# LEX AT LARGE - Finance

*From law to business*

## The growth of green and sustainable loans market: positive dynamics in 2018


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**It has been a while since the financial sector is showing its involvement in social and environmental challenges. This trend was thus not new for the year 2018, which allowed us to observe some positive dynamics in bank loan market.**

**There was a steady growth over the last years in the "green bonds" and "social impact bonds" segments, promoting funding for anti-global warming movement and social programs. Yet, this market segment "*remains a young market niche (...), the total volume of so-called green or sustainable bond funding represents 5% of traditional bond funding*"[1].**

**Although still modest, this type of funding is nevertheless active, particularly in view of the recent arrival of "blue bonds" to finance clean water actions[2].**

1 "*(ce marché) jeune reste une niche (…), le montant total des levées obligataires dites green ou sustainable représente 5% des levées obligataires classiques*" - Interview – A.-C. Husson-Traoré, *Directrice générale de Novethic*, *Option Finance* n°1441, Monday 11 September 2017, p. 20
2 "*La Banque Mondiale vise 3 milliards de dollars de « water bonds »*", Guillaume Benoit, *Les Echos,* Wednesday 5 September 2018

## The sustainable and green loans market

Even more restricted and closed, the market segment of so-called "green" or "sustainable" loans distinguished itself during 2018 by its dynamism, confirming at the same time a clear distinction between these two very specific types of loans.

## The green loans

This type of loan, intended to provide funding to new or already existing "green" projects, has become especially topical this year with the publication of the *Green Loan Principles* (the "GLP") by the *Loan Market Association* (the "LMA") on 21 March 2018. The work done on the GLP underlines the vitality of this market segment.

Even though the LMA's intervention is still quite limited, as it proposes some major principles, the goal of this working group was to gather the financial market players of this practice in order to discuss and elaborate the guidelines for the green loan market.

The objective of the LMA through these GLP is to preserve the integrity of this market segment in order to avoid a risk of overused "green" label. The GLP have been built around four pillars:

- the first pillar "*Use of proceeds*" relates to the allocation of funds from green loans which shall be intended to finance environmental projects (combating climate change, depletion of natural resources, air quality, water and soil pollution, etc.);

- the second pillar "*Process for project evaluation and selection*" gives the borrower a key role in providing information on its environmental sustainability objectives, the process determined to fit within the eligibility criteria adopted and the actions it wishes to carry out to achieve its objectives with the help of its financing partners;

- the third pillar "*Management of proceeds*" addresses the issue of the management of the funds which should be credited on a dedicated account (or several dedicated accounts if multiple tranches) in order to ensure transparency and traceability of the use of proceeds; and

- the fourth pillar "*Reporting*" presents the monitoring and control obligations of a green project, i.e. information undertakings of the borrower and audit of this information which may be carried out in whole or in part by external experts (audit firms, certifiers, specialized rating agencies, etc.).

The "green" loan market should be seen as an alternative or a complement to the issuance of "green" bonds and it implies a closer relationship between the borrower and its lenders than the relationship existing between an issuer of green bonds and its holders.

While the LMA's intervention on this issue is for the moment limited to the publication of the GLP, this first stage may be followed by the drafting of LMA materials on this specific matter (as it is already proposed by the LMA in various financing areas).

## The sustainable or positive impact loans

"Sustainable" or "positive impact" loans (the «PIL») have recently benefited from steady growth due to the implementation of significant transactions both in France (Fromagerie Bel[3], Danone[4] and recently EDF[5]) and in the rest of Europe (BPost[6], Philips[7], Puma[8]).

The particularity of the PIL is its structuration which is based, throughout the duration of the loan, on the evaluation of the borrower's performance on three levels - environmental, social and governance (the "ESG" criteria) - which complements the more "traditional" financial performance assessment. This type of loan will therefore differ from "green" loan at various levels. First, the purpose of a PIL is wide and may equally address the financing of external growth transactions, the financing of the borrower's general corporate purpose or even the refinancing of existing debt. At the opposite, the purpose of a green loan is to implement one or more green project(s) clearly identified (as indicated above). Then, the format of a PIL is more flexible and can be structured as a term loan or a revolving credit facility, while a green loan will more naturally be a term loan because of its specific purpose. Last but not least, the financing cost of a PIL will be able to increase and/or decrease during the duration of the loan, depending on the borrower's ESG performance in relation to the ESG objectives determined when the loan was originated.

The major issue for the PIL will therefore be to determine the "*Key Performance Indicators*" that will make it possible to measure the borrower's ESG performance. These indicators are various (such as greenhouse gas emission control, energy control, air/water quality management, etc.) and will differ from one borrower to another. It will therefore be necessary to identify the KPIs applicable to a borrower in order to define the measures to be taken to achieve the agreed ESG strategy. This phase of development and implementation of the ESG strategy will be carried out by a dedicated team within the borrower, and then discussed with the banks in parallel with the "traditional" dialogue that exists between the financial functions of each party. For instance, Fromagerie Bel indicated that the ESG program set up with its banks is based on "*reducing its greenhouse gas emissions, developing nutritional education programs in the Group's key countries and deploying a program of concrete actions to promote a sustainable upstream dairy sector*"[9].

The legal documentation should then include, in addition to the traditional information undertakings, a periodic disclosure commitment to measure the borrower's ESG performance either by issuing internal certificates (certified by specialized external bodies or the borrower's auditors) or by disclosing an ESG rating assigned by one or more non-financial rating agencies specialized in this field. The assessment methods of the ESG performance are therefore multiple and allow each party to find a suitable solution regarding the borrower's structure.

3 "*Fromageries Bel étend la maturité de sa principale ligne de crédit et y introduit des critères environnementaux et sociaux, E&S*", press release of 10 January 2018
4 "*Danone, EDF, Philips ont choisi de soumettre leurs taux de crédit à leurs performances environnementales et sociales*", article published the 28 February 2018 on Novethic's website
5 "*EDF annonce la finalisation de la syndication d'une ligne de crédit innovante indexée sur des critères ESG*", press release of 27 November 2018
6 "*NG Belgique et BNP Paribas Fortis lancent ensemble le premier crédit durable avec Bpost*", press release of 12 October 2017
7 "*Philips couples sustainability performance to interest rate of its new EUR 1 billion Revolving Credit Facility*", press release of 19 April 2017
8 "*BNP Paribas and PUMA launch innovative financing program for suppliers to reward social and environmental standards*", press release of 7 September 2016
9 "*réduction de ses émissions de gaz à effet de serre, le développement de programmes d'éducation nutritionnelle dans les pays clés du Groupe et le déploiement d'un programme d'actions concrètes en faveur d'une filière amont laitier durable*" - Cf. note n°3

At each ESG test date, the cost of the credit may be impacted in various ways, for example by the granting of a discount or the application of a premium depending on the borrower's compliance or non-compliance with its ESG criteria, or by the implementation of "compensatory" measures consisting, for example, in making donations to selected associations or NGOs in the event of non-compliance with ESG criteria. The business solutions are therefore various and make it possible to qualify different PIL "philosophy" with distinct consequences. It should be noted, however, that failure to comply with ESG undertakings cannot constitute an event of default under the facility agreement and thus allow the banks to accelerate the credit, the idea of the PIL "philosophy" being obviously not to put a borrower at risk on the basis of its ESG performance.

While this new type of financing - the cost of which will vary according to ESG criteria to which the borrower voluntarily agrees to submit - appears to be virtuous, PIL are also a good means of communication for all parties concerned: the borrower can claim a voluntary undertaking to quantifiable ESG criteria which involves all its stakeholders (from its shareholders to its employees) and banks can communicate on their actions in favour of "responsible" borrowers to whom financial conditions adapted to their ESG ambitions are granted.

We therefore note a real dynamic in this segment of "sustainable" financing in view of the increasing number of transactions on the market, but also the desire of the market players to structure this segment. The latest example relates to the launch in mid-January 2019 by sixteen European companies (including six French companies) of the Corporate Forum on Sustainable Finance, which introduces itself as a network dedicated to consideration and exchange between the various actors in sustainable finance (companies, banks, investors or non-financial rating agencies) on the issues raised by this type of financing and as a forum for brainstorming and influence on the regulatory work of "responsible" finance, whose product range is constantly expanding[10].

10 "*Finance durable - Des entreprises européennes unissent leurs forces*", *Option Finance* n°1496, Monday 4 February 2019

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**Our lawyers are available to discuss these topics and support you in your "green" and "sustainable" financing projects.**

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