

LSTA Issues Revised Sustainability Linked Loan Principles

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PRACTICES Environmental, Social and Governance, Finance

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As interest in Environmental, Social and Governance (“**ESG**”) financing has increased, Lenders are increasingly looking to offer financial products for projects or companies that are environmentally friendly, socially conscious or focused on improving a company’s relationship with, or impact on, its community. One such financial product that has grown in popularity is the Sustainability Linked Loan (“**SLL**”), which includes a key pricing mechanism tied to the sustainability operations of the Borrower. Based on the Borrower’s sustainability policies and objectives, the Borrower and the Lender will identify key performance indicators (“**KPIs**”) to measure the Borrower’s progress towards sustainability goals and then set a sustainability performance target (“**SPT**”). By way of example, the Borrower and Lender might determine that the KPI is the reduction of Greenhouse Gas emissions in the Borrower’s operations, while the SPT would be the specific percentage (such as 10%) by which emissions need to be reduced on a year over year basis. If the Borrower meets the SPT and reduces its Greenhouse Gas emissions by 10% each year, it would be eligible to receive a reduction in pricing under the SLL, which might be reflected as a decrease in the margin or interest rate that kicks in once the SPT is met.

Given the increasing popularity of SLLs, the Loan Syndications and Trading Association (“**LSTA**”) developed guidelines to ensure the legitimacy and credibility of the SLL financial product as a means of facilitating and supporting ESG compliant economic activity and growth. Known as the Sustainability Linked Loan Principles (the “**SLLP**”), these voluntary guidelines were first published in May 2019 and together with the accompanying Guidance on Sustainability Linked Loan Principles (the “**Guidance**”) identify five key components of SLLs and provide a framework to better define the recommended or required elements of an SLL. On May 27, 2021, the LSTA issued amendments to the SLLP and Guidance emphasizing that the terms of an SLL should support the core purpose of promoting ESG compliant activity and highlighting the need for sufficient transparency and disclosure to avoid the risk or appearance of sustainability washing or misuse of the product. Specifically, the revised SLLP requires third-party verification of KPIs and significantly strengthens the Lender’s ability to verify the appropriateness of KPIs, the viability and ambitiousness of the Borrower’s ESG strategy and the methodology used for calculation of SPTs.

Read the full alert [here](#).