LMA Loan Market Association

ICMA International Capital Market Association

Guidelines for Sustainability-Linked Loans financing Bonds

June 2024

The Green Bond Principles | The Social Bond Principles | The Sustainability Bond Guidelines | The Sustainability-Linked Bond Principles | Climate Transition Finance

Table of Contents

Introduction

Financial institutions, in particular lending banks, hold an influential position at the interface between financial markets and the real economy, engaging directly with borrowers through the provision of credit products.

There is an opportunity for lending banks to use this position of influence to engage borrowers in dialogue regarding their sustainability performance, and the arranging of a Sustainability-Linked Loan instrument may be an attractive way to transfer the bank's expertise and knowledge with regard to sustainable economic development concepts to the borrower base.

Financial institutions have historically been important contributors to the growth of the sustainable debt market via issuance of 'Use-of-Proceeds' bonds, and there is an opportunity for such institutions to sustain their contribution to the growth of the market by issuing debt instruments which communicate the extent of their engagement with borrower clients, and engage the support of fixed income investors in maximising the potential of this potentially powerful channel for change in the real economy.

Issuing a debt instrument which reflects the issuer's efforts to engage borrowers via Sustainability-Linked Loans may prove attractive for financial institutions who are in the process of replacing green and social assets to support ongoing Use of Proceeds bond issuance.

Additionally, the opportunity to communicate a portfolio of selected[1] Sustainability-Linked Loans to investors in public markets via issuance of a bond may serve as an incentive to enhance the robustness of Sustainability-Linked Loan structures in the market over the longer-term.

It is anticipated that any development of a market for Sustainability-Linked Loan financing Bonds will clearly reflect the evolution and issuance trends in the Sustainability-Linked Loan market overall.

The core recommendation of these Guidelines, as further set out below, is that the existing Sustainability-Linked Loan Principles[2] should be used as the basis for construction of any such portfolio which may be communicated to the market via a bond instrument.

Sustainability-Linked Loans - Definition

As per the Sustainability-Linked Loans Principles ("SLLP") published by the LSTA, APLMA, LMA[3],:

Sustainability-Linked Loans ("SLLs") are any types of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) for which the economic characteristics can vary depending on whether the borrower achieves ambitious, material and quantifiable predetermined sustainability performance objectives.

The use of proceeds in relation to an SLL is not a determinant in its categorisation and, in most instances, SLLs will be used for general corporate purposes. Instead, SLLs look to support a borrower in improving its sustainability performance.

1 Acknowledging the likelihood that not all Sustainability-Linked Loans which a bank is participating in may be selected as eligible under a Sustainability-Linked Loan financing Framework, due to the fact that some loans may incorporate KPIs and targets unrelated to the desired sustainability 'theme', e.g. decarbonisation; emissions reduction.

2 https://www.lma.eu.com/sustainable-lending

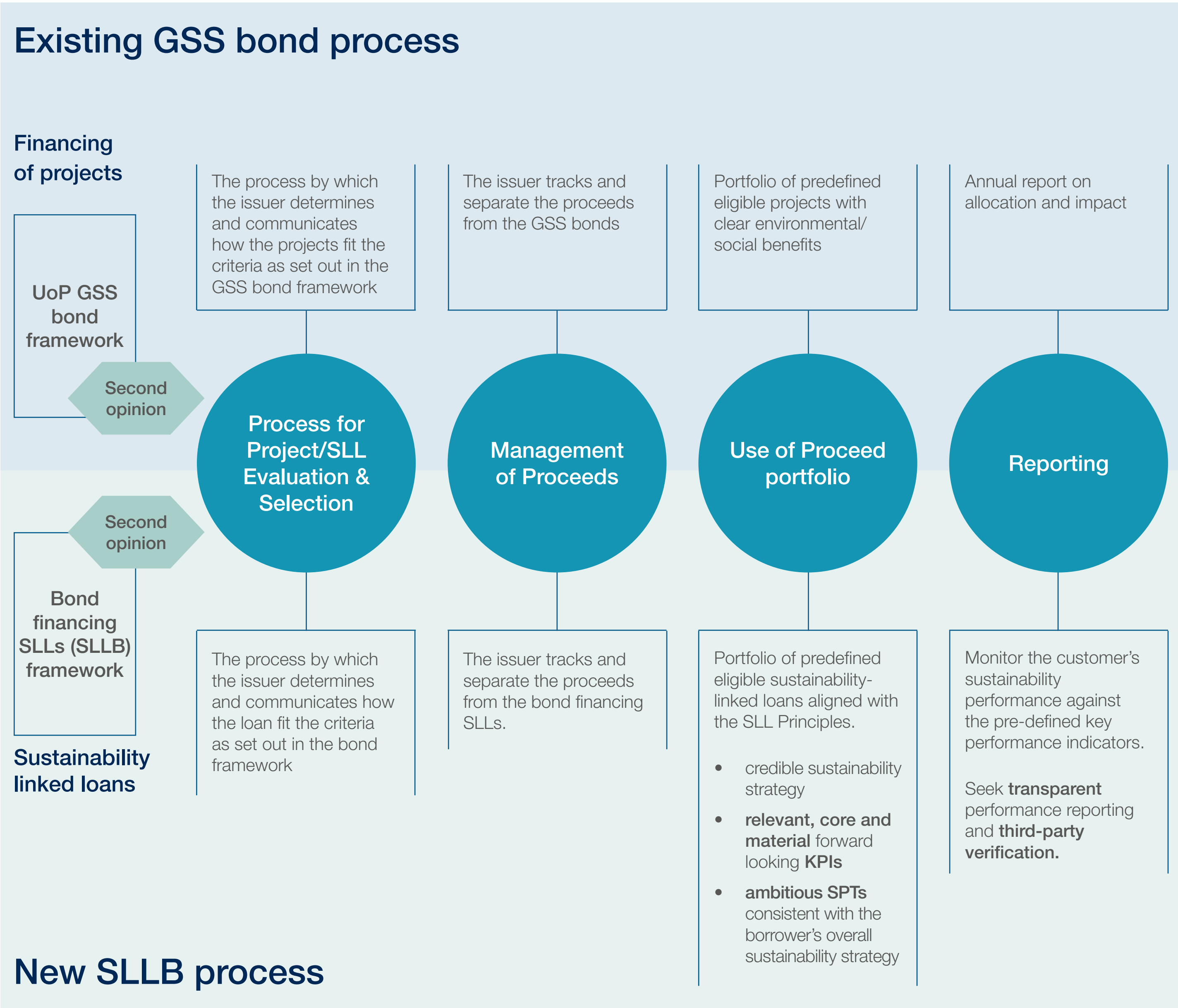
3 Sustainability Linked Loan Principles (SLLP), LTSA, APLMA, LMA

Sustainability-Linked Loans financing Bonds - Definition

Sustainability-Linked Loans financing Bonds ("SLLB") are any type of bond instrument (i) where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, a portfolio of new and/or existing eligible SLLs aligned with the SLLP ("the SLL Eligible Portfolio") and (ii) which are aligned with the four components further detailed below in these Sustainability-Linked Loans financing Bonds Guidelines ("SLLBG"), directly inspired by the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines.

It is important to note that SFBs should be considered as a separate category and not be considered or presented as Green, Social, Sustainability or Sustainability-Linked Bonds ("GSSS Bonds"). However, as illustrated below, there are similarities, in that the financing of a portfolio of SLLs is analogous to the green/social Use of Proceeds financing of GSS Bonds.

SLLBs consist of the financing a portfolio of sustainability-linked loans adopting the Use of Proceeds project financing structuring usual to GSS bonds.



Sustainability-Linked Loans financing Bond Guidelines

The SLLBG establish voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the SLLB market by clarifying the approach for issuance of such type of instrument.

The SLLBG are intended for broad use by the market: they provide issuers with guidance on the key components involved in launching a credible SLLB; they aid investors by promoting availability of information necessary to evaluate the eligible SLLs in light of the (core components of the) SLLP, especially on the relevance and materiality of selected KPI(s) and their level of ambition; they assist underwriters by offering guidance that will facilitate transactions that preserve the integrity of the market, and facilitate the external review.

The four core components for alignment with the SLLBG are similar to the Green Bond Principles and Social Bond Principles:

1. Use of Proceeds[4]
2. Process for SLL Evaluation and Selection
3. Management of Proceeds
4. Reporting

The key recommendations for heightened transparency are:

- SLLB Frameworks
- External Reviews

Issuers are also encouraged to provide information on their overarching entity level objectives, strategy, policy and/or processes relating to environmental and/or social sustainability.

4 For the sake of clarity, SLLs are General Corporate Purpose instruments. The term of Use of Proceeds refers to the Use of Proceeds of the SLLB.

1. Use of Proceeds

The cornerstone of an SLLB is the allocation of the proceeds of the bond towards eligible SLLs[5], with the eligibility criteria appropriately described in the Framework and/or legal documentation of the instrument. The SLLP should form the basis for selecting eligible SLLs.

The credibility of an SLLB relies on the transparency on the basis for selection of the eligible SLLs, noting that in the majority of cases details of borrowers and loans might need to remain private. In this context, issuers should detail the eligibility criteria that they will use for selecting each eligible SLL financed or refinanced by the SLLB, in particular when it comes to the core components of the most recent SLLP:

- Selection of Key Performance Indicators (KPIs)
- Calibration of Sustainability Performance Targets (SPTs)
- Loan Characteristics
- Reporting
- Verification

Several options may be available for issuers to achieve an appropriate level of transparency.

Approach 1

This could include detailed disclosure of their eligibility criteria mapped to the 5 core components of the SLLPs, especially with regards to how the pairs of KPIs/SPTs[6] are assessed (at the SLLB Framework level but not at the individual SLL level). This should be done by providing information on the evaluation process, criteria and/or thresholds in place in the SLLB Framework to assess the SLL Eligible Portfolio, which should include a predefined list of KPIs and accompanying ambition ranges for SPTs.

Approach 2

The issuer can seek an independent external review for each eligible SLL in the eligible portfolio together with a high-level description of the borrowers' sectors, the selected KPIs and their intended sustainability objective[7] that will be used for selecting the eligible SLLs.

In order to increase the transparency for investors, issuers are encouraged to define a single sustainability objective in their eligibility criteria common to all eligible SLLs in their eligible portfolio or at a sub-portfolio level.

Eligible SLLs should be aligned to the most recent SLLP published corresponding to the year of signing of the SLL facility.

There should be no double counting of assets under a SLLB, i.e. where a loan has both a green/social and sustainability-linked component and is included as an eligible green/social asset for the issuer's green/social/sustainability bond, then the loan should not be considered as an eligible SLL.

Issuers should allocate the proceeds only to the drawn part of each eligible SLLs.

Issuers should appoint (an) external review provider(s) to assess through a pre-issuance external review the alignment of their SLLB with the four components of these SLLBG.

For the sake of clarity:

- in Approach 1, the external reviewer reviews the SLLB Framework of the issuer against these SLLBG, but is not required to assess the alignment of each SLL to the SLLP; and
- in Approach 2, the external reviewer reviews the SLLB Framework of the issuer against these SLLBG and opines on each SLL. The external reviewer can be the same as the one reviewing the initial framework.

5 The eligible portfolio of an SLLB should only constitute SLLs
6 Including by making reference to the ICMA KPI registry.
7 It is acknowledged that for many banks, particularly those with larger numbers of smaller loans on their balance sheet, that Approach 2 is not likely to be practicable, due to the likely cost of an external review relative to size of the loans.

2. Process for SLL Evaluation and Selection

The issuer of an SLLB should clearly communicate to investors:

- The governance structure in place to evaluate and monitor SLL eligibility and performance over time, including but not limited to:
    - o The corporate functions engaged in the process, including responsibilities and relevant expertise (e.g. in form of a dedicated committee).
    - o Any external capacities leveraged in the process, including responsibilities and relevant expertise.
    - o The various steps in the decision-making process.
- Any sectorial exclusion criteria and/or other relevant policies applicable to the lending activities at issuer and/or at SLLB Framework's level. Issuers are also encouraged to have processes in place to identify and mitigate ESG risks related to the borrower of each eligible SLL.
- The process and criteria for disqualifying or requalifying SLLs that were initially included in the SLL Eligible Portfolio, in particular when it comes to SLLs where the borrower has missed one or several SPTs.

3. Management of Proceeds

The net proceeds of the SLLB or an amount equal to these net proceeds should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for eligible SLLs.

So long as the SLLB is outstanding, the balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible SLLs made during that period.

The issuer should make known to investors the intended types of temporary placement for the balance of unallocated net proceeds.

Subject to the volatility in the drawn amount of some SLLs, issuers are encouraged to have processes to ensure on a regular basis that at any point in time the proceeds are properly allocated.

For the sake of clarity, bearing in mind the general corporate purpose nature of SLLs, issuers are not required to have processes to track the proceeds of the eligible SLLs.

4. Reporting

Issuers should make, and keep, readily available up to date information on the eligible portfolio of SLLs to be renewed annually during the lifetime of the SLLB, and on a timely basis in case of material developments.

The annual SLLB report should include detailed information where possible on the SLLs to which the SLLB proceeds have been allocated, in particular with respect to:

- the amount of SLLB allocated and/or size of the portfolio of eligible SLLs;
- the sector and geography of the borrowers;
- information on, including achievement of, KPIs/ SPTs in combination with the underlying sector of the borrowers;
- information on the year of origination of the eligible SLLs; and
- information on disqualified SLLs and newly added SLLs.

Where confidentiality agreements, competitive considerations, or a large number of underlying SLLs limit the amount of detail that can or is allowed to be made available, that information should be presented in generic terms or on an aggregated portfolio basis.

Post issuance, the issuer's management of proceeds should be supplemented by the use of an external auditor, or other third party, to verify the internal tracking and the allocation of funds from the SLLB proceeds to eligible SLLs.

Key Recommendations

Sustainability-Linked Loans financing Bond Frameworks

Issuers should explain the alignment of their SLLB with the four core components of these SLLBG (i.e. Use of Proceeds, Process for SLL Evaluation and Selection, Management of Proceeds and Reporting) in an SLLB Framework and/or in their legal documentation. Such frameworks should be available in a readily accessible format to investors.

It is recommended that issuers summarise in their SLLB Framework relevant information within the context of the issuer's overarching sustainability strategy, as well as its efforts in accompanying its customers on their transition.

External Reviews

The SLLB encourages external review providers to disclose their credentials and relevant expertise and clearly communicate the scope of the review(s) conducted. Issuers should make external reviews publicly available on their website and/or through any other accessible communication channel as appropriate.

Contact details

ICMA Paris
25 rue du Quatre Septembre
75002 Paris
France

PrinciplesHelpdesk@icmagroup.org
sustainabilitybonds@icmagroup.org

www.icmagroup.org