Green and Sustainable Lending: A Changing Environment

This panel was chaired by **Nicola Wherity**, Partner at Clifford Chance. Nicola was joined by **Orith Azoulay**, Global Head of CIB Green and Sustainable Hub at Natixis; **Dave Davis**, Director at Barclays Debt Finance; **Peter Ellemann**, Managing Director of Loan Syndications at ABN AMRO Bank N.V.; **Andrew Ferguson**, Chief Executive Officer at the APLMA.

The panel began by providing an outline of the differences between green loans and sustainability linked loans. It was noted that sustainability linked loans do not require use of proceeds for green projects, but instead look to improve the borrower's sustainability profile by aligning loan terms to the borrower's performance against predetermined sustainability performance targets (SPTs). These SPTs are aimed at helping borrowers to improve their sustainability profile and may cover a range of environmental and social themes. There is a need to strike the right balance between flexible and ambitious SPTs, and SPTs are continuing to evolve in this respect.

Market trends: the rise of sustainability linked loans

The panel looked at recent data on green and sustainable lending and noted that global volumes of green and sustainability linked loans have been increasing year-on-year since 2014. Western Europe continues to dominate the green and sustainable lending market in terms of issuance, but there is growing interest in other parts of EMEA and across the world.

Green bonds have traditionally dominated the green and sustainable finance market, but the panel noted that more recently there has been a rapid rise in the volumes of sustainability linked loans and this is helping to close the gap with the green bond market. The rise of sustainability linked loans has seen the green and sustainable lending market opened up to a much wider range of borrowers in a more diverse range of sectors.

In the first quarter of 2019, the growth of sustainability linked loans quickly overtook the growth of green loans, demonstrating the substantial interest in these innovative products amongst borrowers, lenders and investors alike. As sustainability linked loans do not focus on use of proceeds, these loans often act as a good starting point for institutions that are looking to improve their environmental profile.

The panel noted that they were seeing a range of loan types, including revolving credit facilities, term loans and pre-export finance facilities, being structured as green and/or sustainability linked loans. The leveraged loan market was still to see a real uptake in green and sustainability linked loans, but the panel suggested that this was likely to change as green and sustainability linked loans continue to grow in the market as a whole.

The panel noted that the loan market's innovation of sustainability linked loans had very recently been adopted by the bond market with the first sustainability linked issues by Enel. The success of that issue is likely to lead to broader use of that structure in debt capital markets.

Standardisation

The panel recognised that the Green Loan Principles and the Sustainability Loan Linked Principles released by the LMA, LSTA and APLMA, have acted as a starting point for greater standardisation by providing a high-level framework of market guidelines. However, the panel noted that there were still some important areas where greater standardisation was needed in order to promote the continued growth of green and sustainable lending.

The risk of greenwashing remains a key concern in the market. Many people hope that the report on the EU Taxonomy, which was produced by the European Commission's EU Technical Expert Group on Sustainable Finance, will help to drive common standards in the EU and beyond as to what should be classified as 'green'. It was noted that market participants have mixed views on the EU Taxonomy, but overall the panel agreed that the EU Taxonomy will provide a useful resource for market participants looking to determine what is, and is not, 'green'.

Sustainability Ratings commissioned to support green and sustainability linked loans are another area where greater standardisation could help market participants. Depending on the rating provider used, there may be differing methodologies employed to calculate the sustainability performance, which makes comparisons between companies more challenging. The panel noted that the fact one recent study identified that corporates were reporting their CO_2 emissions in over 700 different ways which demonstrates the need for a more consistent approach.

In addition, greater accuracy, consistency and transparency of data standards, metrics and methodologies was noted as another important area where improvements would need to be seen over the next few years.

The panel hoped that greater standardisation would help to grow the green and sustainable finance market by improving transparency for market participants. Nonetheless, it was recognised that there remains a need for green and sustainability linked loans to retain their flexibility to adapt to individual borrowers' needs.

The LMA, alongside the APLMA and the LSTA, is hoping to release further guidance to accompany the Sustainability Linked Loan Principles and Green Loan Principles in due course.

Disclosures

In addition to the need for greater standardisation, it was noted that there was also a focus on the form of disclosures provided by issuers of green or sustainability linked loans. The panel noted, in particular, that the Taskforce on Climate-related Financial Disclosures (TCFD) had been working to develop voluntary, consistent climate-related financial risk disclosures for use by companies providing information to investors, lenders, insurers, and other stakeholders.

More consistent disclosures by borrowers could help information flow for lenders and enable them to better embed green and sustainability considerations into their decision making processes. For some lenders, this type of assessment was already standard and in these institutions all loans would be assessed against environmental and/or other sustainability criteria at the point of origination.

The road ahead

The panel concluded that overall 2019 had been a very positive year for green and sustainability linked lending. In particular, the rise of sustainability linked loans has opened up the potential for green and sustainable lending to be accessed by a much wider range of borrowers and to be integrated into mainstream lending in the future.

It was, however, acknowledged that some challenges still exist in the market. There remains a clear need for greater standardisation to help support the development of green and sustainable lending. Greater consistency in disclosure by issuers is also needed so that lenders can make informed decisions in relation to green and sustainability linked loans, both at the point of origination and throughout the loan term. Future regulation and/or regulatory incentives in the market could potentially help to overcome some of these obstacles but, in the meantime, market participants were already working hard to find solutions.