SLAUGHTER AND MAY/

JUNE 2023

LOAN MARKET ASSOCIATION LAUNCHES DRAFT PROVISIONS FOR SUSTAINABILITY-LINKED LOANS

What do treasurers need to know?

- The identification of key performance indicators (**KPIs**) and sustainability performance targets (**SPTs**) is typically the most difficult and time-consuming aspect of putting a sustainability-linked loan (**SLL**) in place. However, SLL documentation terms can also take time to settle. In the absence of any generally agreed framework or terminology, there are a range of views on their scope and content.

- In May 2023, the Loan Market Association (**LMA**) published draft provisions for SLLs (the **Draft Provisions**). The Draft Provisions were produced in response to strong demand from LMA members, with the aim of promoting more consistency in the drafting of SLLs.

- The availability of template drafting may be helpful to lenders and borrowers in standardising the terminology and structure of SLL provisions. A common starting point and options should also help market participants to develop a better understanding of the parameters of the product and their respective expectations.

- The Draft Provisions (available to LMA members from its website) cover territory that is reasonably familiar, in terms of the provisions required/proposed by lenders when turning an LMA-based facility agreement into an SLL. The devil, as ever, is in the detail.

- The Draft Provisions reflect trends in market practice as it has developed in recent years, and as a consequence may be more complex and extensive than those found in older SLLs (for example, the formulation and presentation of KPIs and SPTs and the information and reporting requirements).

- The Draft Provisions highlight a number of areas that are likely to require negotiation and/or supplementation, meaning that borrowers can continue to expect SLL terms to absorb a substantial chunk of time in documentation discussions.

- As SLLs are a relatively new product, the LMA has indicated that it will keep the Draft Provisions under review, to be refined further as market practice develops.

- In this briefing, we introduce the key components of the Draft Provisions, touch on the breadth of their application (a key reason why they require customisation) and consider how borrowers might use and react to them in practice.

Key components of the Draft Provisions

The Draft Provisions are designed to align with and articulate the requirements of the Sustainability-Linked Loan Principles and accompanying guidance published by the LMA and its sister trade associations. These are voluntary recommended guidelines which specify, at a high level, the criteria a loan ought to meet in order to be labelled as an SLL.

The key components of the Draft Provisions are as follows:

- **ESG metrics**: a framework for documenting the agreed KPIs and SPTs, and associated calculation/benchmarking methodologies and standards.

- **Sustainability margin adjustment**: providing for the margin applicable to the facility to adjust upwards, downwards or remain unchanged according to the borrower's performance against the SPTs.

- **Repeating representations**: relating to the sustainability information provided to the lenders.

- **Annual reporting**: comprising a Sustainability Compliance Certificate confirming the borrower's performance against the SPTs plus its Sustainability Report (form to be agreed).

- **External review of KPI performance**: the Sustainability Compliance Certificate must be accompanied by a Verification Report from an external reviewer (form to be agreed).

- **Sustainability amendments**: the circumstances in which the sustainability provisions will be reopened, the process for renegotiation and the consequences of failure to agree.

- **Declassification**: provisions setting out the circumstances in which the loan will cease to be an SLL, the margin impact of that happening and related restrictions on publicity.

- **Sustainability Breach**: details of the consequences of breach of sustainability provisions i.e. the sustainability margin adjustment defaults to the highest level (as opposed to an Event of Default).

- **Sustainability Coordinator**: provisions to be added to the agreement if any sustainability coordinator is appointed by the borrower (and assuming its role is limited to pre-signing).

- **Agency provisions**: extension of Agency protections to reflect sustainability-related aspects of the agreement.

Most of these key components are reasonably customary features of more recent SLLs; the attention required from the borrower's point of view stems from how these components are framed and defined. For example, a "sustainability amendment" or "rendezvous" clause is typical in SLLs; the triggers for the amendment and the process for reaching agreement (and what happens if not) may, however, vary quite significantly from the framework in the Draft Provisions.

The Draft Provisions have been drafted with the LMA's leveraged agreement in mind but are intended to be capable of use in conjunction with any of the LMA's recommended forms of facility agreement.

Application of the Draft Provisions

Inclusiveness is a positive feature of the SLL product, but its accessibility (potentially) to borrowers and lenders of all types means complete standardisation of drafting terms is challenging, if not impossible.

The terms of an SLL will inevitably be coloured by the specific circumstances of the borrower in question, including the reporting and disclosure requirements to which they are subject (which continue to evolve). Lenders, similarly, have different perspectives and priorities, and are working within a regulatory framework that remains work in progress. In anticipation of future developments, lenders must shape their own policies and requirements which means that there are a number of aspects of SLL terms on which there are a range of views.

The numerous blanks, options and footnotes in the Draft Provisions reveal the extent of issues on which there is (as yet) no consistent market view. They are also an unavoidable result of seeking to produce a single drafting template for the full range of market participants, borrower sectors and circumstances.

The potential breadth of situations to which the Draft Provisions might be applied is a key reason why they are expected to be subject to case-specific customisation and negotiation. The terms of a leveraged SLL involving a private company borrower for example, might be quite different to those applicable to a listed company borrower (in particular, the applicable information and reporting requirements).

Key takeaways for treasurers

Our key message for treasurers contemplating an SLL is to get in front of what lenders are likely to want and need to enable you to determine whether you are able to meet those requirements.

Engagement with lenders is particularly important in terms of the identification of KPIs and setting of SPTs, and information and reporting obligations, which will ideally be clarified at term sheet stage. A cost/benefit analysis (which takes into account the "soft" benefits of reinforcing the borrower's sustainability goals through putting in place an SLL, as well as economic factors) will inevitably be relevant.

We would suggest the following:

- Open discussions on SLL terms early and consider lenders' due diligence and information requirements in collaboration with your ESG colleagues and/or consultants.
- Due diligence your lender group - understand their "redlines" and policy requirements in terms of SLL-labelling.
- Collaborate - if there are difficulties or challenges, ask the lead banks (or your sustainability coordinator) to work with you to articulate where the gaps are and how they might be bridged and over what time frame.

The Draft Provisions are already being adopted by many lenders as a reference point in new SLL transactions as well as in refinancings of pre-existing SLLs. It may be that, as greater understanding and consensus emerges around certain points, the Draft Provisions will require less customisation and adjustment. For the moment, however, there are a number of aspects of the Draft Provisions which will prompt discussion and they should be approached by treasurers as a basis for negotiation.

Further information

For more information, please speak to your usual Slaughter and May contact or one of the lawyers listed on the contacts page below.

Slaughter and May contacts

MATTHEW TOBIN
PARTNER AND HEAD OF FINANCE
T: 0207 090 3445
E: matthew.tobin@slaughterandmay.com

ED FIFE
PARTNER AND HEAD OF BANKING
T: 0207 090 3662
E: edward.fife@slaughterandmay.com

KATHRINE MELONI
SPECIAL ADVISER AND HEAD OF TREASURY INSIGHT
T: 0207 090 3491
E: kathrine.meloni@slaughterandmay.com

LATIFAH MOHAMED
SENIOR PSL
T: 0207 090 5093
E: Latifah.mohamed@slaughterandmay.com