

External Review Guidance for Green, Social, and Sustainability-Linked Loans



1. Introduction

The Green Loan Principles (“GLP”), Social Loan Principles (“SLP”), and Sustainability-Linked Loan Principles (“SLLP”) (collectively referred to as the “Principles”) recommend, or in certain circumstances require, the appointment of external review provider(s) to undertake external reviews in connection with green, social, or sustainability-linked loans.

This Guidance is intended to complement the Principles (and the accompanying guidance documents) (the “Principles and Guidance Documents”).

Obtaining an external review may assist parties with ensuring credibility and robustness in sustainable lending transactions by providing an expert, independent third party perspective.

This Guidance aims to promote best practice and provides voluntary guidance relating to professional and ethical standards for external reviewers, as well as to the organisation, content and disclosure of their reports. It is based on the ICMA 2022 Guidelines for Green, Social, Sustainability and Sustainability-Linked Bonds External Reviews (the “ICMA Guidelines”). Alignment with the ICMA Guidelines as much as possible is desirable to promote consistency across the debt (bond and loan) markets.

This Guidance is also intended to sit alongside other existing voluntary guidance relating to professional and ethical standards for external reviewers, as well as to the organisation, content and disclosure of their reports.

This Guidance has been developed by experienced working groups, consisting of representatives from leading market participants active in the global loan markets in consultation with a group of prominent external reviewers. It strives to represent a consensus view from all parties involved as of the date of publication and will be reviewed and updated periodically with feedback from the market.

2. Types of external review

There are various types of external review which may be obtained by borrowers in the course of a green, social or sustainability-linked loan transaction. Independent external reviews vary in scope and may, amongst other things, cover:

- a green, social or sustainability linked loan/finance framework;
- an individual green, social or sustainability-linked loan or a portfolio of these loans;
- the underlying assets (in the case of specific green or social loans);
- the reporting undertaken in relation to an individual green, social or sustainability-linked loan or a portfolio of these loans; and/or
- the related procedures.

It should be noted that terminology is not always used consistently in relation to external reviews, so parties should take care to ensure they are “speaking the same language”. However, external reviews can broadly be grouped into the following types, with some providers offering more than one type of review, either separately or combined:

1. Second Party Opinion (“SPOs”) :

a) Pre-execution

An SPO typically entails a pre-execution assessment of the alignment of a green, social or sustainability-linked loan and/or the related framework with the relevant overarching Principles.

In some cases, an SPO may, in addition to Principles alignment, confirm the alignment of a particular loan transaction or loan framework with:

- (i) borrower specific information, such as the borrower’s overarching sustainability profile, strategy or long-term sustainability targets; and/or
- (ii) a specified taxonomy or taxonomies.

For green and social loans, SPO providers may, amongst other things, assess:

- (i) the environmental and/or social features of the type of projects intended for the use of proceeds;
- (ii) the environmental and/or social benefits and impact targeted by the eligible Green and/or Social Projects (as defined in the respective Principles) financed by the green or social loan (or related framework); and/or

(iii) any potentially material environmental and/or social risks associated with the projects, (where relevant) and any process applied to identify and manage such risks.

For sustainability-linked loans, SPO providers may, amongst other things, assess:

- (i) the relevance, materiality, robustness and reliability of selected key performance indicators (“KPIs”), and how relevant these are in the context of the borrower and/or its sector;
- (ii) the rationale and level of ambition of the proposed sustainability performance targets (“SPTs”), which can be by assessment against a credible benchmark, standard, historic and/or science-based trajectory and/or baseline as well as by benchmarking/comparison with peers in similar or relevant sectors, and to any sector specific guidance (if available); and/or
- (iii) the relevance and reliability of selected benchmarks and baselines, and the credibility of the strategy outlined to achieve them, based on scenario analyses and external references and standards, where relevant.

Each SPO provider will have its own approach and methodology, and the scope of an SPO may vary depending on the parties and the specific circumstances.

b) Post-execution

As mentioned above, where used, an SPO will typically be prepared pre-execution and this is generally considered to be best practice. There are, however, some exceptional circumstances where it may be agreed that a post-execution SPO may be provided. Where agreed, these may include situations where an SPO will be provided as a condition precedent or condition subsequent to drawdown. In these circumstances, the application of the green, social or sustainability-linked loan label/classification and related publicity may not be permitted until such time as the SPO has been delivered in accordance with the loan documentation.

2. Verification:

Verification is a high-level term used in the market to describe a type of external review of financial or non-financial information carried out by an independent third party against, in most cases, a detailed external standard. Verification differs from an SPO due to the typically more detailed nature of the assessment and the fact this takes place against a specific external standard or methodology.

For green and social loans, verification may include, but is not limited to:

- allocation of proceeds;
- an evaluation against a designated set of use of proceeds criteria and/or impact metrics;
- an evaluation of the environmental or social features of underlying assets against specific external criteria; and
- alignment of impact reporting with specific external criteria.

For sustainability-linked loans, in accordance with the SLLP, borrowers must obtain independent and external verification of the borrower’s performance level against each SPT for each KPI for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the sustainability-linked loan economic characteristics, until after the last SPT trigger event of the loan has been reached. As opposed to pre-signing verification, which is recommended only, post-signing verification is a mandatory requirement of the SLLP.

There are a number of different types of verification available in the market which include, but are not limited to:

- assurance;
- attestation; and
- certification

The methodology used by the external reviewer will vary depending on the type of verification undertaken, whether the external reviewer is a regulated entity and the nature of what is being verified.

a) Assurance

Within this, there are two distinct levels of assurance that are commonly used in sustainable lending transactions:

- **Limited assurance:** Limited assurance is the most common standard in the market, but this is not possible for all KPIs and can be difficult to obtain in specific types of lending transaction. Limited assurance usually involves a review of a sample of raw underlying data.
- **Reasonable assurance:** Reasonable assurance generally refers to a higher standard of assurance than limited assurance. It generally involves a more detailed/ extensive review of the underlying data and/or procedures and methodologies used to derive such data.

Verification by way of assurance can, but will not always, form part of an audit report undertaken by an auditor.

b) Attestation

In an attestation (also known as assertion-based engagement), the external reviewer carries out the measurement or evaluation of the subject matter and reports the information. This subject matter information contains the external reviewer's assertion (for example: "The subject matter information is fairly stated as of date/month/year"). The work the external reviewer performs is to give an assurance conclusion on this assertion.¹

Attestation is not typically seen in relation to sustainability-linked loans but is sometimes used to confirm the internal processes in place to comply with the management of proceeds component for green and social loans.

c) Certification:

A borrower can have its:

- (i) green, social and sustainability-linked loan;
- (ii) green, social, or sustainability-linked loan framework;
- (iii) use of proceeds; and/or
- (iv) KPIs and/or SPTs,

certified against specified criteria and then awarded with a score or label.

A score or label defines specific criteria, and alignment with such criteria is normally tested by qualified, accredited third parties, who may verify consistency with the certification criteria.

At the end of the certification process, the label/score may be awarded signifying that the certification criteria have been met. There are, for example, a number of sustainable certifications available for buildings.

Certifications may be used in relation to green or social loans to ensure that the project or asset being funded meets the eligibility criteria. On sustainability-linked loan transactions, certifications may be used in the definition of a KPI and to benchmark performance.

3. Green, Social and Sustainability-Linked Loan Scoring/Rating:

A rating or score may be provided by an external reviewer in connection with a green, social or sustainability-linked loan. This rating or score may include elements of an SPO.

A borrower can itself obtain an ESG rating or score or can have: (i) its green, social and sustainability-linked loan and/or its associated green, social and sustainability-linked loan framework or (ii) a key feature such as use of proceeds, selection of KPIs and/or calibration of the level of ambitiousness of SPTs, evaluated or assessed by third parties, such as specialised research providers, consultancy firms, assurance providers or rating agencies, according to their established scoring/rating methodology.

In relation to sustainability-linked loans, it is possible for ESG scores/ratings to be used as KPIs – although this is no longer a common practice in the market.

Ratings providers should be asked to explain their methodology to the borrower.

3. Ethical and professional standards for external reviewers

Different types of organisations can provide external reviews. At a high level, all firms providing external reviews should be guided by the following five fundamental ethical and professional principles

1. Integrity;
2. Objectivity;
3. Professional competence and due care;
4. Confidentiality; and
5. Professional behaviour.

Some external reviewers may already be subject to existing professional standards (e.g., professional accountants) and/or be subject to regulatory regimes, (e.g., accounting firms, accredited verifiers, regulated credit rating agencies), the elements of which may already address many, if not all, of the aims of this voluntary guidance.

There are a variety of professional standards and industry wide codes of conduct that external reviewers should look to adhere to, where relevant, when they provide services to borrowers of green, social or sustainability-linked loans. For example, external reviewers should consider the relevance of:

- the International Code of Ethics for Professional Accountants paying particular attention to section 4B – Independence for Assurance Engagements other than Audit and Review Engagements;
- the Attestation Standards established by the American Institute of Certified Public Accountants;
- AA1000, ISAE 3000 (Revised);
- Assurance Engagements Other than Audits or Reviews of Historical Financial Information;
- IESBA Handbook of the Code of Ethics of Professional Accountants, section 291 Independence - Other Assurance Engagements; and
- the AICPA Code of Professional Conduct (AICPA Code);
- the standards provided by ISO 17021, ISO 14065, ISO 14064-3 and the ISO 14030 series;
- certification from the Association for Responsible Investment Services (ARISE).

The external reviewer should be independent from the borrower's green, social and sustainability-linked loan structure or framework adviser (as applicable), and should not be a borrower or sponsor affiliate. If relevant, appropriate procedures such as information barriers should be implemented within the institution to ensure the independence of the SPO. Any circumstance that could reasonably be seen to compromise the institution's independence should be disclosed to lenders and relevant stakeholders.

4. Organisation of external reviewers

While providing external reviews for green, social and sustainability-linked loans (as part of a framework or an individual loan structure review), external reviewers should ensure that they:

1. have an organisational structure, working procedures, and other relevant systems for carrying out the external review;
2. employ appropriate staff with the necessary experience and qualifications for the scope of the external review being provided;
3. If applicable, carry the appropriate professional indemnity/professional liability insurance cover; and
4. be regularly engaged in the application and monitoring of relevant ESG standards and ESG calculation methodologies.

For an SPO, external reviewers should have expertise in:

1. for a green or social loan, the eligible Green or Social Project categories as well as any associated exclusion criteria under the relevant recognised international/national/industry guidance and/or frameworks; or
2. for a sustainability-linked loan, the selected KPIs, SPTs, and any relevant benchmarks, baselines and sector standards; and
3. where relevant, climate change strategy, governance and science-based trajectories, review and assessment.

The above requirements may also be relevant for verification, or green, social or sustainability-linked loan scoring/rating, depending on the methodology and standards being applied, which should be disclosed by the external reviewer.

5. Content of external reviews

The content of an external review will vary depending on the type of review carried out and when it is carried out. External reviews should, however, either include or indicate at a minimum:

1. A general description of the objective, scope of work, the procedures conducted and the external reviewer's credentials.
2. Where relevant, the requisite credentials to evaluate:
 - a. for sustainability-linked loans, KPIs, SPTs and related benchmarks, baselines and strategies; and
 - b. for green or social loans (as applicable), the perceived, actual or potential environmental and/or social risks associated with the relevant Green and Social Project categories.
3. A statement on independence and conflict-of-interest policy.
4. Details of definitions, analytical approach, criteria and/or methodologies used.
5. The conclusions or output of the external review report, including any limitations on the external review.
6. Where applicable, the level of verification and a description of any relevant international professional standards to which such verification will be aligned to (such as those set out in Section 3).
7. Where applicable, whether or not the borrower has allocated green and/or social loan proceeds according to its predefined eligibility criteria.

Below is a summary of some of the key points that may also be included under the different types of external reviews.

1. Second Party Opinion:

The scope of an SPO should be clearly set out therein so that all parties understand what is and is not covered by the SPO.

SPOs may be complete or partial, and this should be clearly indicated in the SPO. Complete external reviews assess alignment of a given green, social or sustainability-linked loan or associated framework with all core components of the relevant Principles. Partial reviews assess alignment with certain core components of the relevant Principles only.

2. Verification:

As mentioned above, there are a number of different types of verification available in the market and the content of a verification report will vary accordingly.

In any event, it is recommended that a verification report describe, amongst other things:

- the level and type of verification, for example whether a limited or reasonable assurance, or other, engagement has been conducted and the standards applied;
- a description of the procedures conducted by the practitioner and any inherent limitations;
- a description of the subject matter of verification and the criteria, such as sustainability standards used to assess conformance; and
- confirmation of the practitioners' independence and conformance with a quality management system.

It should be noted that, in some cases, information may already have been verified as part of an audit process or regulatory submission. In such cases, the information will not typically need to be verified again for the purposes of the SLLP.

3. Green, Social and Sustainability-Linked Loan Scoring/Rating:

The output of any external review may include a focus on environmental and/or social performance data or processes relative to the relevant Principles or another benchmark. Such scoring/rating is distinct from credit ratings which may nonetheless reflect material environmental/social/sustainability risk.

6. Disclosure for external reviews

Where applicable, any external review in relation to a green, social or sustainability-linked loan or associated framework should be communicated and made available by the borrower in a timely manner to all the financial institutions party to the loan in accordance with the relevant Principles and Guidance Documents and as set out in the relevant loan documentation provisions. Where appropriate, and taking into account confidentiality and competitive considerations, borrowers should make publicly available any external review, or an appropriate summary, via their website or otherwise.

Timing of an external review may depend on the nature of the review and publishing an external review may be constrained by business and/or any contractual confidentiality requirements.