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A world gone green

This panel was chaired by **Martyn Rogers**, partner at Ashurst. He was joined by **Orith Azoulay**, Global Head of CIB Green & Sustainable Finance at Natixis; **Herry Cho**, Head of Sustainable Finance in Asia Pacific at ING; **David Davies**, Director, Structuring for Debt Finance at Barclays and **Peter Ellemann** Managing Director, Loan Syndications at ABN AMRO Bank N.V.

A green loan, by definition, is any type of loan instrument made available exclusively to finance or re-finance a green project. The size of the market is approximately €180 billion at present, which is one tenth of the size of the green bond market. Whilst the green loan market may be relatively new, it is increasing in popularity with its ability to provide flexible solutions to borrowers who want to make environmentally friendly loans.

Forces of green

Banks may want to issue a green loan for a whole host of reasons. These would include a reaction to market opportunity, shareholder and investor demands and global climate change initiatives (such as the UN – through its Sustainable Development Goals with the specific focus of combating threats of climate change by 2030, the EU Commission or financial regulators). At present however, no regulatory capital relief is specifically available to banks for green finance.

Green lending developments have caught the attention of senior management, with many banks deploying a top down approach to green thinking. From a lender perspective, adopting a sustainability profile can enhance 'brand value' through demonstrating an awareness of environmental concerns. In addition, green loans tend to be more flexible and accessible than green bonds, attracting a wider range of borrower clients.

The European Commission's Action Plan for a Greener and Cleaner Economy was launched in March 2018. The proposals included a taxonomy for climate change and environmentally sustainable activities, that could be used to set standards for financial investments across Europe. The aim of this taxonomy is to create a harmonised set of criteria that will be used in different areas such as labels, standards and benchmarks, and has the end goal of being embedded into EU law. A Technical Expert Group was set up in June to assist in developing the Commission's proposals.

LMA publishes Green Loan Principles

Following the direction taken by the Green Bond Principles (GBP) published by ICMA in 2014, the Green Loan Principles (GLP), published in March 2018, provide a high-level framework of market standards and guidelines, and allow for consistent methodology to be applied across the whole green loan market. The GLP set out a clear framework of recommendations, to be applied by market participants on a deal-by-deal basis depending on the underlying characteristics of the transaction, based on the four following components:

1**. Use of Proceeds**
The loan proceeds should be allocated to provide environmental benefits; allowing institutions to clearly define green lending activity, with corresponding benefits around external PR.
2. **Process for Project Evaluation and Selection**
The borrower of a green loan should clearly communicate its environmental sustainability objectives.
3. **Management of Proceeds**
Management of proceeds should be credited to a dedicated account to maintain transparency and integrity of the product.
4. **Reporting**
Borrowers should make available information on the use of proceeds which should be updated on a rolling basis.

The LMA's green finance working party has recognised that specific governance targets are more difficult to impose and therefore the market will likely focus primarily on environmental (and then social) targets.

Maintaining the integrity of the GLP

With any green loan or bond, there is a risk of a loan being marketed as green, but loan proceeds not actually being applied to an appropriate project – this is known as 'greenwashing'. This presents a reputational risk for any financial institutions providing the loan and creates a credibility risk for the green loan market as a whole. Where appropriate, an external review is recommended to combat these risks. There are several levels and types of review that can be provided to cover aspects of the green loan framework, to ensure alignment with all four core components of the GLP and provide assurance on the achievement of any key performance indicators (KPI) set out in performance-based facilities.

Other than adoption of the appropriate "green methodology" – (use of proceeds, KPI performance or ESG[1] index) documentation of green facilities is almost identical to non-green. Green imposes higher reporting standards but does not impose additional events of default. The challenge to financiers is correct identification of the relevant performance measurement.

Future developments

Looking ahead, the working party will be seeking to expand the scope of the GLP to cater for revolving working capital facilities. In addition, the working party will seek to establish principles for environmental & social (E&S) performance driven loans. Creating a separate set of principles will present its own challenges, as the key green test of 'use of proceeds' will no longer be relevant. Nevertheless, the indicators chosen for E&S loans should be measurable and should be ambitious in their sustainability goals. Targets, price mechanisms and external reviews will be encompassed in the extension of the GLP. As corporate reporting requirements continue to develop (for example, Task Force on Climate-related Financial Disclosures recommendations), there is likely to be further development in the green lending market as participants refine their propositions.

When seeking to create principles for E&S loans, a ratings approach may be preferred, to allow shades of green to be introduced to incentivise business change. The publication of the EU taxonomy in 2019 and use of market data combined will be particularly instrumental in creating E&S guidance. With regards to ESG index-based loans (where an overall "ESG Score" is provided by an external agency based upon its [annual] review of a multiple number of factors), rating agencies can continue to develop their methodologies and companies may benefit from an improving score through better reporting or improved governance rather than achieving specific environmental goals. Social loans will require indicators to track their progress, which will be inherently more challenging given they encompass broader environmental impacts.

All in all, there is a bright future for the green loan market, with plenty of opportunities available to both lenders and borrowers.

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[1] Environmental, social and governance.