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Canadian investment markets turning green: Sustainable finance and green lending

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Global recognition of the importance of environmental, social and governance (ESG) considerations among investors and firms has prompted an emerging trend of "sustainable" or "green finance" in lending and investment activities. Broadly, "sustainable finance" is a term that involves financial products which facilitate the financing of green, sustainable projects and sustainable businesses. These financial products generally reward borrowers for achieving predetermined sustainability performance goals which, in turn, impact the interest rate payable over the duration of the credit facilities.

Two of the newest sustainable finance products in the debt market are green loans and sustainability linked (SLL) loans. A green loan requires that the use of loan proceeds be used exclusively for green projects. In contrast to green loans, SLL loans are credit facilities that incentivize a borrower to achieve predetermined sustainability performance objectives. The Loan Syndications and Trading Association (LSTA), the Loan Market Association (LMA) and the Asia Pacific Loan Market Association (APLMA) have developed a set of voluntary guidelines which set out Green Loan Principles (GLP) and Sustainability Linked Loan Principles (SLLP), which are generally based on the GLP. It is important to note that green loans and SLL loans are not limited to companies operating in green industries. In fact, companies operating in oil, gas and mining industries are encouraged to join in on the emerging trend of sustainable finance to support the fossil fuel industry in its recent efforts towards sustainability. Regardless of the industry, lenders may require, as one basis for evaluating efficacy of the sustainable loan, that borrowers display a minimum commitment to sustainability in accordance with the GLP and SLLP. Borrowers should demonstrate commitment and accountability by reporting on their internal and publicly disclosed policies and empirical performance targets.

Some important considerations in negotiating a sustainable loan include:

1) Sustainability targets: The parties should negotiate realistic targets that are meaningful to the borrower's business and based on recent performance levels to provide baseline targets.

2) Criteria for selecting sustainability targets: Some examples of targets include improved waste/water management and greenhouse gas emissions.

3) Reporting: The borrower should provide accurate and up-to-date reporting on its sustainability targets, with such information provided at least annually to lenders. Unlike traditional financial reporting, lenders may need to engage a third party to monitor.

The growth of sustainable finance will continue and will likely become increasingly prevalent in the Canadian investment market.

For more information on this topic, please contact a member of Osler’s Banking and Financial Services Group.