Guidance on Green Loan Principles

APLMA Asia Pacific Loan Market Association 25 Successful years in the loan market 1998-2023

LMA Loan Market Association

LSTA ADVANCING THE CORPORATE LOAN MARKET

1 Introduction

The Green Loan Principles (GLP) were originally launched in 2018 and provide a framework to articulate the fundamental characteristics of a green loan. In order to promote the development of this product, and to underpin and strengthen 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 should be read alongside the GLP.

Guidance is also available for the Sustainability-Linked Loan Principles (SLLP) and the Social Loan Principles (SLP). These sets of Guidance are intended to highlight the differences between, and suitability of application of the GLP, the SLP and /or the SLLP to any particular deal.

2 Fundamentals

A. Is there a definition of green loans?

The GLP define green loans as:-

"...any type of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) made available exclusively to finance, re-finance or guarantee, in whole or in part, new and/or existing eligible Green Projects and which are aligned to the four core components of the GLP."

Borrowers are recommended to explain the alignment of their green loan with the four core components of the GLP in a green loan framework and/or legal documentation, as appropriate.

The definition of green loans will be reviewed on a regular basis in light of the development and growth of the green loan market. Whilst it is recognised that definitions of "green" and "Green Projects" may vary depending on sector and geography[1], the GLP do contain a high-level, non-exhaustive list of potential categories of eligibility for Green Projects (See – 1. Use of Proceeds in the GLP).

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

Entering into a green loan in this context may have a number of wide-ranging advantages for borrowers and lenders, including, but 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; and
- meeting regulatory, strategy and policy targets/commitments.

C. Who can borrow a green loan?

Subject to any applicable law, regulation and credit assessment, any type of borrower may borrow a green loan, provided the borrower is able to provide the strategic elements necessary for the structure to be aligned with each of the four core components of the GLP.

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

The fundamental determinant of a green/social loan is the utilisation of the loan proceeds for green/social projects. Whilst use of proceeds is the key determinant, the other core criteria set out in their respective principles (GLP/SLP) must also be met, i.e. the criteria for project evaluation and selection, management of proceeds and reporting.

Under the SLLP, use of proceeds is not a determinant in its categorisation. The focus is instead on supporting a borrower in improving its sustainability performance, via the achievement (or not) of predetermined sustainability performance

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 support green and sustainable finance strategies, of which green loans form a key component.

targets. As a result, the proceeds may be used to finance any kind of business activities that the borrower is pursuing, be they project based, acquisition based and so on.

E. **Can a loan follow a combination of the GLP, the SLP and/or the SLLP?**

Technically, a loan can follow a combination of the GLP, the SLP and/or the SLLP.

In this instance, there would need to be a rationale to both qualify the proceeds of the loan as green and/ or social and to support the underlying assets' green and/or social performance through the additional introduction of key performance indicators and sustainability performance targets.

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. A list of examples of categories of eligible Green Projects is set out in Part 1 (Use of Proceeds) of the GLP. Furthermore, it is recommended that the borrower of a green loan clearly communicates to its lenders its environmental sustainability objectives and positions 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 would not qualify the loan as green. However, broader ESG considerations should be included in the impact assessment of the projects – either from a risk management perspective under project selection and evaluation (i.e., negative impacts) or from a positive outcome perspective in the impact reporting.

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

The GLP build on and are closely aligned to the Green Bond Principles (GBP) administered by the International Capital Market Association 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.

It is envisaged that on some occasions, the GLP will be used together with the GBP. For example, a company may issue green bonds using the GBP, and thereafter, when it comes to using the proceeds of the bond issuance, the same company may act as a lender and use the GLP to provide green loans to one or more ultimate borrowers. Alternatively, a green bond may be used to refinance an existing green loan.

In a similar way, it is envisaged that the GLP may be used by an original borrower to borrow an initial green loan, and, thereafter, the original borrower may act as lender to provide green loans to one or more ultimate borrowers. This is more likely to be the case where the original borrower is a government or semi-public institution such as a municipality or a development finance institution. Each of the loans will need to comply with the four core components of the GLP to be classified as a green loan, and care will need to be taken to avoid the double counting of any such green loans.

H. **Can a green loan be entered into by a borrower at the start of their transition journey i.e., borrowers not yet able to claim alignment with the Paris Agreement, but taking ambitious steps in that direction?**

The focus of green loans is on the eligible projects rather than on the borrower itself.

It should nonetheless be noted that the GLP require that borrowers clearly communicate to lenders their environmental sustainability objectives overall; the process by which the borrower determines how the project(s) to be funded fits within the eligible Green Projects categories; and any complementary information on the processes by which the borrower identifies and manages perceived, actual or potential environmental and social risks associated with the relevant project(s).

Many lenders take into consideration the quality of the borrower's overall profile and performance regarding environmental sustainability for green loans. In the presence of controversial issues, lenders may require additional transparency from the borrower. In particular, additional disclosures may be sought around the strategic importance of sustainability for the business, demonstration of the borrower's transition strategy and/or the sustainability benefits of the underlying projects that go beyond established sector norms and business as usual.

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I. Can 'pure play' companies enter into green loans? Are all loans entered into by pure play companies automatically green loans?

Loans entered into by companies whose business activities are exclusively focused on the green economy (pure play) are considered as green loan if they are explicitly aligned with the GLP (see definition of Green Loan above).

3 Green Loan Principles

A. Green loan definition

I. Can a revolving credit facility (RCF) be a green loan?

Green loans include any type of bilateral or syndicated loan instrument which aligns with the four core components of the GLP, including RCFs. Appendix 1 of the GLP specifically relates to the application of the GLP to RCFs.

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 RCF as a green loan provided the eligible category (or categories) of Green Projects for which the loan proceeds may be utilised is sufficiently identifiable and the loan satisfies all four core components of the GLP. The parties may agree a green loan framework for the purposes of identifying what amounts to an eligible Green Project on such transactions.

It will ultimately be for the parties to agree whether and at which point the revolving loan can be designated and marketed as a green loan. Where a RCF is made available for general corporate purposes, but also allows for draw down of the RCF for eligible Green Project(s), only those proceeds that are allocated for Green Project(s) may be classified as green loans, provided they comply with all the core components of the GLP.

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 RCF agreement, and agree whether any additional reporting requirements and/or other conditions will apply at the point of drawdown under the RCF.

III. Refinancing of Projects

a) How can borrowers be transparent about the age of refinanced assets?

Green loans are often used to refinance assets that have a longer operating lifetime than a loan's tenor. Eligible projects would qualify for refinancing as long as they are in use, follow the relevant eligibility criteria at the time of the refinancing , and are still assessed as making a meaningful impact. Note, however, that many lenders differentiate between the refinancing of capital projects and operating expenditures and may expect a shorter lookback period for operating expenditure. Lenders may also seek additional information on the clear environmental benefits of refinanced projects with longer look back periods.

The GLP recommend that borrowers clarify which Green Projects are to be refinanced and disclose, to the extent relevant, the expected look-back period (i.e. the number of previous years that the borrower will look back to) for these refinanced Green Projects.

b) Can eligible assets be refinanced with the proceeds of a green loan before the original borrowing has matured?

Yes. In addition to providing clarity on the assets to be refinanced, the borrower should make clear when the original financing is due to mature. As the proceeds of any green loan should not be used contemporaneously against the same asset more than once, in the overlapping period, the borrower should ensure that the proceeds raised from the new financing will not be used for any purposes that would lead to double counting.

c) Can long-dated green assets be (re)financed by (multiple) consecutive green loans?

Long-dated green assets, including their maintenance and/or upgrade costs, may be (re)financed by multiple consecutive green loans subject to key disclosures by the borrower. The easiest way to do this may be in a portfolio-based 'Management of Proceeds' approach where multiple green loans finance one single pool of assets and expenditures. Specifically, the borrower should make explicit: the age and remaining useful life of the asset, as well as any (re)financed amounts; and their (re)evaluation of the continuing environmental benefits of all eligible projects/assets and, as appropriate, that of an external reviewer. This information should be communicated to the lenders at the time of the origination, extension or refinancing of the loan and it is recommended, where possible, be made publicly available on the borrower's website as part of the overall information on the related green loan.

d) Can existing assets that are pledged as collateral against another borrowing be refinanced through a green loan?

Yes, unless the eligible assets are included in the use of proceeds of an outstanding green, social or sustainability loan, or equivalent bond instrument. The borrower should make clear that the assets are pledged as collateral, as well as conforming to all core components of the GLP. The refinancing should be done within the useable lifetime of the green asset (See 3.A.III.c above).

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 mandatory?

Borrowers should make, 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 (or until the loan maturity in the case of an RCF), and on a timely basis 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;
- a brief description of the projects;
- the amounts allocated; and
- the expected and, where possible, achieved impact.

The borrower and the lender(s) may agree that this information should be reviewed by an external reviewer. The borrower and the lender(s) 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.

c) Are intangible assets or expenditures (such as training, monitoring, R&D) also eligible for green loan financing?

The proceeds from a green loan may be used to finance or refinance other expenditures related to or in support of eligible Green Projects, as long as those intangible assets and expenditures are associated with clear environmental benefits.

d) When a loan finances projects that have both social and environmental benefits, such as sustainable social housing, sustainable public transport and access to clean water, can the borrower freely choose the designation of the loan as either a green or social loan?

Yes, as long as the loan is aligned with the core components of the GLP or SLP. The borrower should determine the designation depending on the primacy of the intended objectives of underlying projects. Where the borrower's prime focus is on the intended environmental objectives of the project, they should label the loan a green loan. Where the borrower's prime focus is on the intended social objectives of the project, they should label the loan a social loan. Borrowers may also align to both the SLP and GLP as per 2.E above, in which case the loan may be labelled as a 'sustainability loan'.

e) Can a borrower enter into 'theme' loans focusing only on one category out of a more general green, social and SLL framework?

Yes, a green, social and SLL framework can allow the loan proceeds to be allocated to a project(s) belonging to one or several defined categories. A borrower may enter into loans focusing on different "themes" using a single framework that encompasses all the relevant themes, or they may highlight thematic differences in their approach to any of the core components of the GLP through establishing additional frameworks. Whatever the focus of the loan or framework, it is helpful to ensure that all loan communications and documentation state clearly whether the loan is aligned with the core components of the GLP.

f) Do all green loans have to be climate related?

No, the GLP explicitly recognise several broad categories of eligibility for Green Projects, which contribute to environmental objectives such as: climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control. The list of eligible Green Project categories, which is not exhaustive, can be found in the GLP (See 1. - Use of Proceeds above).

g) Is there an eligible Green Project category in the GLP, which would consider carbon offsetting?

Carbon offsetting has not been envisaged within the GLP list of eligible projects.

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. Borrowers and other stakeholders can refer to examples contained in the ICMA's 'Compendium of international policy initiatives' (see 3).

Examples of eligible categories of Green Projects are found in the GLP (see 1. - Use of Proceeds). Definitions of Green Projects may also depend on sector and geography.

Where appropriate, an external reviewer may also be able to assist the borrower when seeking to confirm alignment to the GLP.

b) The GLP states that a borrower should clearly communicate "the processes by which the borrower identifies and manages perceived, actual or potential environmental and social risks associated with the relevant project(s)". 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, actual or potential environmental and social risks associated with the proposed projects. Borrowers are encouraged to seek through their processes to identify mitigants to known and likely risks of material social and/or environmental impacts from the project(s), which may include relevant trade-off analysis and monitoring undertaken where the borrower assesses the potential risks to be meaningful.

c) Can a green loan be made to a borrower that has low ESG ratings, exposure to controversial issues or 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 to have a process in place by which the borrower identifies and manages perceived, actual or potential social and environmental risks associated with the proposed projects.

In the presence of controversial issues, 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. Management of Proceeds

a) How should you deal with surplus money arising when green loan proceeds exceed green projects?

3 https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/ICMA-Sustainable-finance-Compendium-of-internationalpolicy-initiatives-best-market-practice-February-2020-200220.pdf.

The GLP state that the proceeds of the loan will be exclusively applied to finance or refinance eligible Green Projects. It nevertheless recognises that there may temporarily be unallocated loan proceeds, and that the borrower should make known the intended types of temporary placement of any unallocated loan proceeds. Borrowers may consider temporary placements (preferably thematically relevant/ESG placements) pending allocation to eligible Green Projects. Borrowers should seek to ensure that, in the selection of such temporary investments, they do not damage the integrity of the green loan market.

IV. 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 commonly accepted 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.

Parties may wish to refer to market guidance, such as the ICMA's 'Harmonised Framework for Impact Reporting (June 2022)', Cerise SP14 for further guidance on impact reporting and/or any other relevant market guidance.

b) How often and for how long should a borrower be expected to report on green loans?

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 (or until the loan maturity in the case of a revolving credit facility), and on a timely basis 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 each project's resulting environmental benefits. Alternatively, 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.

The expected and, where possible, achieved impact of projects should also be communicated to the lenders. The GLP recommend the use, where feasible, of quantitative performance measures of expected and achieved impact.

Borrowers are encouraged to report throughout the life of the loan and, to the extent possible, are encouraged to make available the latest report either on their website or in another publicly available space or to their lenders, with the date as at which it was prepared.

c) Is there a standard methodology for reporting on the impact of the loan proceeds?

Transparency is of particular value in communicating the expected and/or achieved impact of Green Projects, including through the use of qualitative performance indicators and, where feasible, quantitative performance measures.

In the bond market, ICMA has encouraged harmonised impact reporting by providing core principles for reporting the impact of projects, together with suggested metrics and the provision of templates to cover most eligible Projects. ICMA has produced a Harmonised Framework for Impact Reporting (June 2022), which highlights recommended disclosures of the key underlying methodology and/or assumptions used in the quantitative determination, and which may also be useful for loan market participants.

d) How should a borrower report impact for projects where the borrower has provided only partial financing?

Borrowers are encouraged to report the impacts of the prorated share of the total project cost that they are financing, and to provide the total project cost when available, subject to confidentiality considerations. Borrowers who do so are further encouraged to provide confirmation that they have chosen to report using a pro-rata methodology. Where borrowers have used estimates to determine their share of financing of the total project cost, they should clearly state so. In circumstances where the borrower believes an alternative impact reporting methodology is appropriate, borrowers are encouraged to explain their rationale, and to provide transparency regarding the share of the project they financed as well as the share of the impacts they are reporting.

e) Should a borrower report on actual and/or estimated impact?

It is understood that for certain Green Projects, actual impact cannot be calculated until those assets are operational and/or projects completed, which may/may not be at the origination, extension or refinancing of a green loan. In these cases, borrowers should report on their estimated impact. With either approach, actual or estimated, borrowers are encouraged to provide detailed insight with clear disclosure on the scope and limitations of data presented.

C. Review

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

Where appropriate, it is recommended that borrowers appoint (an) external review provider(s) to assess through pre-origination external review the alignment of their green loan or green loan programme with the four components of the GLP (i.e. Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds and Reporting).

Post-origination, it is recommended that a borrower's management of proceeds 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 green loan proceeds.

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

Borrowers are recommended to document thoroughly such expertise, including the related internal processes and expertise of their staff. This documentation should be communicated to lenders participating in the loan on request. When appropriate, and taking into account confidentiality and competitive considerations, borrowers are encouraged to make publicly available, via their website or otherwise, the parameters on which they assess Green Projects, and the internal expertise they have to assess such parameters.

For more information, see the APLMA, LMA and LSTA 'Guidance for Green, Social and Sustainability-Linked Loans External Reviews'.

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 help to 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)?

None of the APLMA, LMA or LSTA can 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 (including the related timeframes) 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.
- Disclosure – Given the increasing regulatory requirements on financial institutions to make ESG disclosures, and subject to any confidentiality requirements, lenders may wish to consider whether to include an express consent from the borrower for lenders to disclose the existence and the details of any green/ESG transaction for both internal reporting and external disclosure purposes.
- Conditions precedent – Details of any conditions precedent required to confirm alignment of the green loan with the GLP and/or any other green conditions precedent should be included in the facility agreement.
- No communication – The facility agreement will typically include provisions providing that the parties should hold the communication of the loan as a green loan until such time agreed between the parties, and/or, where there is a breach of the covenants under the facility agreement, the borrower should cease to refer to the facility as a green loan in any future communications.
- Green Loan Coordinator – See An Introduction to the Sustainability Coordinator Role for more information on points to consider including in documentation.
- Desclassification – Provisions dealing with when the loan will be declassified as a green loan to be considered.