# Haynes Boone Serves as Project Counsel for LSTA and LMA: “A Guide to the Application of the Sustainability Linked Loan Principles in Fund Finance”

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PRACTICES Fund Finance, Finance, Environmental, Social and Governance

Haynes Boone is pleased to have worked as project counsel for the Loan Syndications and Trading Association (“***LSTA***”) and the Loan Market Association (“***LMA***”) in connection with the drafting and issuance of “A Guide to the Application of the Sustainability Linked Loan Principles in Fund Finance” (the “***Fund Finance SLLP Guidance***”). New York Fund Finance Partner and chair of the Haynes Boone ESG Practice Group Deborah Low worked as lead counsel with the assistance of associate Kayla Culver, while London Partner Emily Fuller served on the LMA working group. The Fund Finance SLLP Guidance was drafted with the participation of a global LSTA, LMA and Asia Pacific Loan Market Association working group comprised of over 40 lenders and law firms established in the fund finance space with experience in drafting, negotiating and administering sustainability-linked loans (“***SLLs***”) and is issued in collaboration with the Fund Finance Association.

The LSTA and LMA have demonstrated a significant commitment to supporting the financial services industry in developing standardized metrics and guidance for green loans and SLLs, through their impressive library of topical publications. Hot on the heels of the “Guidance for Green, Social and Sustainability-Linked Loans External Reviews” (our summary of which can be found *here*), the Fund Finance SLLP Guidance looks to tailor the previously issued Sustainability Linked-Loan Principles (“***SLLPs***”) specifically to the nuances of fund finance transactions. This is an exciting step for the fund finance industry, as this is the first time that these authoritative voices in the U.S. and EMEA syndicated loan markets have commented on SLLs specifically as they relate to fund finance.[1]

SLLs are loans where an economic benefit of the loan, such as margin or other pricing is adjusted based on the borrower’s attainment of sustainability performance targets (“***SPTs***”), measured by key performance indicators (“***KPIs***”), which are negotiated and agreed in the final loan documentation. As investors and sponsors are increasingly looking to incorporate environmental, social and governance (“***ESG***”) metrics into their investment strategies and decisions, significant interest has arisen in the implementation of SLLs in the fund finance industry due to the potential impact of ESG focused investments. Importantly, the Fund Finance SLLP Guidance aims to be jurisdiction agnostic and does not focus on any specific regulation or standards but reminds lenders to remain apprised of relevant considerations for each lender’s specific jurisdiction.

Although lenders and sponsors remain focused on ESG, challenges have emerged in the application of SLLs to fund finance transactions for many reasons, including, but not limited to: (1) limited historical data on a fund’s performance, (2) diversified investment strategies and difficulty applying standardized metrics across differing investments, (3) uncertainty of investment pipeline and difficulty in obtaining sufficient data from underlying investments, (4) cost considerations attendant to obtaining third-party verification, and (5) shorter tenored facilities relative to other financial transactions. The Fund Finance SLLP Guidance acknowledges these challenges and aims to provide guidance on approaches that have been implemented in the market, while recognizing that each transaction will be bespoke and lenders and borrowers need to carefully consider the various circumstances that could be relevant.

Ultimately, the Fund Finance SLLP Guidance reinforces that all sustainability-linked fund finance transactions should follow the key components of the SLLPs. This includes selection of KPIs that are sufficiently relevant and ambitious, representing steps beyond “business as usual” for a borrower, calibration of KPIs against accepted and reputable external benchmarks, necessary reporting from borrowers, loan characteristics in line with the standard SLL provisions published in tandem with the SLLP, and third-party verification of data provided in support of the SPTs. For funds that have not progressed a sufficiently advanced ESG strategy and goals, an SLL may prove to be difficult and infeasible.

The Fund Finance SLLP Guidance further reminds readers of the key distinctions between SLLs, green loans and social loans, with the main differentiator being that green loans and social loans require the use of the loan proceeds for green or social purposes, whereas SLLs can be used for a wide variety of purposes with the intention that the fund will obtain lower pricing if it achieves the SPTs. SLLs may be more appropriate for subscription line deals, which are often used for bridging or working capital purposes, and therefore the necessary and rigid tracking of the use of proceeds may not be workable; conversely, in a scenario where a fund is using loan proceeds solely for a green or social purpose, a green or social loan could be appropriate and should follow guidance issued regarding green loans and/or social loans, as applicable.

While the fundamental principles of the SLLPs apply to fund finance transactions, the Fund Finance SLLP Guidance highlights particular areas that lenders and borrowers should be cognizant of when applying the SLLPs to fund finance deals. In particular, the structure of investment funds and their use of financial products (particularly subscription lines) present some unique challenges when determining KPIs and setting SPTs. As with any area of green or sustainable finance, increasing regulation should assist in terms of producing a common language and providing a minimum level of reporting when it comes to a firm’s ESG impact, but until the further implementation of regulation and standardization of ESG concepts occurs, lenders should carefully consider SLL parameters and ensure that any agreed provisions comply with the SLLP and the lender’s internal standards.

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[1] The Fund Finance SLLP Guidance refers to subscription line facilities (where facilities are secured by the capital commitments of investors in the fund), NAV facilities (where facilities are secured by the investments of the fund), hybrids between subscription line facilities and NAV facilities, and credit lines offered to a sponsor to support its investment in managed investment funds as ‘fund finance’ transactions.