LMA publishes model provisions for sustainability-linked loans

The Loan Market Association (the "**LMA**") has published draft model provisions for sustainability-linked loans (the "**SLL Rider**"), available on the LMA website.

What are sustainability-linked loans?

Sustainability-linked loans are any types of loans or facilities for which the economic terms can vary (e.g. by inclusion of a margin adjustment) depending on whether the borrower achieves "*ambitious, material and quantifiable predetermined sustainability performance objectives*" ("**SPTs**"), which are measured against key performance indicators ("**KPIs**"). The KPIs must be material to the borrower's core sustainability and business strategy, and address relevant environmental, social and/or governance challenges of its industry sector. Unlike for green/social loans, the use of proceeds is not a determinant in categorising a loan as a sustainability-linked loan; instead, sustainability-linked loans look to support borrowers in improving their sustainability performance via the achievement (or not) of predetermined SPTs, measured against the relevant KPIs.

What is the SLL Rider and why does this matter?

The SLL Rider contains proposed draft provisions which, subject to case-specific customisation and negotiation, can be inserted directly into the LMA leveraged facilities agreement and can be adapted for use in conjunction with the LMA's other recommended forms of facility agreement. It may also be useful to consider in the context of non-LMA form loan documentation. The SLL Rider also includes extensive drafting notes setting out points for parties to consider when undertaking a sustainability-linked loan transaction. The SLL Rider is in non-binding form and is intended to act as a starting point for drafting and negotiation, seeking to reflect current market practice.

The SLL Rider has been prepared in response to the rapid growth of sustainability-linked loan issuance in recent years. One of the objectives of the SLL Rider is to better protect the integrity of the sustainability-linked loan market by providing a basic drafting framework, bringing a greater degree of standardisation to the documentation used in the market and streamlining the negotiation process which, until now, has often proved time consuming given the range of differing drafting standards within the market.

The SLL Rider was prepared in consultation with a working party comprising representatives of financial institutions and law firms active in sustainable finance, including Simon Johnston and Caroline Barr, CMS Partner and Of Counsel respectively. We anticipate that it will be an extremely useful framework for both lenders and borrowers. However, by its very nature, sustainable finance involves a range of circumstances and complexities and the final negotiated position for sustainability-linked loans will be specific to the facts of each case. Indeed, certain provisions which are commonly negotiated between parties have been intentionally omitted from the SLL Rider (for example sustainability-linked conditions precedent which will be for the parties to negotiate on a transaction-specific basis), and it is expected that the provisions which have been included in the SLL Rider will be subject to case-specific customisation and subsequent negotiation.

In order to promote the development of, and strengthen the integrity of, sustainability-linked, green and social loans, the LMA, the Loan Syndications & Trading Association and the Asia Pacific Loan Market Association have published high-level frameworks of recommended market standards for these loans, comprising recommended principles and accompanying guidance notes. The SLL Rider is aligned with (and the drafting notes cross-refer the user to) the principles and accompanying guidance notes for sustainability-linked loans (see our recent **Sustainable Finance publication** for further detail on the updates to the principles and accompanying guidance notes which were published on 23 February 2023).

What trends should we look out for going forward?

Market practice for sustainability-linked loans is constantly evolving and the SLL Rider will be subject to future changes as market practice develops. Here are some key themes to watch out for going forward:

- ✓ The SLL Rider includes a *rendez vous* clause, which broadly enables the parties to enter into negotiations with a view to agreeing any necessary amendments to the calculation methodology, SPTs, KPIs and/or related terms included in the loan agreement at a later stage. Where will the market settle on the appropriate level of lender consent required to effect amendments, waivers or consents in respect of sustainability-related provisions (including any amendments effected pursuant to the *rendez vous* clause)?

- ✓ The SLL Rider includes a “declassification” concept, which essentially allows the Agent to declassify the facilities as “sustainability-linked”, following the occurrence of certain events (referred to as “Declassification Events”). Following declassification, the margin ratchet mechanism ceases to apply and the borrowing group is prevented from making any disclosure which describes the loan as “sustainability linked”. The SLL Rider includes one drafting suggestion for what will constitute a “Declassification Event”, leaving parties to consider additional limbs on a case-by-case basis (the drafting notes suggest a few examples including consecutive non-achievement of SPTs). Will certain “Declassification Events” emerge as market-standard going forward? And where will the market land on the approach to restrictions on publicity following a “Declassification Event” (e.g. imposing additional obligations on borrowers to remove historic references to the loan being sustainability-linked)?

Any questions?

Sustainability-linked loans, green loans and social loans are an ever-changing set of products. If you need any assistance navigating these, or have any questions, then please feel free to get in touch.

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