Practice Note

Practice note on the application of the Sustainability-Linked Loan Principles to SMEs

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LMA Loan Market Association

30 YEARS SHAPING MARKETS. THEN AND NOW

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Introduction

This Practice Note responds to growing market awareness in extending sustainability-linked financing to small and medium sized enterprises (***SMEs***), alongside increasing expectations placed on lenders to engage and provide sustainable finance to support a just transition.

While the Sustainability Linked Loan Principles (***SLLP***) provide a globally recognised framework applicable across borrower types, challenges have emerged in their application to SMEs, reflecting differences in sustainability maturity, data availability and market practice. Their practical application may vary across institutions, including through the use of internal sustainable finance frameworks, eligibility criteria or transaction-specific requirements.

This Practice Note supports the consistent and credible application of the SLLP in SME contexts, recognising the particular characteristics and constraints that may arise in SME lending. It provides practical guidance on applying the existing core components of the SLLP to SMEs through a lens of proportionality, without creating a new label, category or alternative set of principles[1]. It does not reinterpret or dilute any mandatory requirement ("shall") under the SLLP, including when applied to SMEs that are early in their sustainability journey.

This Practice Note draws on market engagement and survey findings to reflect market practice and evolving expectations in SME sustainable finance as at the date of publication[2]. It is intended to support market consistency, scalability and integrity in SME sustainability linked lending, while preserving the flexibility and discipline embedded within the SLLP. It should be read alongside the SLLP and related LMA guidance.

Nothing in this Practice Note is intended to modify, override or reduce any mandatory requirement set out in the SLLP, and, in the event of any inconsistency, the provisions of the SLLP shall prevail.

Defining SMEs

For the purpose of this Practice Note, SMEs should be understood in a flexible and jurisdiction appropriate manner. As SME definitions can vary significantly across markets, lenders should reference the local / regional regulatory or government's SME definition in the market where the borrower operates. These definitions typically consider factors such as annual revenue, number of employees, and total assets, and provide the most appropriate reference for contextualising the size and complexity of an SME within its domestic business environment.

In the event that no official or widely recognised local definition exists, lenders may refer to established internationally recognised definitions of SMEs, such as that of the International Finance Corporation (*IFC*)[3], and Science Based Targets initiative (*SBTi*)[4]. These international frameworks offer practical reference points for lenders assessing SME eligibility in the absence of national guidance.

[1] This Practice Note is not intended to capture impact-linked loans, which are structured around the generation of measurable, additional positive social or environmental outcomes and are governed by distinct frameworks (e.g. Operating Principles for Impact Management, IRIS+).

[2] See LMA's Scaling Sustainable Finance for SMEs: Insights from the Loan Market, September 2026 for more information.

[3] Definitions of Targeted Sectors, IFC. https://www.ifc.org/en/what-we-do/sector-expertise/financial-institutions/definitions-of-targeted-sectors

[4] SBTi Announces Updated SME Definition and Fees, SBTi, 1 November 2023. https://sciencebasedtargets.org/news/sbti-announces-updated-sme-definition-and-fees

Lenders shall take steps to ensure that the guidance in this Practice Note is applied only to independent SMEs and not, for example, subsidiaries of large or multinational corporates, regardless of the entity's standalone size. This recognises that subsidiaries of large corporates can typically benefit from the parent's sustainability capabilities and therefore do not face the same challenges that this SME focused Practice Note is designed to address. For the avoidance of doubt, the existence of external ESG support, including support provided by a financial sponsor, private equity sponsor or private debt fund, should not in itself prevent an otherwise eligible SME from making use of the proportionate approaches described in this Practice Note.

Overview of the Sustainability-Linked Loan Principles

The SLLP define sustainability linked loans (*SLLs*) as loan instruments whose financial and/or structural characteristics vary depending on whether the borrower achieves ambitious, material and predefined sustainability performance objectives. They aim to support the transition of borrowers to more sustainable business practices, helping companies shift towards long-term, positive environmental and social outcomes.

The five core components of the SLLP are:

01 **Selection of Key Performance Indicators (*KPIs*)**

02 **Calibration of Sustainability Performance Targets (*SPTs*)**

03 **Loan Characteristics**

04 **Reporting**

05 **Verification**

The SLLP are voluntary recommended guidelines intended for broad application, while maintaining flexibility across borrower types and jurisdictions, and draw a clear distinction between mandatory requirements ("shall"), recommendations ("should") and optional approaches ("may" / "can").

Challenges of Applying the SLLP to SMEs

The following challenges were identified in the LMA's Q1 2026 market survey, to which 30 individual organisations responded.

Selection of KPIs:

- May not have developed an in-depth sustainability strategy (yet)
- Limited ESG data, weak data infrastructure, and lack of baseline metrics
- Difficulty identifying material, sector-relevant, and quantifiable KPIs
- Early-stage SMEs face difficulties defining quantitative indicators (reliance on qualitative commitments)
- Lack of standardised, SME-tailored KPI frameworks, with sector-agnostic approaches often unsuitable to SME contexts [5]
- Limited internal ESG expertise and capacity

Calibration of SPTs:

- Short-term competitive challenges competing with long-term sustainability goals
- Lack of leverage on their value chain (suppliers and clients) due to their size
- Lack of standardised benchmarks for SME-level ambition
- Lack of (3 years of) historical data needed to create a baseline and demonstrate beyond BAU targets
- Misalignment of SPTs with SME financial structure (e.g. capex-heavy targets vs. SME opex focus) or strategy (e.g. external growth)
- Uncertainty around economic viability and feasibility of ambitious decarbonisation pathways

Loan Characteristics:

- High proportional costs (legal, advisory, structuring, internal time)
- Limited ability to absorb structuring costs within lending margins
- Use of "sleeping" SLLs and rendez-vous clauses increasing complexity and cost
- Use of simplified, bespoke bilateral facility letters limits standardisation and comparability across transactions

Reporting:

- Limited ESG reporting systems, data pipelines, and automation
- Capacity and resource constraints (time, staff, expertise, weak internal governance and ESG ownership)
- High reporting burden relative to SME size

Verification:

- Verification perceived as disproportionately costly relative to loan size
- Additional external costs (auditors, verifiers) with limited perceived value
- Lack of standardised verification approaches for SMEs
- Increased compliance burden and administrative complexity

[5] The following non-exhaustive list of resources relate to the sustainability-focused financing of SMEs in the loan market: EU's 2025 Streamlining sustainable finance for SMEs; ICC 2024 Unlocking sustainable finance for SMEs and current globalstocktake on SME sustainable finance; UK Finance 2024 Unlocking the SME Net Zero Transition; EFRAG 2024 Voluntary Sustainability Reporting Standard for SMEs; FranceInvest's 2023 Best Practice Guide for Private Debt Sustainability-Linked Financing; IFC's on-going SME Finance Programmes; and Invest Europe's ongoing publications on SMEs and private capital.

Application of the SLLP to SMEs

The SLLP do not prescribe a minimum level of ESG performance and do not impose exclusions, provided that all five core components of the SLLP are satisfied. In SME contexts, early engagement between lenders and borrowers is encouraged, where collaborative work may be needed to support a SME's capacity building and progressive improvement in sustainability targets, without compromising relevance of KPIs, ambition of SPTs or credibility of the SLL instrument.

i. Selection of KPIs

Summary of SLLP Requirements

Under the SLLP:

- KPIs **shall** be relevant, core and material to the borrower's overall business and sustainability strategy.
- KPIs **shall** address relevant ESG challenges for the borrower's sector.
- KPIs **shall** be measurable, transparent, capable of being benchmarked and, where feasible, externally verifiable.

SME Specific Application

Relevance and materiality:

When applying the SLLP to SMEs, lenders may need to consider that some borrowers may lack formalised sustainability strategies and/or established robust ESG data systems and may not have completed materiality assessments. The lack of formal documentation and relevant data systems does not, in itself, preclude the use of SLL structures, provided that the selected KPI is demonstrably relevant and material to the borrower's business activities and sustainability context. Where a borrower does not have a formal sustainability strategy, lenders should nevertheless be able to demonstrate how the selected KPI aligns with the borrower's relevant sustainability objectives, priorities, commitments or transition plans, as applicable. Consideration should also be given to the borrower's ability to influence the relevant outcome. This may be particularly relevant for certain Scope 3 emissions categories, where emissions may be material, but the borrower has limited control over the underlying drivers.

Operationally focused KPI selection:

For SMEs, KPIs may focus on material priority sustainability risks or opportunities that are most closely connected to the borrower's operations, scale and geographic footprint (for example, operational energy use, direct greenhouse gas emissions, or key product or process level environmental impacts), rather than broader industry-wide ESG challenges, unless such challenges are material to the borrower's business model, operations or impact.

The requirement that KPIs be capable of being benchmarked remains; however, in SME contexts, this may be achieved using proxy, indicative or limited peer data where direct benchmarking is not feasible, and where publicly available peer data is limited or the borrower has insufficient historical data to establish a reliable baseline, provided such comparative information is substantiated (e.g. source, methodology). Where appropriate, borrowers may wish to consider alignment between SLL KPIs and sustainability metrics already used within the borrower's internal management processes, as this may support implementation, monitoring and reporting.

Transitional use of qualitative KPIs:

Where quantitative KPIs are not feasible at inception due to limited data availability or measurement capability, clearly defined qualitative or activity-based KPIs supported by objective assessment criteria and evidence requirements may be used, provided that such KPIs remain measurable on a consistent methodological basis and capable of objective assessment over the life of the loan.

Where such KPIs are primarily intended to establish measurement capability (for example, development of baseline measurement processes, implementation of data collection systems, or adoption of sustainability management procedures), they should be used as transitional, time-bound milestones and, where appropriate, evolve into more outcome-based or quantitative indicators within an agreed timeframe, typically falling within the life of the SLL. This phased progression from foundational sustainability measures towards more outcome-oriented indicators as the borrower's data maturity develops may be described as a "stackable KPI" approach. However, not all qualitative KPIs are necessarily transitional. Certain measurable qualitative or binary KPIs, such as obtaining, maintaining or progressing against recognised sustainability certifications, accreditations or standards, may constitute appropriate standalone KPIs where they are relevant, material, objectively verifiable and capable of evidencing sustainability performance over time.

Any qualitative KPI should be sufficiently robust to demonstrate meaningful sustainability outcomes and should not be used to circumvent the requirement for ambition under the SLLP. The use of qualitative KPIs should not detract from the requirement that KPIs be measurable, transparent and capable of being benchmarked, where feasible.

Example of stackable KPI/SPT structure for environmental footprint improvements:

Year 1	Establish the baseline

Calculate a CO^2e baseline using recognised standards, such as the GHG Protocol.

Year 2	Set reduction targets

Establish CO^2e reduction targets, covering at least operational emissions.

Year 3	Deliver reductions and expand measurement

Reduce operational emissions in line with the targets established in Year 2, while continuing to map additional emissions categories, such as value chain emissions (Scope 3).

Use of certifications, ratings and third-party standards:

Credible and market-recognised certifications, ESG ratings or other third-party standards may be appropriate as KPIs where they are relevant, credible, aligned with the borrower's sustainability objectives, and capable of tracking performance over the life of the loan (for example, product level sustainability labels or externally assessed ESG scoring frameworks). However, borrowers should be aware that the evolution of certain certifications, ratings or externally assessed scoring frameworks may not be entirely within their control and could be influenced by changes to the underlying methodology or assessment criteria.

Where certifications, ratings or scoring frameworks are used, consideration should also be given to whether the metric is sufficiently specific to the material sustainability objective being tracked and whether the underlying methodology provides sufficient transparency to support the calibration and assessment of ambitious performance targets over the life of the loan. Parties may also consider the nature of the certification or rating, including whether it relates to obtaining, improving, extending, renewing or maintaining a certification or rating over the life of the loan, and whether the selected approach is appropriate having regard to the borrower's sustainability objectives and level of ambition.

ii. Calibration of SPTs

Summary of SLLP Requirements

Under the SLLP:

- SPTs **shall** be set in good faith.
- SPTs **shall** be ambitious and represent a meaningful improvement beyond a business as usual (*BAU*) trajectory and regulatory required targets.
- SPTs **shall** remain relevant throughout the life of the loan.
- Ambition **should** be assessed using recent performance levels and be based on a combination of benchmarking approaches.

Reminder: Sleeping SLL Structures

- Where KPIs and/or SPTs are not agreed before or concurrently with origination, a loan is not an SLL and should not be communicated as such.
- Any loan which includes sleeping sustainability-linked provisions and/or mechanisms to defer the selection of KPIs and/or calibration of SPTs should include: (i) a clear rationale for delaying KPI/SPT selection, (ii) disclosure of the borrower's sustainability strategy or objectives, (iii) a defined backstop date for agreeing KPIs/SPTs (ordinarily within 12 months of origination), and (iv) an amendment process that subjects post-closing KPIs and SPTs to the same scrutiny and attention as they would have received had they been proposed at the outset of the transaction.
- These considerations apply irrespective of the mechanism used to defer KPI and/or SPT setting, including sleeping structures, rendez-vous provisions, sustainability amendment provisions or similar deferred calibration mechanisms.

SME Specific Application

Assessing ambition where data is limited:

In SME contexts, the calibration of SPTs may require a more contextualised assessment of ambition, particularly where historical performance data or established benchmarks are unavailable. In these circumstances, lenders should reference a relevant combination of available information, including the borrower's past performance, indicative sector level expectations, the borrower's transition plans or operational commitments, any publicly declared targets, and the sustainability expectations of financial sponsors (e.g. private equity funds), key customers or value chain participants. Where historical baseline data is unavailable, the initial phase of the loan may include the establishment of a reliable baseline, provided that the methodology, timeline for baseline development, and subsequent target-setting process are clearly documented at inception.

Preparatory and binary targets:

SPTs may include a preparatory element at the outset, such as the establishment of baselines (for example, calculating an initial greenhouse gas emissions footprint) or implementation of specific sustainability measures, provided that such targets are time bound, clearly articulated, and designed to support progression towards more measurable outcomes in subsequent periods. Such preparatory targets may form part of the phased or "stackable KPI" approach described above.

In appropriate cases, SPTs may also take the form of binary outcomes, such as achieving a credible and market-recognised sustainability certification, where these represent a meaningful step in the borrower's sustainability journey. Binary targets may be used either as standalone outcomes or as part of a phased progression. Any preparatory target should contribute towards a credible pathway to achieving measurable sustainability improvements and should not replace the requirement that SPTs be ambitious and represent a meaningful improvement beyond a BAU trajectory.

Frequency of SPT assessment:

It is noted that under core component 2 of the SLLP, while setting an annual SPT for each KPI is considered best practice, borrowers and lenders currently have the flexibility of adjusting the frequency of SPTs, provided that it is justifiable with strong rationale and gives due consideration to the nature of the transaction and KPI in question.

Practical operational measures:

When selecting KPIs and calibrating SPTs, borrowers should seek to use practical, operationally meaningful measures. SMEs will often have greater familiarity with, and an ability to influence, direct operational metrics than derived sustainability metrics. For example, where greenhouse gas emissions are driven primarily by purchased electricity or fuel consumption, measuring reductions in electricity (kWh) or fuel use may provide a more practical and readily verifiable basis for setting ambitious SPTs than requiring emissions calculations at every measurement point, while still supporting the borrower's broader decarbonisation objectives. Another example involves companies with external growth strategies, where integrating newly acquired entities (e.g., CSR strategy, action plans, data systems) can require a transition period: this may justify a limited scope for KPIs and SPTs, provided it remains significant, material, time-bound and clearly justified.

Assessing improvement beyond BAU:

In assessing whether an SPT represents improvement beyond BAU, lenders may consider the scale and nature of resources required to achieve the target. For smaller enterprises, the relative magnitude of the financial, operational and managerial resources required to achieve the target, compared to the resources typically available to or deployed by the SME (for example, investment in more energy efficient equipment or cleaner technologies) may provide relevant additional context when assessing ambition.

Application to Specific Structures

Supply chain and anchor client expectations:

For SMEs operating within established supply chains, the sustainability expectations, reporting frameworks and data requirements of larger "anchor clients" may provide a practical basis for calibrating KPIs and SPTs. Where appropriate, an SME's targets may be aligned with, or derived from, the sustainability objectives of its anchor client, provided that they remain relevant to the SME's own business and satisfy the SLLP requirements for ambition. Where an anchor client has established an SLL framework that extends to its supply chain or supply chain impacts, that framework and the SME's alignment with it may also provide relevant evidence to inform the selection and calibration of the SME's KPIs and SPTs, provided that the resulting KPIs and SPTs remain appropriate for the SME and satisfy the SLLP requirements. This approach may be particularly relevant in sectors such as agriculture and manufacturing, where SMEs are closely integrated into larger value chains.

Example of a Furniture and Wood Products Supply Chain SME:

An SME supplying furniture or wood-based products to international retailers may enter into a SLL with KPIs linked to increasing the share of certified sustainable wood (e.g. FSC- or PEFC-certified materials), improving raw material traceability, reducing production waste, and enhancing sustainability reporting. Achievement of these targets may support the borrower's ability to meet evolving customer sustainability requirements, maintain access to key export markets, and strengthen its position within international supply chains.

Although illustrated through the furniture and wood-processing sector, similar supply chain-driven sustainability objectives may be relevant across a wide range of SME sectors, including manufacturing, food processing, textiles, packaging and other industrial supply chains, where customer sustainability requirements are becoming increasingly important.

Standardised and programme-based approaches:

In some SME lending markets, particularly where lenders operate programme-based or standardised sustainability-linked lending frameworks, lenders may utilise common KPI and SPT structures across groups of borrowers with similar characteristics. Where such approaches are adopted, lenders should take care to ensure that SPTs remain relevant to the borrower's business activities and sustainability context and continue to satisfy the SLLP requirements on ambition. Lenders should also ensure that any benchmarks, criteria or external frameworks used to calibrate ambition are applied consistently with the eligibility criteria and definitions on which those benchmarks are based. For example, where SME-specific pathways or criteria are used, these should be applied only to borrowers that meet the relevant qualifying criteria. While standardisation may support scalability and consistency, it should not replace borrower-specific assessment of KPI relevance and SPT ambition.

Examples of anchor-client sustainability programme:

Standardised KPI and SPT approaches may also be derived from established sustainability programmes operated by major customers or cooperatives.

Arla Foods' FarmAhead™ Incentive Model applies a common sustainability framework across thousands of dairy farms in Northern Europe, using predefined indicators covering areas such as greenhouse gas emissions, feed efficiency, manure management, renewable energy use and biodiversity measures. Under such models, SMEs are assessed against a standardised set of sustainability criteria and performance thresholds, while retaining responsibility for implementing improvements at farm level.

Danish Crown's CrownFarm Track (Klimavejen) provides a common ESG reporting and benchmarking framework for livestock producers across multiple Nordic and European markets. Participating farmers report a standardised set of sustainability indicators, including climate, feed, production efficiency, animal welfare and other ESG metrics, and receive individual performance assessments and benchmarking against peer groups.

In an SME SLL context, programmes of this nature may provide a practical basis for identifying relevant KPIs, benchmarking performance and calibrating SPTs across groups of borrowers with comparable activities, provided that the resulting KPIs and SPTs remain relevant to each borrower and satisfy the SLLP requirements.

Portfolio-based baseline setting and benchmarking:

In certain programme-based SME lending structures involving a large number of borrowers with similar characteristics, lenders may utilise portfolio-level data, statistical sampling techniques or representative cohorts to support the development of baseline assumptions, benchmarking methodologies or calibration frameworks. Such approaches may be particularly relevant where obtaining individual historical data for each borrower would be operationally challenging or disproportionate. In applying these approaches, lenders should ensure that the underlying methodology is transparent, scientifically robust and appropriate to the characteristics of the relevant borrower population. Any portfolio-level approach should support, and not replace, borrower-specific assessment of KPI relevance and SPT ambition.

iii. Loan Characteristics

Summary of SLLP Requirements

Under the SLLP:

- Financial and/or structural characteristics of the loan **can** vary depending on whether SPTs are met.
- Adjustments **may** include margin ratchets or other agreed mechanisms.

SME Specific Application

In August 2026 the LMA published updated Draft Provisions for Sustainability-Linked Loans, together with an accompanying Term Sheet and Educational Note, ***Provisions for Sustainability-Linked Loans: Promoting sustainability goals and preserving integrity*[6].** While these documents are drafted for syndicated transactions rather than bilateral facilities, they can provide a useful starting point for considering the loan characteristics appropriate to an SME SLL.

iv. Reporting

Summary of SLLP Requirements

Under the SLLP:

- Borrowers **shall** report at least annually, and additionally for any date/period relevant for assessing SPT performance leading to a potential adjustment of the SLL's financial and/or structural characteristics.
- The report **shall** give lenders sufficient information to monitor performance of the selected KPIs and include a sustainability confirmation statement outlining performance against the SPTs and, where relevant, the impact and timing of any adjustment to the loan's financial and/or structural characteristics, attaching a verification report.
- Borrowers **should** publicly report SPT-related information, including details of any underlying methodology of SPT calculations and/or assumptions.

SME Specific Application

Reporting arrangements for SMEs should be proportionate, practical and aligned with the borrower's internal capabilities. Where possible:

- existing regulatory or voluntary disclosure frameworks applicable to SMEs may be leveraged to reduce duplication;
- lenders may support SMEs in initial structuring and first period reporting, particularly where reporting systems are still being developed;
- reporting arrangements should be aligned with the borrower's existing reporting processes, data cycles and internal systems.

Where SPTs are structured or assessed on a non-annual basis, additional reporting should be provided at the relevant observation date(s) necessary to assess SPT performance and any potential adjustment to the loan's financial and/or structural characteristics. The frequency and scope of reporting should remain proportionate to the SME's circumstances and reporting capabilities.

[6] See https://www.lma.eu.com/documents-guidelines/documents. Available to LMA members only.

v. Verification

Summary of SLLP Requirements

Under the SLLP:

- Borrowers **shall** obtain external and independent verification of performance against each applicable SPT, where relevant to a potential adjustment of loan characteristics.

SME Specific Application

Verification in SME contexts should be applied on a proportionate and risk based basis, taking into account borrower size, data complexity and the nature of the KPI.

Where appropriate:

- existing audited disclosures, regulatory reporting, or credible third party certifications may satisfy the requirement for verification; or
- KPI data sourced directly from independent and reliable third party providers (e.g. utility bills, certification bodies, external agencies or professional advisors) may support satisfaction of the verification requirement, particularly where such information has already been subject to an appropriate level of independent review, verification, certification, assurance or regulatory scrutiny.

Example of KPI data sourced directly from independent and reliable third-party providers:

Some waste management providers can produce detailed customer-specific reports covering metrics such as waste volumes, waste fractions, recycling rates, sorting ratios and diversion from landfill. Where such data is generated through established measurement systems and provided by an independent third party, lenders may consider this information as providing independently generated source data capable of supporting the verification process for the relevant KPI.

Where relevant KPI data has already been subject to an appropriate level of independent review, verification, certification or assurance, lenders should consider whether further assurance would materially enhance the credibility, accuracy or integrity of the SLL and seek to avoid unnecessary duplication.

Any deviation from standard third party verification practices should be appropriately justified, documented, and applied in a manner consistent with maintaining compliance, transparency and the integrity of the sustainability linked loan structure.

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