Green Loan Principles to Guide Environmental and Sustainability Finance

22 March 2018

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With banks playing an integral role in real estate and infrastructure finance, the imperative to guide them into lending for environmental and sustainable purposes is categorical, and a set of green lending guidelines could be the catalyst to develop a robust green lending market and all that it entails. The issuance of the Green Loan Principles has set the ball rolling for "green labelled lending" as a separate and distinct financing mechanism with its own set of recognisable characteristics.

Green Lending

The Loan Market Association (LMA) and the Asia Pacific Loan Market Association (APLMA) have issued the eagerly-awaited Green Loan Principles as a benchmark for the wholesale green loan market.[1] With labelled Green Bonds breaking through $150 billion mark in 2017, attention has been quickly turning to the feasibility of other instruments to meet the gargantuan need for funding climate change adaptation, sustainable development and commitments to carbon reduction made by countries internationally under the Paris Agreement. As the drivers for green lending have reached the mainstream over the past few years, it has become clear that green lending could follow the lead of the green bond market and market guidance is a welcome tool to encourage the development of new and different green loan structures. Enter, the Green Loan Principles.

Green Loans are defined in the Green Loan Principles as "any type of loan instrument made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible Green Projects". What constitutes Eligible Green Projects is set out in Appendix 1 of the Green Loan Principles, which is the same indicative list of projects issued by the International Capital Market Association (ICMA) for green bonds. Indicative categories of eligibility for Green Projects include production and transmission of renewable energy, pollution prevention and control, sustainable natural resources management, biodiversity conservation, climate change adaptation and green buildings.

The Green Loan Principles look familiar as they have been developed with the assistance of ICMA, amongst others. ICMA is the secretariat of the Green Bond Principles (GBP), which have in a few short years become a market standard for green bond issuances. Like the GBP, the Green Loan Principles are voluntary guidelines "to be applied on a deal-by-deal basis" using a high-level framework for identification, disclosure and reporting, which is expected to allow a level of flexibility as the green loans market matures. Also like the GBP, the four components of the Green Loan Principles are: Use of Proceeds; Process for Project Evaluation and

1 The Green Loan Principles, supporting environmentally sustainable economic activity, were issued by the Loan Market Association together with the Asia Pacific Loan Market Association on 21 March 2018, and may be found at http://www.lma.eu.com

Selection; Management of Proceeds; and Reporting. External review of alignment with the Green Loan Principles (self-certified by a borrower or conducted for example by a third party consultant, verifier, certification body or a rating agency) is also recommended for a borrower's use of proceeds or its Green Loan framework.

Components of the Green Loan Principles

Use of Proceeds

Green Loan proceeds must be used for Eligible Green Projects (including related expenditures and R&D). This must be clearly articulated in the finance documents along with the expected environmental benefits, which must be assessed, quantified, measured and reported by the borrower. Green Loans could include investments or project portfolios that may be refinanced or that may take the form of a "green tranche" in a loan facility.

Process for Project Evaluation and Selection

Green Loan lenders should expect a borrower to communicate the environmental sustainability objectives of the financing, how it is determined that a project would fit into the Appendix 1 Eligible Green Project categories and the eligibility criteria for the proposed projects.

Management of Proceeds

To ensure transparency, Green Loan proceeds should be credited to a dedicated account and/or tracked by the borrower, including where the Green Loan is a tranche of a loan facility. This highlights the need for internal governance processes of borrowers in order to track proceeds going to Eligible Green Projects.

Reporting

In addition to transparency, the Green Loan Principles focus on accountability, which is integral to the growth of the market. To this end, annually updated information on the use of proceeds (e.g., description of projects, amounts and anticipated impacts based on qualitative performance indicators and quantitative performance measures, where feasible) should be provided to lenders until the relevant loan is fully drawn, on a project-specific or aggregated project portfolio basis (or generically if there are confidentiality or commercial considerations).

The Future of Green Loans

The Green Loan Principles make it clear that loans not aligned with the Green Loan Principles would not be "Green Loans". This new categorisation framework may inject the necessary integrity required to encourage instruments like Green Loans to be the new shape of green finance. It may also set the groundwork for innovative projects and financial solutions.

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