What exactly is a Green Loan?

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In 2018, the "Green Loan" was identified by the London Market Association (LMA) as one of the fastest growing trends in the loan market.

The world seems fixated by green (funds, bonds, debt listing and other things green), but what exactly is a Green Loan? It is any type of loan product or instrument which adheres to a set of principles, but is unregulated. The LMA has produced a set of 'Green Loan Principles'.

A Green Loan can be made available exclusively to finance or re-finance, in whole or in part, new or existing Green Projects. The list of Green Projects is comprehensive enough to cover almost any project with environmentally positive credentials, the obvious ones being renewable energy, pollution prevention and control, clean transportation and climate change adaptation.

To qualify as a Green Loan, the loan must align with the four core components of the Green Loan Principles:

1. **Use of Proceeds:** a Green Loan must be utilised for a Green Project and its loan documentation should clearly detail the green project, its environmental benefits and, where feasible, how those benefits will be quantified, measured and reported by the borrower.

2. **Process for Project Evaluation and Selection:** borrowers should communicate to lenders the environmental sustainability objectives of the financing, together with the process by which it determines whether a project falls within eligible Green Project criteria.

3. **Management of Proceeds:** the proceeds of a Green Loan (or tranche) 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 Green Loan.

4. **Reporting:** borrowers should make and keep readily available up to date information on the use of proceeds to be reviewed annually until fully drawn, and as necessary thereafter in the event of material developments.

Environmental sustainability may not be a chief concern of a certain leader of the free world, but for now the US remains signed up to the Paris Agreement along with 193 other States and the European Union. The Paris Agreement's long-term goal is to keep the increase in global average temperature to below 2 °C on pre-industrial levels in an effort to substantially reduce the effects of climate change. Each participating State is setting its own targets to meet this objective. The UK for instance is committed to an 80% decrease in CO_2 emissions by the year 2050 relative to 1990 levels.

Increasing numbers of corporates based in these jurisdictions aren't waiting for the government stick on this issue; they are proactively looking to demonstrate their corporate responsibility by setting their own internal sustainability targets. This might be in the form of their products (plastic free, passive house builds) or their processes (use of renewable energies, reduction in emissions).

For UK based lenders the offering of Green loans isn't just a business opportunity and an exercise in social responsibility, it may become a requirement of the Prudential Regulation Authority (PRA). The PRA wants UK Banks to view climate change as a core financial and strategic risk to the UK banking sector, not just an issue to be addressed with social responsibility initiatives. To this end in late 2018 the PRA published a consultation paper on "Enhancing banks' and insurers' approaches to managing risks from climate change". The paper challenges Banks to take a more responsive and strategic approach to managing the unique financial risks posed by climate change and sets out the PRA's expectations for this new strategic approach. Broadly, the PRA wants Banks to:

- embed the consideration of financial risks from climate change in their governance arrangements;
- incorporate the financial risks from climate change into existing financial risk management practice;
- use (long term) scenario analysis to inform strategy setting and risk assessment and identification; and
- develop an approach to disclosure on the financial risks from climate change.

The PRA's goals clearly extend far beyond what green products a bank may offer, but this illustrates that whether the driver comes from borrowers, internal sustainability and social responsibility targets or by the regulator, the banking sector is going green one way or another.

Green Loans generally include a financial incentive for the borrower, usually a reduction in bank margin, but this will be fairly modest. The main benefit for lenders and borrowers is less tangible, the value is in being able to say that you have provided or that you have received a Green Loan. That is why the Green Loan Principles are so important, because without safeguarding the standards that separate a Green Loan from an ordinary loan the product will lose its integrity, and its integrity is where its value lies.

Guernsey is developing its green credentials with its own range of green products (Guernsey Green Funds, TISE Green Segment, Green bonds etc.). Green Loans would be a great addition to the Island's green armoury.