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Green Loans – The FCA's Review of the Sustainability-Linked Loans Market

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Background

On 29 June 2023, the UK's Financial Conduct Authority ("**FCA**") published a letter on the findings of its review of the sustainability-linked loans ("**SLL**") market. SLLs aim to support sustainable economic activity and growth, with interest rates linked to meeting certain agreed sustainability goals.

Although the FCA does not regulate this market directly, it wants to ensure that the sustainable finance market works well, and that market integrity is maintained. The FCA engaged stakeholders in March and April 2023 with the following objectives:

- to better understand the functioning of the SLL market;
- to gather additional market intelligence on the SLL market from a cross-section of key stakeholders;
- to determine what measures might improve the market integrity of the SLL product, where concerns have been noted; and
- to understand where the FCA may be able to encourage further development of the SLL market as an important financing tool for the transition to a net zero economy.

Findings

The FCA's key findings were as follows:

- **Not realising potential:** While a number of banks are keen to promote SLLs, the market is currently not achieving its potential. Increased trust and transparency could deliver wider uptake.
- **Borrower concerns:** Borrowers are concerned about unwelcome scrutiny if they miss performance targets. They may also consider the time and costs of doing an SLL against a more conventional loan.

- **A prescriptive framework:** The market participants engaged with, believed thata more prescriptive framework would improve market integrity and reduce thethreat of greenwashing accusations. This could include more meaningful, science-based targets.
- **Conflicts of interests:** There is the potential for conflicts of interest if banks accept weak targets and count the loan as part of their sustainable finance quota.
- **Disclosures:** Several banks are advocating for uniform disclosure and independent monitoring and verification of targets. This could include well disclosed targets aligned to borrowers' published transition plans.

Next steps

Although the FCA has no current plans to introduce regulatory standards or a code of conduct for this market, it has stated that it will continue to monitor this market as part of its wider work on transition finance, with a view to considering the need for further measures to support the development of a robust transition finance ecosystem.

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