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LOAN MARKET ASSOCIATION LAUNCHES DRAFT PROVISIONS FOR GREEN LOANS

In May 2023, the Loan Market Association (**LMA**) published draft provisions for sustainability-linked loans (**SLLs**). Over a year on and the LMA has now turned its attention to drafting for use of proceeds loans, with green loans first on the agenda.

On 7 November 2024, the LMA published draft provisions for green loans (the **Green Loan Drafting**). While modelled on the SLL drafting (discussed in further detail in our Borrower's Guide to SLL terms), the Green Loan Drafting differs in a number of important respects, reflecting key differences between the two products - green loans being those where the proceeds are to be applied exclusively towards green projects, as compared with SLLs which have no restrictions on the use of proceeds, but where instead the margin is tied to the borrower's sustainability performance over the term of the loan measured against one or more KPIs.

Despite their differences, both sets of drafting share a common purpose - to promote drafting consistency, streamline negotiation and ensure that the documentation aligns with, and reflects, the requirements of the voluntary guidelines that underpin the relevant product market (being the Green Loan Principles for green loans and the Sustainability-Linked Loan Principles for SLLs).

The drafting in both cases is, however, a starting point only. In the absence of market consensus on a number of points, the Green Loan Drafting (much like the SLL drafting although perhaps to a lesser extent) contains a number of blanks, square brackets and placeholders. As consensus builds around certain outstanding issues, it is expected that the universe of points left open for negotiation will narrow. For now, the Green Loan Drafting will need to be, and indeed is expected by the LMA to be, customised and negotiated on a case-by-case basis.

In this briefing, we discuss the key features of the Green Loan Drafting, noting where the outstanding areas of negotiation lie and key points for corporate borrowers to keep in mind.

Key features of the LMA's Green Loan Drafting

The Green Loan Drafting comprises a set of template provisions for insertion into an LMA-based facility agreement to turn it into a green loan. The drafting aligns with, and articulates, the requirements of the current versions of the Green Loan Principles and accompanying guidance, published in February 2023.

In contrast to the SLL drafting which uses the LMA leveraged agreement as its base, the Green Loan Drafting has been drafted by reference to the LMA investment grade agreement referencing Term SOFR (although both sets of drafting can easily be adapted for insertion into any of the LMA's other recommended form facility agreements).

Key features of the Green Loan Drafting include the following:

Applicable facilities: The Green Loan Drafting assumes that the green loans are term loans. The drafting will need to be adapted if the green loans are to be drawn under a revolving credit facility.

Use of proceeds: The restriction on the use of the proceeds for green projects is the defining feature of a green loan. The Green Loan Drafting provides a welcome degree of flexibility in its framing of this requirement, giving the option for the parties to either specify upfront particular green projects to which the proceeds will be applied, select green projects to which the proceeds will be applied post-signing in accordance with a set of eligibility criteria or a combination of the two. The specific projects or eligibility criteria (as appropriate) are left to be specified either in a schedule to the agreement or by reference to the borrower's Green Loan Framework.

Management of proceeds: One of the core components of the Green Loan Principles is that the proceeds of the green loan should be "credited to a dedicated account or otherwise tracked by the borrower in an appropriate manner, so as to maintain transparency and promote the integrity of the product". In practice, designated green accounts are not commonly used to track and monitor green loan proceeds. Reflecting this, the Green Loan Drafting simply requires that the borrower provide the Agent with appropriate evidence to enable the tracking, monitoring and evaluation of the manner in which the loan proceeds have been applied (with provision made, in the alternative, for specifying any particular method by which the borrower intends to demonstrate tracking of the loan proceeds in compliance with the Green Loan Principles).

The Green Loan Drafting also includes a placeholder for the parties to specify any agreed process for the management of unallocated loan proceeds in the event that they are not immediately applied.

Reporting: Another core component of the Green Loan Principles is that the borrower report annually to the lenders on matters including the green projects to which the loan proceeds have been allocated and the expected or achieved impact of such projects. This is reflected in the Green Loan Drafting by way of an obligation on the borrower to deliver a Green Loan Report to the lenders on a regular basis, in the form agreed and scheduled to the agreement. The definition of "Green Loan Report" sets out in detail the minimum content requirements of the report and includes a placeholder for the parties to agree additional transaction- or project-specific information requirements. This is a definition that borrowers will want to pay particular attention to, to ensure that they are able to provide the required information within the agreed timeframe.

It is worth noting that, in contrast to the SLL drafting, there is no separate requirement to deliver a compliance certificate - it is anticipated that all required information will be included in the Green Loan Report.

The obligation to deliver a Green Loan Report is supplemented by undertakings to supply such information that the lenders may reasonably request to enable them to determine and confirm the allocation of the loan proceeds and the borrower's compliance with its obligations under the Green Loan Drafting and Green Loan Principles.

External review: In contrast to the Sustainability-Linked Loan Principles which require that borrowers obtain independent and external verification of their performance against each KPI on a regular basis, post-signing external review is not mandatory under the Green Loan Principles. For this reason, while there are references to verification of the Green Loan Report and an external reviewer in the Green Loan Drafting, these are all presented as optional. The drafting also acknowledges that, where there is to be external review post-signing, there are a range of forms such review may take (for example, limited or reasonable assurance, or a form of attestation or certification), which must be agreed between the parties.

Representations and general undertakings: The Green Loan Drafting introduces various representations and undertakings. Mirroring the SLL drafting, the borrower is required to represent that all the "green loan" information provided is true, complete and accurate and not misleading in any respect. The Green Loan Drafting, however, also requires that the borrower make representations relating to the selection and evaluation of the green projects to which the proceeds are applied (supported by a new undertaking regarding the same). These additional representations, which are required to be repeated on the date of each green utilisation request and the date of each Green Loan Report, and related undertaking, reflect a further core component of the Green Loan Principles related to the process for project evaluation and selection.

The Green Loan Drafting imposes two further obligations on the borrower to (i) not take any action or omit to take any action which would result in a selected project ceasing to be eligible and (ii) not amend its Green Loan Framework (where applicable) without the prior consent of the lenders (the precise consent level being left to be agreed between the parties) other than minor amendments or corrections of manifest errors that, in each case, do not adversely affect the interests of the lenders.

Borrowers will want to ensure that each additional representation and undertaking imposed on it is framed in a way that is proportionate and with which it can comply.

Breach of Green Loan Provisions: The Green Loan Drafting makes clear that failure to comply with a Green Loan Provision will not constitute an event of default. It will, instead, amount to a "Declassification Event" (discussed further at "Declassification" below). The new defined term "Green Loan Provisions" captures all the provisions related to the facility being a green loan, but importantly excludes the restriction on the use of the proceeds (discussed at "Use of proceeds" above) and the restriction on publicity (discussed at "Publicity" below). The consequence of excluding these restrictions from the definition of "Green Loan Provisions" is that breach of them is not carved out of the events of default and will therefore amount to an event of default (subject to any applicable grace period).

Declassification: Declassification provisions, which describe the circumstances in which the loan will cease to be sustainably labelled, are now common in sustainable loan documentation. The Green Loan Drafting sets out the various triggers for declassification in the definition of "Declassification Event", the occurrence of which gives the Agent the right to declassify all the green loans and following which the loans may no longer be labelled as "green loans" and each Green Loan Provision will cease to apply.

The triggers include (i) a misrepresentation in relation to the new green loan-related representations (discussed at "Representations and general undertakings" above), (ii) breach of a Green Loan Provision (discussed at "Breach of Green Loan Provisions" above), (iii) delivery of a Green Loan Report (or verification report where relevant) which details non-compliance with the Green Loan Principles and (iv) the Agent being of the opinion (acting reasonably) that the green projects no longer comply with the relevant eligibility criteria or that the green loans are no longer aligned with the Green Loan Principles. A placeholder is included for the parties to specify further declassification triggers where relevant. Borrowers will want to ensure that any additional triggers are kept to a minimum and framed appropriately.

We would highlight that the occurrence of any of these Declassification Events (subject in some cases to a grace period) gives the Agent the right to declassify the relevant loans. There is no requirement in the Green Loan Drafting, as there is in the SLL drafting, for the parties in the first instance to negotiate in good faith with a view to agreeing any necessary amendments to the terms of the agreement.

Publicity: The borrower is not permitted to refer to any loan or utilisation as "green" at any time following declassification. Prior to declassification, loans may be labelled as "green" by the parties in any disclosure referencing them, however the Green Loan Drafting requires the borrower to consult in good faith with the Agent prior to making any such disclosure. This consultation requirement is something which we would expect borrowers to firmly push back on.

As noted above, the publicity restrictions in the Green Loan Drafting are not included in the definition of "Green Loan Provisions" and their breach is, as a result, not carved out of the events of default (see "Breach of Green Loan Provisions" above). The consequence is that breach of a publicity restriction will amount to an event of default, a key reason why borrowers will want to ensure that the restrictions are framed appropriately.

Conditions precedent: The Green Loan Drafting does not specify any conditions precedent related to the loan being green. In the absence of market consensus, the LMA has simply included a placeholder to highlight that conditions precedent will need to be considered by the parties on a case-by-case basis.

Green Loan Coordinator: The Green Loan Drafting provides optionally for the involvement of a Green Loan Coordinator, appointed by the borrower to assist with structuring and designing the green aspects of the agreement. The approach taken to the role in the Green Loan Drafting has been simply to reflect the approach taken to the Sustainability Coordinator role in the SLL drafting, most notably the assumption that the role will be limited to pre-signing. This is discussed in further detail in Part 4 of our Borrower's Guide to SLL terms. We understand that the LMA will be reviewing the terms across both sets of drafting and the coordinator role more broadly in the new year.

Our view

The LMA's new drafting for green loans is a helpful development for the sustainable lending market. The availability of template drafting to help standardise terminology and structure, and improve new entrants' understanding of the parameters of the product, is no doubt a positive step forward, in particular given that green loans are often used to finance green projects that are of insufficient size to support a green bond issuance.

The drafting, for the most part, covers territory that is broadly familiar in the market, in terms of the provisions required to turn a facility agreement into a green loan. The devil, as ever, is however in the detail. Borrowers are encouraged to review any drafting based on the LMA form carefully, paying particular attention to the information requirements, additional representations and undertakings, events of default, and declassification and publicity provisions.

The LMA has made clear that the Green Loan Drafting is intended to reflect where the market is today and that it will be kept under review and refined further as market practice develops (in the same way as its SLL drafting which it plans to review in the new year). The LMA is also looking to produce drafting for social loans, being loans where the proceeds are to be applied exclusively towards social projects, most likely based on the Green Loan Drafting, as well as to revisit the coordinator role for both use of proceeds and sustainability-linked loans. With the deadline for transitioning to net zero drawing closer by the day, the pipeline of projects to support the sustainable lending market is as full as ever.

Our financing practice, in conjunction with our wider sustainability team, remains at the forefront of ESG developments. For more information, please contact any of the lawyers listed below or your usual adviser at Slaughter and May.

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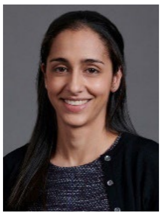

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