SLAUGHTER AND MAY

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SM Treasury Insights

LMA updates draft provisions for sustainability-linked loans

Over the summer, the Loan Market Association (**LMA**) completed its first comprehensive review of its draft provisions for sustainability-linked loans (the **Draft Provisions**), originally published in May 2023. The updates, agreed with a taskforce of experienced market participants, preserve the core architecture of the Draft Provisions while streamlining the drafting, improving clarity and reflecting developments in market practice.

The original provisions were developed at a time when the sustainability-linked loan (**SLL**) market was expanding rapidly but the produact itself was still evolving. Although SLL volumes have since declined from their earlier highs, the market has continued to mature, with greater emphasis on quality, credibility and integrity. Against that backdrop, the updated drafting is both important and welcome, providing a clearer and more robust framework for documenting SLLs.

Below we summarise some of the key changes.

- Base LMA document: The Draft Provisions were initially designed for use with the LMA's leveraged finance documentation. They have now been broadened for use with any of the LMA's recommended forms, although the LMA's investment grade multicurrency term and revolving facilities agreement is used as the illustrative reference document. The accompanying term sheet has also been revised so that its provisions can be incorporated into any LMA-based term sheet.

- Triggers for declassification: Declassification Events are events which give the lenders the option to declassify the facility as sustainability-linked, the ultimate sanction under an SLL. The original drafting specified a failure to agree amendments following the occurrence of a Sustainability Amendment Event as a Declassification Event, and then left a placeholder for other triggers to be added on a transaction-specific basis. The definition has been expanded in the latest round of updates to include other declassification triggers frequently seen in the market, namely repeated failure to deliver a Sustainability Compliance Certificate and the occurrence of a prolonged Sustainability Breach. Failure to agree sustainability performance targets (**SPTs**) for future years where these have not been specified upfront (see below) has also been added as an optional trigger. The placeholder for additional events has been retained, reflecting the fact that parties often agree further triggers on a transaction-specific basis.

- Agreeing SPTs for future years: The updated drafting introduces a mechanism for agreeing SPTs for future years where the parties are unable to do so at the outset, for example because the relevant period extends beyond the borrower's strategic planning horizon or the data required to set the targets is not yet available. Future SPTs may now be agreed through a built-in amendment process, subject to a longstop date, with the required level of lender consent – Majority Lender or all-lender consent – to be determined on a transaction-specific basis.

- Aligning information requirements with market practice: The updated Draft Provisions expressly permit the SLL information and verification requirements to be satisfied by delivering existing reports, in hard or electronic copy, thereby avoiding duplicative disclosure. This reflects market practice, as information demonstrating compliance with the SPTs – and, in some cases, the related verification – will often be included in the borrower's annual report or annual sustainability report. The verification provisions have also been clarified to specify the matters that the Verification Report must address, including the degree of verification (e.g. limited or reasonable assurance) agreed between the parties.

- Drafting for sleeping SLLs: The most significant development in this round of updates is the introduction of drafting for sleeping SLLs, under which the KPIs (and associated SPTs) are not agreed at the outset. The Draft Provisions set out two alternative approaches. Under the first, the SLL provisions, together with the KPIs and associated SPTs, are agreed by way of an amendment process by a specified date after signing. Under the second, the SLL provisions are agreed and incorporated into the facility agreement at signing but become effective only when the KPIs and associated SPTs are subsequently agreed, again by a specified date. The LMA has included both approaches to reflect differing market practice. A footnote also directs users to the Guidance on the Sustainability-Linked Loan Principles, which sets out parameters for the use of sleeping SLL structures.

Alongside the updated Draft Provisions, the LMA has published an educational note explaining the purpose and operation of the contractual "guardrails" that underpin the SLL product. The note will be a useful resource both for those less familiar with SLLs and for market participants seeking a deeper understanding of how the sustainability breach provisions, sustainability amendment mechanism and declassification clause operate both individually and together to preserve the integrity of the SLL product.

The updated Draft Provisions, together with the educational note referred to above, are available to LMA members from the LMA's Sustainable Lending microsite.

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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