LMA | Loan Market Association

ICMA International Capital Market Association

Guidelines for Sustainability-Linked Loans financing Bonds

June 2024 (including June 2025 Annex on FAQ)

The Green Bond Principles | The Social Bond Principles | The Sustainability Bond Guidelines | The Sustainability-Linked Bond Principles | Climate Transition Finance

Table of Contents

Introduction

Financial institutions, in particular lending banks, hold an influential position at the interface between financial markets and the real economy, engaging directly with borrowers through the provision of credit products.

There is an opportunity for lending banks to use this position of influence to engage borrowers in dialogue regarding their sustainability performance, and the arranging of a Sustainability-Linked Loan instrument may be an attractive way to transfer the bank's expertise and knowledge with regard to sustainable economic development concepts to the borrower base.

Financial institutions have historically been important contributors to the growth of the sustainable debt market via issuance of 'Use-of-Proceeds' bonds, and there is an opportunity for such institutions to sustain their contribution to the growth of the market by issuing debt instruments which communicate the extent of their engagement with borrower clients, and engage the support of fixed income investors in maximising the potential of this potentially powerful channel for change in the real economy.

Issuing a debt instrument which reflects the issuer's efforts to engage borrowers via Sustainability-Linked Loans may prove attractive for financial institutions who are in the process of replacing green and social assets to support ongoing Use of Proceeds bond issuance.

Additionally, the opportunity to communicate a portfolio of selected[1] Sustainability-Linked Loans to investors in public markets via issuance of a bond may serve as an incentive to enhance the robustness of Sustainability-Linked Loan structures in the market over the longer-term.

It is anticipated that any development of a market for Sustainability-Linked Loan financing Bonds will clearly reflect the evolution and issuance trends in the Sustainability-Linked Loan market overall.

The core recommendation of these Guidelines, as further set out below, is that the existing Sustainability-Linked Loan Principles[2] should be used as the basis for construction of any such portfolio which may be communicated to the market via a bond instrument.

Sustainability-Linked Loans - Definition

As per the Sustainability-Linked Loans Principles ("SLLP") published by the LSTA, APLMA, LMA[3],:

Sustainability-Linked Loans ("SLLs") are any types of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) for which the economic characteristics can vary depending on whether the borrower achieves ambitious, material and quantifiable predetermined sustainability performance objectives.

The use of proceeds in relation to an SLL is not a determinant in its categorisation and, in most instances, SLLs will be used for general corporate purposes. Instead, SLLs look to support a borrower in improving its sustainability performance.

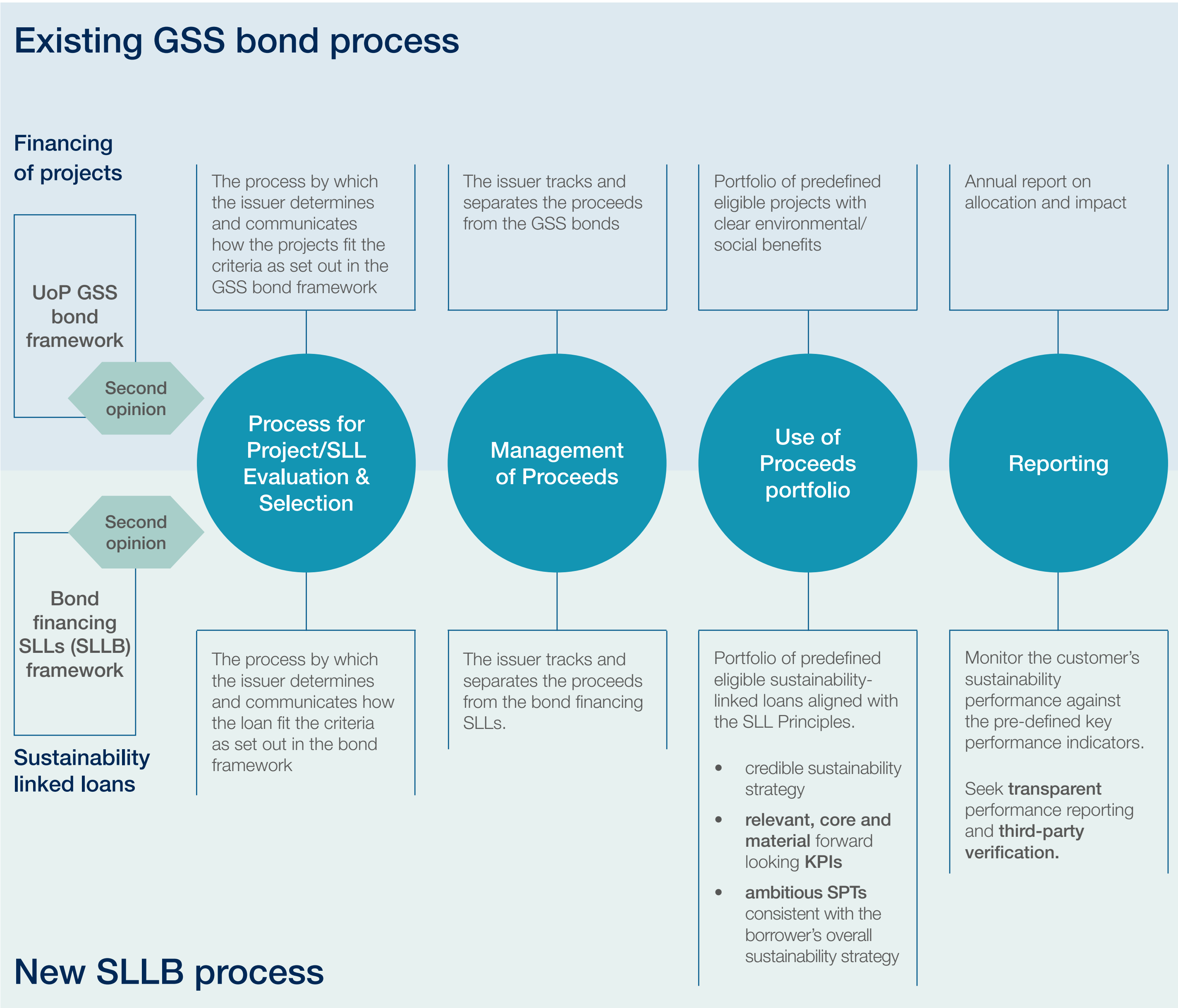
1 Acknowledging the likelihood that not all Sustainability-Linked Loans which a bank is participating in may be selected as eligible under a Sustainability-Linked Loan financing Framework, due to the fact that some loans may incorporate KPIs and targets unrelated to the desired sustainability 'theme', e.g. decarbonisation; emissions reduction.
2 https://www.lma.eu.com/sustainable-lending.
3 Sustainability Linked Loan Principles (SLLP), LTSA, APLMA, LMA.

Sustainability-Linked Loans financing Bonds - Definition

Sustainability-Linked Loans financing Bonds ("SLLBs") are any type of bond instrument (i) where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, a portfolio of new and/or existing eligible SLLs aligned with the SLLP (the SLL eligible portfolio) and (ii) which are aligned with the four components further detailed below in these Sustainability-Linked Loans financing Bonds Guidelines ("SLLBG"), directly inspired by the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines.

It is important to note that SLLBs should be considered as a separate category and not be considered or presented as Green, Social, Sustainability or Sustainability-Linked Bonds ("GSSS Bonds"). However, as illustrated below, there are similarities, in that the financing of a portfolio of SLLs is analogous to the green/social Use of Proceeds financing of GSS Bonds.

SLLBs consist of the financing a portfolio of sustainability-linked loans adopting the Use of Proceeds project financing structuring usual to GSS bonds.



Sustainability-Linked Loans financing Bond Guidelines

The SLLBG establish voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the SLLB market by clarifying the approach for issuance of such type of instrument.

The SLLBG are intended for broad use by the market: they provide issuers with guidance on the key components involved in launching a credible SLLB[4]; they aid investors by promoting availability of information necessary to evaluate the eligible SLLs in light of the (core components of the) SLLP, especially on the relevance and materiality of selected KPI(s) and their level of ambition; they assist underwriters by offering guidance that will facilitate transactions that preserve the integrity of the market, and facilitate the external review.

The four core components for alignment with the SLLBG are similar to the Green Bond Principles and Social Bond Principles:

1. Use of Proceeds[5]
2. Process for SLL Evaluation and Selection
3. Management of Proceeds
4. Reporting

The key recommendations for heightened transparency are:

- SLLB Frameworks
- External Reviews

Issuers are also encouraged to provide information on their overarching entity level objectives, strategy, policy and/or processes relating to environmental and/or social sustainability.

4 See Annex Q1
5 For the sake of clarity, SLLs are General Corporate Purpose instruments. The term of Use of Proceeds refers to the Use of Proceeds of the SLLB.

1. Use of Proceeds

The cornerstone of an SLLB is the allocation of the proceeds of the bond towards eligible SLLs[6], with the eligibility criteria appropriately described in the Framework and/or legal documentation of the instrument. The SLLP should form the basis for selecting eligible SLLs.

The credibility of an SLLB relies on the transparency on the basis for selection of the eligible SLLs, noting that in the majority of cases details of borrowers and loans might need to remain private. In this context, issuers should detail the eligibility criteria that they will use for selecting each eligible SLL financed or refinanced by the SLLB, in particular when it comes to the core components of the most recent SLLP[7]:

- Selection of Key Performance Indicators (KPIs)
- Calibration of Sustainability Performance Targets (SPTs)
- Loan Characteristics
- Reporting
- Verification

Several options may be available for issuers to achieve an appropriate level of transparency.

Approach 1[8]

This could include detailed disclosure of their eligibility criteria mapped to the 5 core components of the SLLPs, especially with regards to how the pairs of KPIs/SPTs[9] are assessed (at the SLLB Framework level but not at the individual SLL level). This should be done by providing information on the evaluation process, criteria and/or thresholds in place in the SLLB Framework to assess the SLL eligible portfolio, which should include a predefined list of KPIs and accompanying ambition ranges for SPTs.

Approach 2

The issuer can seek an independent external review for each eligible SLL in the SLL eligible portfolio together with a high-level description of the borrowers' sectors, the selected KPIs and their intended sustainability objective[10] that will be used for selecting the eligible SLLs.

In order to increase the transparency for investors, issuers are encouraged to define a single sustainability objective in their eligibility criteria common to all eligible SLLs in their SLL eligible portfolio or at a sub-portfolio level.

Eligible SLLs should be aligned to the most recent SLLP published corresponding to the year of signing of the SLL facility.

There should be no double counting of assets under a SLLB, i.e. where a loan has both a green/social and sustainability-linked component and is included as an eligible green/social asset for the issuer's green/social/ sustainability bond, then the loan should not be considered as an eligible SLL.

Issuers should allocate the proceeds only to the drawn part of each eligible SLLs.

Issuers should appoint (an) external review provider(s) to assess through a pre-issuance external review the alignment of their SLLB with the four components of these SLLBG.

For the sake of clarity:

- in Approach 1, the external reviewer reviews the SLLB Framework of the issuer against these SLLBG, but is not required to assess the alignment of each SLL to the SLLP; and
- in Approach 2, the external reviewer reviews the SLLB Framework of the issuer against these SLLBG and opines on each SLL. The external reviewer can be the same as the one reviewing the initial framework.

6 The SLL eligible portfolio should only constitute SLLs.
7 See Annex Q 2 and Q4.
8 See Annex Q3.
9 Including by making reference to the Illustrative KPIs Registry.
10 It is acknowledged that for many banks, particularly those with larger numbers of smaller loans on their balance sheet, that Approach 2 is not likely to be practicable, due to the likely cost of an external review relative to size of the loans.

2. Process for SLL Evaluation and Selection

The issuer of an SLLB should clearly communicate to investors:

- The governance structure in place to evaluate and monitor SLL eligibility and performance over time, including but not limited to:
  - o The corporate functions engaged in the process, including responsibilities and relevant expertise (e.g. in form of a dedicated committee).
  - o Any external capacities leveraged in the process, including responsibilities and relevant expertise.
  - o The various steps in the decision-making process.
- Any sectorial exclusion criteria and/or other relevant policies applicable to the lending activities at issuer and/or at SLLB Framework's level. Issuers are also encouraged to have processes in place to identify and mitigate ESG risks related to the borrower of each eligible SLL.
- The process and criteria for disqualifying or requalifying SLLs that were initially included in the SLL eligible portfolio, in particular when it comes to SLLs where the borrower has missed one or several SPTs[11].

3. Management of Proceeds

The net proceeds of the SLLB or an amount equal to these net proceeds should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for eligible SLLs.

So long as the SLLB is outstanding, the balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible SLLs made during that period.

The issuer should make known to investors the intended types of temporary placement for the balance of unallocated net proceeds.

Subject to the volatility in the drawn amount of some SLLs, issuers are encouraged to have processes to ensure on a regular basis that at any point in time the proceeds are properly allocated.

For the sake of clarity, bearing in mind the general corporate purpose nature of SLLs, issuers are not required to have processes to track the proceeds of the eligible SLLs.

4. Reporting

Issuers should make, and keep, readily available up to date information on the SLL eligible portfolio to be renewed annually during the lifetime of the SLLB, and on a timely basis in case of material developments.

The annual SLLB report should include detailed information where possible on the SLLs to which the SLLB proceeds have been allocated, in particular with respect to:

- the amount of SLLB allocated and/or size of the SLL eligible portfolio;[12]
- the sector and geography of the borrowers;
- information on, including achievement of, KPIs/ SPTs in combination with the underlying sector of the borrowers;[13]
- information on the year of origination of the eligible SLLs; and
- information on disqualified SLLs and newly added SLLs.

Where confidentiality agreements, competitive considerations, or a large number of underlying SLLs limit the amount of detail that can or is allowed to be made available, that information should be presented in generic terms or on an aggregated portfolio basis.

Post issuance, the issuer's management of proceeds should be supplemented by the use of an external auditor, or other third party, to verify the internal tracking and the allocation of funds from the SLLB proceeds to eligible SLLs.

11 See Annex Q5.
12 See Annex Q6.
13 See Annex Q7.

Key Recommendations

Sustainability-Linked Loans financing Bond Frameworks

Issuers should explain the alignment of their SLLB with the four core components of these SLLBG (i.e. Use of Proceeds, Process for SLL Evaluation and Selection, Management of Proceeds and Reporting) in an SLLB Framework and/or in their legal documentation. Such frameworks should be available in a readily accessible format to investors.

It is recommended that issuers summarise in their SLLB Framework relevant information within the context of the issuer's overarching sustainability strategy, as well as its efforts in accompanying its customers on their transition.

External Reviews

The SLLBG encourage external review providers to disclose their credentials and relevant expertise and clearly communicate the scope of the review(s) conducted. Issuers should make external reviews publicly available on their website and/or through any other accessible communication channel as appropriate.

ANNEX – Frequently Asked Questions

Global

Q1 What are the benefits of issuing a Sustainability-Linked Loans financing Bond?

Sustainability-Linked Loans financing Bonds ('SLLBs') offer a range of benefits to the market:

- Creating incentives in the financial system to drive improved environmental and social outcomes across material sustainability indicators, e.g. 'driving decarbonisation'. This helps ensure alignment across the broader ecosystem of stakeholders and supports the transition toward more sustainable practices, such as bank (or other credit provider) efforts to decarbonise their balance sheets.
- Complementing Green, Social and Sustainability (GSS) 'Use of Proceeds Bonds': Unlike GSS Use of Proceeds bonds, which primarily seek impact through the financing of specific green or social projects or assets (including green, social and sustainability 'Use of Proceeds loans'), the SLLs which SLLBs (re)finance aim to improve overall sustainability performance of loan borrowers across pre-determined Key Performance Indicators (KPIs). This flexibility enables issuers to fund a wide range of sustainability initiatives (e.g. for 'asset-light' borrowers) while driving progress toward key sustainability goals such as decarbonisation.
- Highlighting the issuer's engagement with clients on sustainability: The instruments also permit SLLB issuers to transparently communicate their engagement efforts with borrower clients signalling their leadership to the broader market. They also allow the issuer to use an SLLB transaction to market its own priorities and ambitions to other market participants, and to potentially motivate more issuers with regard to their SLL and SLLB activities.
- Engaging investors in the transition: These instruments allow investors to contribute to sustainable business practices, aligning their portfolios with long-term sustainable development objectives. As an extension of the broader Sustainability-Linked product family, SLLBs may be recognised as complementary instruments which can be used to support the transition finance market, which is essential for meeting global sustainability targets. Sustainability-Linked financial products represent important tools for financial market participants to demonstrate a credible and measurable commitment to long-term sustainability goals.[14]
- Enhancing SLL structure robustness: SLLBs can strengthen the long-term effectiveness of SLL structures in the market. By exposing issuers and (anonymised) borrowers to the scrutiny of public markets, they encourage more ambitious and transparent sustainability targets. This level of accountability boosts investor confidence and reinforces the credibility of sustainability-linked instruments, ensuring the evolution of the SLL market into a scalable and impactful tool for sustainable finance.
- Creating new financing opportunities: SLLBs present a new avenue for debt markets. As interest in sustainable investments grows, this innovative instrument enables issuers and investors to engage more deeply with transition finance concepts, supporting the continued scaling of sustainable finance whilst addressing global sustainability goals.

Composition of the SLL eligible portfolio/Disclosure and Transparency

Q2 What level of transparency should be provided to investors regarding the sectors represented by borrowers in the SLL eligible portfolio underlying an SLLB?

The level of transparency provided by issuers should be as comprehensive as possible, ensuring that investors have sufficient up-to-date information to assess the sustainability performance of the underlying borrowers in the SLL eligible portfolio. At the level of the framework, this includes providing clear details on the industry sectors in scope/excluded (along with the eligibility criteria used to select the underlying SLLs). In the context of reporting, issuers should detail sustainability targets and progress towards those targets. However, it is important to balance transparency with confidentiality considerations. The level of disclosure

14 This alignment is highlighted in the existing guidance provided in the Guidance Handbook, which underscores the strategic role of such instruments in supporting global climate and sustainability targets.

should also take into account the information needs of the various market participants (for example, information required to implement investor exclusion/restriction policies), and any regulatory requirements. Ensuring consistency in reporting across the SLL eligible portfolio over time, as well as aligning with established reporting frameworks and standards, will further enhance the SLLB market.

Q3 What action should issuers take to achieve an appropriate level of transparency for Use of Proceeds Approach 1?

To achieve an appropriate level of transparency for Approach 1 as outlined under the Use of Proceeds section of the SLLB Guidelines:

1. Issuers should clearly outline the KPI(s) relating to the 'single sustainability objective' of eligible SLLs and their associated SPT(s). This should include for example, the scope of operations addressed by the KPI(s), target thresholds or ambition ranges, relevant benchmarks/trajectories (e.g. 'Paris-alignment' in the case of SLLs based on the decarbonisation theme) and the basis of target validation, if any. To be eligible for refinancing via an SLLB, the underlying SLL should have at least one KPI/SPT contributing to the single sustainability objective.
2. For 'additional KPIs' (i.e. KPIs that do not relate to the single sustainability objective), if any, issuers are encouraged to include all the KPIs that may be included in the eligible SLLs, but which do not relate to the 'single sustainability objective'. This should be done on a best-efforts basis, ensuring a comprehensive set of information for potential investors. However, given the variety of KPIs available in the SLL market, it is acknowledged that this approach might not always be feasible. Where not all additional KPIs are listed, issuers should provide a description of the processes which will be established to assess the acceptability of those KPIs/SPTs, for example by referencing the Illustrative KPIs Registry or other guidance or practice established by each jurisdiction or region. Transparent reporting on any additional KPIs that may be added is expected.

This level of transparency will enable investors to assess the alignment of the SLLB with their sustainability goals, whilst leaving issuers sufficient flexibility to include SLLs with a high level of ambition relating to the single sustainability objective and with a variety of additional KPIs.

Q4 What considerations should SLLB issuers take into account regarding the financial or structural characteristics of the underlying SLL eligible portfolio?

The basic principle to be observed is that the Sustainability-Linked Loan Principles be taken into account at all times when establishing the SLL eligible portfolio underlying any SLLB. This therefore includes Core Component 3 of the Principles ('Loan Characteristics'). This component highlights the fact that 'variation of margin' is the most common example of loan characteristics adjustment, but other forms of adjustment are not precluded, therefore prospective SLLB issuers should be free to consider other approaches to varying financial or structural characteristics.

Disqualification, Missed Targets, etc.

Q5 What should SLLB issuers take into account when thinking about the circumstances under which SLLs may need to be removed from the underlying SLL eligible portfolio?

The approach to SLL eligible portfolio management should be defined by each SLLB issuer in their framework.

Issuers should ensure they are transparent and clear regarding the process and relevant criteria for disqualifying SLLs that were initially included in the SLL eligible portfolio.

While trigger events for removal may not occur annually, progress reports should be provided at least once a year.

Issuers should recognise that progress toward sustainability targets may vary from year to year due to external factors, market conditions, or other unforeseen challenges. Therefore, it is important to allow for flexibility in how progress is assessed, ensuring that the evaluation process reflects the reality of achieving long-term sustainability goals. Issuers should communicate to investors (ideally in advance via the framework) any flexibility measures regarding performance against SPTs (e.g. performance within a defined range).

If a borrower fails to meet the SPTs over a defined period or fails to show meaningful progress, the SLLB issuer may consider that this triggers a need for reassessment and potential disqualification of the SLL from the SLL eligible portfolio. It is important that issuers are transparent and provide a clear approach to reassessments and potential disqualifications if they choose this approach. If the reinstatement of disqualified SLLs after meeting their targets later is allowed, this should also be transparently disclosed to investors in the framework. In the case of shortfall of eligible SLLs in the SLL eligible portfolio, the issuer should clearly indicate the reason behind it and temporary placements pending full allocation.

If feasible, issuers may also consider communicating on the size of the SLL eligible portfolio and any targeted buffer between the SLL eligible portfolio and the total outstanding SLLBs, to provide reassurance to investors on the balance of tracked bond proceeds and allocation

Reporting

Q6 What considerations should SLLB issuers take into account in allocation reporting?

Issuers should report annually, and also on a timely basis if material changes occur in the SLL eligible portfolio composition or allocation status, on the amount of SLLB proceeds allocated and/or the size of the SLL eligible portfolio throughout the lifetime of the SLLB. This reporting should also include information on the sector and geography of the borrowers, year(s) of origination and maturities of eligible SLLs, as well as information on disqualified/requalified and newly added SLLs. This can be done on an aggregate basis for confidentiality purposes. A description of how unallocated proceeds are managed should also be reported on.

It would also be considered best practice to (i) clearly state the calculation methodology of the drawn amount (e.g. average amount through the reporting period, amount as of the reporting date, etc.), and (ii) if there are any unallocated proceeds, clearly state the expected timeline for full allocation where feasible.

Q7 How should SLLB issuers approach outcome reporting?

For SLLBs, the key reporting focus is generally on progress toward the chosen KPIs and SPTs rather than the direct impact of any Use of Proceeds.

As noted in the SLLB Guidelines, issuers should report "information on, including achievement of, KPIs/SPTs in combination with the underlying sectors of the borrowers". Issuers should therefore report by measuring their borrowers' progress toward achieving the SPTs for the relevant KPIs, rather than detailing any impact of loan proceeds. This will enable investors to analyse the way in which the SLLB is contributing towards the 'single sustainability objective' outlined by the SLLB issuer in its SLLB Framework, e.g. decarbonisation.

Issuers should also report annually on the KPI breakdown. Failing this, reporting the KPI split by thematic might also serve as a substitute.

If the selected KPIs directly relate to measurable societal or environmental outcomes (for example, GHG emissions' reduction), issuers can include aggregated figures in their reporting. However, issuers should be cautious not to 'claim' any related impacts, as the issuer is simply acting in the role of an enabler or facilitator of the outcomes which are delivered by SLL borrowers. Such aggregate figures should be simply considered as a means of communicating the sustainability benefits of the SLL eligible portfolio and the methodology for calculating them should be clearly disclosed.

Information on reassessments, restatements or adjustments to KPIs, SPTs, baselines, or KPI scope should be disclosed.

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