QUICK START GUIDE:
KEY CONSIDERATIONS FOR SUSTAINABILITY-LINKED LOANS

Momentum for companies to address universal challenges such as climate change, social inclusion, and sustainable development has rapidly increased over the past decade. In response, innovative financial instruments, such as sustainability-linked loans (SLLs), have emerged to support and incentivize improved corporate sustainability performance. Since funds from SLLs can be used for general corporate purposes rather than specific green or social projects, the selection of relevant and ambitious sustainability performance targets and key performance indicators is critical for the continued credibility of sustainability-linked financial instruments.

According to the Sustainability-Linked Loan Principles, there are five components that distinguish an SLL from other sustainable finance instruments. **In this checklist we highlight key considerations to ensure your SLL is credible and meets market expectations.**

SELECTION OF KEY PERFORMANCE INDICATORS (KPI)

What it Means for Borrowers	How to Address It
Selected KPIs should be material and specific to the corporate borrower's organizational and sustainability strategy, as well as comparable across time and industry peers.	☐ Companies can map KPIs against a materiality assessment of corporate borrower's industry to help ensure their relevance to the borrower's business.[i] ☐ Companies can also track internal KPIs or externally focused assessments against peers, an external rating (e.g., Sustainalytics' ESG Risk Rating), or scientific benchmarks (e.g., Science Based Targets initiative).

CALIBRATION OF SUSTAINABILITY PERFORMANCE TARGETS (SPT)

What it Means for Borrowers	How to Address It
Since SLLs aim to incentivize corporate sustainability improvements, the selection of relevant KPIs and the calibration of ambitious SPTs are crucial in structuring an effective SLL. Without a robust selection process, the credibility of the financial instrument is undermined, and accusations of greenwashing can occur.[ii]	☐ Selected SPTs should be ambitious and reach beyond the current business-as-usual trajectory, remain relevant throughout the life of the loan and, where possible, be compared to an external reference or standard. ☐ Stated SPTs should also include timelines for achievement, key milestones, the frequency of reviews, and details on how the company intends to reach the target.

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DETERMINING LOAN CHARACTERISTICS

What it Means for Borrowers	How to Address It
With an SLL, an economic outcome should be linked to whether the corporate borrower meets the predefined SPTs.	☐ The borrower and the lender both agree to a predetermined pricing mechanism for the loan. For instance, the loan margin could be reduced when the SPTs (as measured by the predetermined KPIs) are achieved or increased if the SPTs are missed.

REPORTING

What it Means for Borrowers	How to Address It
Corporate borrowers should report to lenders at least once per year with information on their progress towards achieving the SLL's SPTs, as well as to determine whether the selected SPTs remain relevant and ambitious.	☐ Companies are encouraged, but not required, to include disclosures relating to SPTs in the company's annual or sustainability report.

VERIFICATION

What it Means for Borrowers	How to Address It
Corporate borrowers must conduct annual post-signing verification of their performance level against the SPTs and KPIs.	☐ The verification should be conducted by an independent, external reviewer and is recommended to be made publicly available.

DOWNLOAD Sustainability-Linked Loans: A Bridge to Connect Sustainability and Finance to learn more about ambitious targets, material KPIs and the benefits of sustainability-linked debt instruments.

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[i] A materiality assessment is a process of identifying and prioritizing ESG and other material issues that have a significant impact on a company and are important to its stakeholders. Material issues are those issues that are important enough to influence stakeholders' decisions in relation to the company, such as sustainable sourcing, cybersecurity, and social and economic inclusion.

[ii] Greenwashing and its variations of social washing and ESG washing describe situations where a company's sustainability claims are misleading or inaccurate. Accusations of greenwashing can occur when KPIs and SPTs are not sufficiently ambitious or meaningful, as well as inaccurate or weak monitoring and disclosing of a company's progress against SPTs.

Visit https://www.lsta.org/content/sustainability-linked-loan-principles-sllp/, to review the Sustainability-Linked Loan Principles.

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