

There is currently no template wording available for use in green loan documentation due to the varied nature of this market and, as such, a case-by-case approach will be required. However, there are some important considerations which should be kept in mind when drafting green loans:-

- **Purpose/use of proceeds provisions** – The eligible green project categories should be clearly set out in the purpose/use of proceeds provisions.
- **Information undertakings/covenants** - Information undertakings/covenants relevant to the Green Project(s) should be clearly identifiable in the facility agreement.
- **Representations** - The borrower should be under an obligation to represent the accuracy of any reporting.

II. What will constitute a "green" breach?

Whilst there is currently no established market standard in relation to what will constitute a "green" breach, this should be clearly documented in the facility agreement in respect of each deal.

The application of use of proceeds is a key determinant of a green loan. Consequently, any breach of the use of proceeds provisions should be taken seriously and the loan should not be considered green from the date of occurrence of such event, subject to any cure rights.

Parties should give due consideration as to whether or not a failure to apply the proceeds of a green loan towards a Green Project will trigger an event of default, and a subsequent cross-default across outstanding loans.