

Fear of Failure Frustrating Ambition

Ambition and additionality is at the heart of every single sustainability-linked loan (SLL) and is often the factor on which most negotiations focus.

In the first of this series, “KPI Selection – a matter of materiality”, we focused on the selection of KPIs and how materiality matters. With the KPIs selected, attention now turns to the setting of the sustainability performance targets (SPTs). These SPTs represent the level of ambition the borrower is ready to commit to, and indeed they must be ambitious.

In the Guidance on Sustainability-Linked Loan Principles, ambitious is described as “meaning a target that represents a true reach for the borrower”, but what does that mean?

1. Beyond a ‘Business as Usual’ trajectory

Borrowers are increasingly pushing themselves in their public sustainability pledges, with these pledges representing ambitious targets in themselves. Public scrutiny and the power of the press require this to be true. When borrowers have suitably ambitious public targets, it might be that these can be used as the SPTs for a SLL, as far as the ambition is at the right level. These targets should therefore not be blindly accepted. All SPTs should be reviewed by the sustainability coordinator (where such role exists), and **every single syndicate lender**, and where relevant the SPTs should be challenged. **Relationships should not drive acceptance of SPTs.** Whilst the relationship may drive lending, if the SPTs are not suitably ambitious, the loan should not be labelled a SLL.

Where SPTs track a borrower’s public targets, parties might look to include a provision in the loan documentation that requires the SPTs never be lower than any publicly announced targets. If a borrower therefore publicly announces more ambitious targets during the life of the loan, the SPTs will be amended to reflect this. This ensures that the SLL continues to be true to the core principle of ambition for the entire tenor of the loan.

In addition, SPTs should be seen to go beyond regulatory requirements and indeed be set beyond performance targets already achieved by the borrower, unless there is a clear rationale for exception in these instances. This focus here is on the “beyond”, as only by going beyond a Business as Usual trajectory can ambitious targets truly be set.

2. Procrastination prevents progress

The SLL can make long term targets viable via the setting of short term SPTs. These short-term milestones will act as a useful tool to focus a borrower’s mind in achieving any long-term sustainability targets and hold them accountable to any publicly announced targets. Particularly with sustainability there appears to be a gap between intention/commitment and action/behaviour, which could have a negative effect on the integrity of the SLL product.

Recognition should also be given to the fact that targets might not always be linear. For example, there may be instances where heavy investment is needed at the outset to achieve a certain KPI, before significant improvement is seen. SPTs relating to this KPI would need to reflect this, although sufficient narrative should always be provided to understand non-linear targets. In such cases some borrowers may set a range of dynamic targets that should capture non-linear targets. By permitting such KPIs to form part of a SLL, procrastination on necessary actions can be prevented.

3. Don’t Fear Failure

When setting SPTs that represent a ‘true reach’, failure might occur. Whilst hopefully not inevitable, the possibility of failure should not frustrate the setting of ambitious targets. Not achieving a target should not be seen as a failure, and sustainability is about the journey, with all improvements being a gain.

Furthermore, failure to achieve SPTs is built into the loan documentation, often via the incentives mechanic, and is therefore catered for.

What should not be encouraged is “sustainability á la carte”, i.e. the ability to declassify and reclassify the deal as a SLL depending on whether the borrower is meeting its targets at any point in time. This greatly undermines the integrity of the market, and whilst there might be a narrative to support the declassification of a deal in very specific instances, it is difficult to see how any narrative could support repeated declassification and reclassification of a sustainability deal.

4. Recalibration

A borrower meeting its ambitious targets is something to celebrate, but what happens when a borrower hits all of its targets in year 2 of a 5-year loan? Or significantly overshoots its targets (e.g. by 20% or even 30%)? Whilst this does not necessarily evidence the setting of unambitious targets, it probably acts as a pointer to call parties back round the table to discuss whether a recalibration of remaining SPTs is required.

These are all factors to consider and adhering to the principle of ambition is vital to maintaining the integrity of the SLL market. The SLL label is to be earned, not handed over. We therefore encourage all our members to remain vigilant in scrutinising SPTs for every KPI set on every SLL, and to challenge these targets where appropriate.

About us



Gemma Lawrence-Pardew

Director - Legal

gemma.lawrencepardew@lma.eu.com
+44 (0)20 7006 1372



Hannah Vanstone

Senior Associate Director – Legal

hannah.vanstone@lma.eu.com
+44 (0)20 7006 2034