LSEG Yield Book

Trepp®

Does ESG matter for CLOs?

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Summary

The ESG principles have been growing rapidly in the financial world, reflected by the quick expansion of UNPRI signatory list, regulatory proposals and industry-level efforts and standards.

The ESG concept firstly appeared in CLO offering documents in 2018 and began to emerge in CLO indentures rapidly as investors increasingly focused on sustainable and responsible investing through the years. ESG disclosure in CLOs is typically voluntary, with negative screening through eligibility criteria or exclusions being the predominant method of ESG consideration.

We analyzed CLO deals with and without ESG language by identifying and categorizing the ESG-related language in their documentation. We found deals with ESG language are more likely to have better collateral composition (lower WARF, higher WAS, and lower Caa%) and stronger structural protection, compared to those without such provisions.

Looking at performance, ESG deals have outperformed non-ESG deals across vintages, with more recent vintages tending towards having ESG language. Our analysis shows that ESG investments favor conservative, low-risk strategies that yield high returns. These deals appear to have a more balanced risk-reward profiles. In contrast, non-ESG deals are performing weaker, maintaining a more conservative approach but not achieving the same robust returns.

Unlike the exclusionary language in the CLO deal documentation, the ESG language in loan documents usually comes in the form of KPI and margin ratchets. The loan borrower could be rewarded with a margin reduction if they meet the ESG-tied KPIs or be penalized with higher financing cost for failing the KPIs.

Amid geopolitical tensions, high inflation, and market volatilities, the ESG trajectory has faced some headwinds in the last two years. However, market has stabilized in 2024 on rate cut hopes, and the recent stainability-linked loan issuance activity has recovered from the 3Q23 low, signaling a positive outlook for sustainability loan financing.

Chapter 1. Introduction to ESG

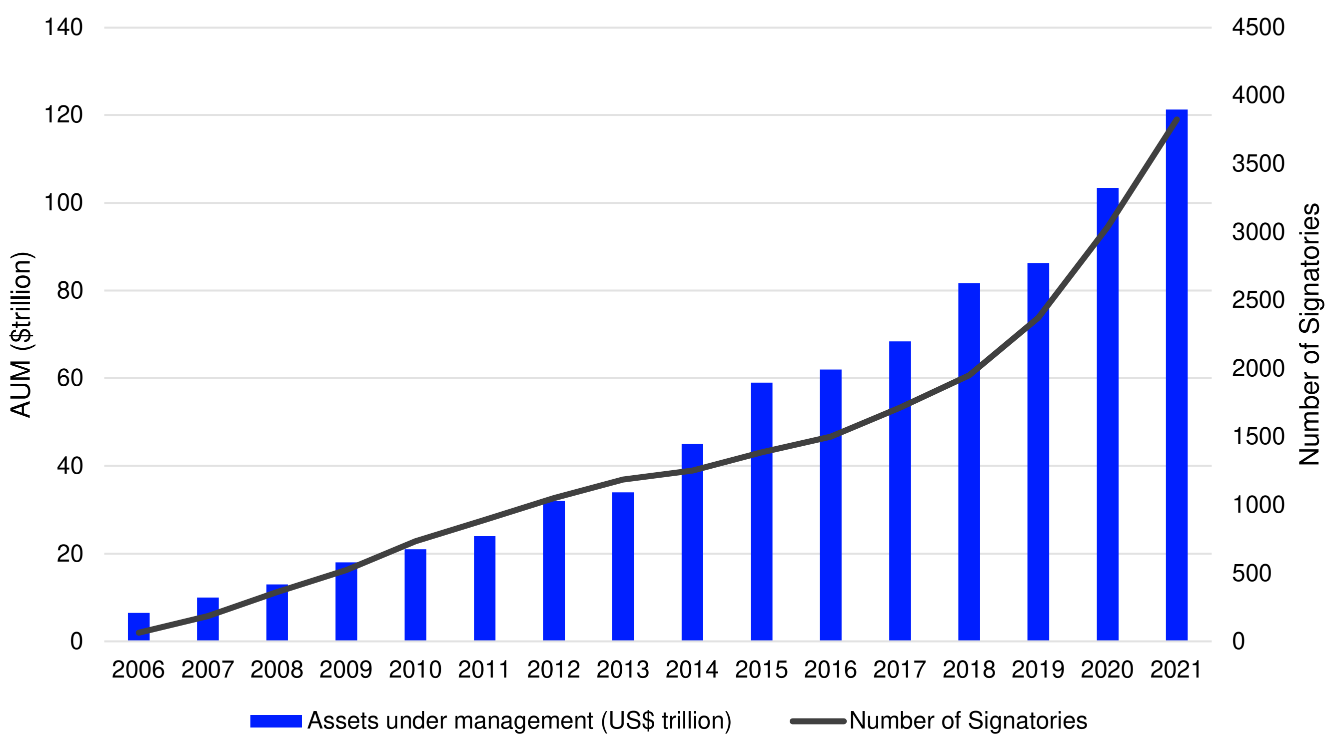
ESG stands for Environmental, Social and Governance (ESG), and it is used by investors to evaluate non-financial risks that reside in these three dimensions and make investment decisions that align with their value. The principle has evolved rapidly across the globe since launched. The three pillars of the ESG principle are usually defined as below:

- The environmental (E) component assesses how a company's operations affect the environment, such as greenhouse gas emission, waste management and energy efficiency. The need to tackle the climate change requires certain environmental goals including carbon neutral.
- The social (S) aspect reflects the relation and impact between a company and its employee, communities and customers. This aspect covers customer satisfaction, diversity and inclusion and community impact.
- The governance (G) requirement refers to the structure and process that a company takes to guide the decision-making progress. The independence of board, shareholder rights, integrity and transparency of financial reporting are usually considered under the G category.

The concept of ESG investing started to form in the early 2000s, though the practice of ESG started much earlier when multiple campaigns took place to guide companies to sustainable business activities. In a report from UN back in 2004, ESG was officially mentioned to general public as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs". The concept has gained significant traction in the financial industry since then. Over the years, investors have shown growing interest in ESG factors as they recognize the potential impact of environmental, social and governance issues and associated risks. On the other side of the table, asset managers have been integrating ESG principles into their investing methodology or philosophy to show their value and sustainability goals as well.

In 2005, the United Nations launched the Principles for Responsible Investment (UNPRI) initiative. Companies and organizations registered as PRI signatory to publicly demonstrate their commitment to responsible investment and build a more sustainable financial system. The PRI signatory list has expanded quickly and consistently to 3,826 names across the globe with $121.3 trillion AUM at the end of 2021, according to the PRI official website.

Exhibit 1: UNPRI signatory growth since launched (globally)



Source: UNPRI (June 2024)

The regulatory landscape surrounding ESG considerations in finance has been evolving, with authorities around the world taking steps to incorporate ESG factors into financial regulations. The Sustainable Finance Disclosure Regulation (SFDR), developed by European authorities, is a significant milestone in this regard. By setting standards for ESG terminology, investment practices, and reporting requirements, SFDR aims to promote transparency and consistency in ESG disclosures within the European financial sector. This regulation has implications for various financial products, including Euro CLOs, where investors subject to SFDR seek to invest in assets that meet certain ESG criteria.

The SFDR is designed to make the sustainability profile of funds more comparable and better understood by end-investors. It aligns with the European Green Deal, aiming for the EU to become carbon neutral by 2050. This was followed by the "Taxonomy Regulation" to establish a framework to enable sustainable investments and address greenwashing by screening investments using a common set of criteria. If an investment falls under Article 8 or 9 of SFDR, it must disclose details on environmentally friendly activities and the proportion of such investments. From a documentation standpoint, the majority of Euro CLOs prohibit sectors such as oil, thermal, and coal, through the process of exclusionary policies, also known as negative screening.

In the United States, while the SEC has proposed enhancing and standardizing climate disclosure requirements for public companies, the ABS/CLO market has been exempted from these proposed rules due to challenges related to the availability of necessary climate data. However, the Structured Finance Association (SFA) has taken proactive steps to address ESG disclosure practices within the structured finance industry. The establishment of the SFA ESG disclosure taskforce and the publication of ESG best practices for Auto ABS and RMBS disclosures highlight industry efforts to develop and enhance ESG reporting standards. As ESG factors continue to gain prominence among investors and regulators alike, we can expect further initiatives and guidelines aimed at promoting sustainable and responsible investing practices across different sectors of the financial industry.

The increased investor demand for ESG-compliant CLO transactions has led to notable changes in the strategies and procedures adopted by CLO managers. Many managers are recognizing the importance of integrating ESG principles into their investment processes to meet this growing demand and align with broader sustainability goals. Some CLO managers have taken proactive steps such as launching formal ESG policies and dedicating resources to sustainable investing assessment. By applying ESG principles to their credit selection process, these managers aim to incorporate ESG considerations into their investment decisions. Additionally, many CLO managers have voluntarily become adherents or signatories to ESG or sustainability-linked investment codes or initiatives, including UNPRI. As of May 2024, 102 CLO managers out of a total 187 active CLO managers that we cover (US and EU) have joined the UNPRI signatory, reflecting a broad commitment within the industry to responsible investing practices.

While positive strides are being made, it's important to note that most CLO deals issued still primarily utilize negative screening. These policies typically involve excluding certain industries or sectors, such as tobacco, weapons, and thermal coal mining, from investment targets. However, these excluded sectors typically only represent a minor portion of CLO investment targets. Moving forward, there's an opportunity for CLO managers to go beyond negative screening and implement more comprehensive positive screening systems that consider a broader range of ESG factors. By doing so, managers can enhance risk management, improve transparency, and better meet the evolving expectations of investors who are increasingly prioritizing ESG concepts in their investment decisions. In CLOs, as ESG considerations become mainstream, managers that prioritize sustainability and social responsibility are likely to enjoy competitive advantages, fostering a future where financial success is intrinsically linked with positive societal and environmental impact.

Chapter 2. ESG in CLOs

In the US the concept of ESG first appeared in CLO indentures in 2018, and it has since gained traction in CLO documentation as investors increasingly prioritize sustainable and responsible investing, though European CLOs have been ahead of their US counterparts in adopting negative screening measures, particularly in excluding sectors such as oil, thermal, and coal from their investment portfolios.

ESG disclosure in CLOs is typically voluntary, with negative screening through eligibility criteria or exclusions being the predominant method of ESG consideration. However, the nuances of negative screening vary across CLO deals due to the lack of standardization in language issued by government entities or industry protocols. Below, we provide a few examples of varying negative screening language in CLOs and offer our assessment on them.

1. **Classification of obligor's industry sector**
   The debt obligation or debt security could exclude obligors that derive revenue of product from a certain industry. However, it can be ambiguous in classifying the industries. For example, one of the most common exclusions across CLOs is the obligors with an industry classification of Tobacco. Some of the deals only rely on rating agencies' industry classification, while some deals will clearly specify the exclusion as "manufacturing and distribution of tobacco or tobacco-related products". The former exclusion might only capture the tobacco manufacturers, while the latter requirement is much more specific and covers more tobacco-related businesses. We would consider latter one a tighter restriction, though it might also be hard to identify whether an entity's primary business is tobacco-related in some cases.

2. **Definition and calculation of obligor's revenue threshold**
   In the ESG exclusion language, there may be a revenue threshold that helps determine whether the obligor's business belong to the prohibited industry, but some deals may have more vague language. For example, one deal documentation may exclude a company with primary business activity belonging to thermal coal mining or generation of electricity with coal, while another deal applies similar exclusion to a company that extracts more than 20 million tons of coal per year or a power generation company that has 30% or more of its annual revenue from thermal coal mining. The former, seemingly banning the coal miners completely with higher scrutiny, can be difficult to be applied given the ambiguous definition. The latter, however, quantified the thresholds more explicitly and clearly.

3. **Manager's discretion on the obligor**
   As an active managed securitized product, CLOs offer high flexibility to manager's interpretation of deal language and any ESG-related transactions are at manager's sole discretion. A good example is the exclusion regarding human rights, which is often stipulated as severe breaches of International Labor Organization's (ILO) conventions and OECD guidelines. But the judgement on whether a company has "severely breaches" these guidelines are often subject to manager's judgement. Although a manager must operate within the guidelines set forth in the offering documents, it remains to be seen how a manager conforms to the guideline in practice and what the actual impact of an exclusion is.

Despite the nuance and ambiguity, the ESG language has been evolving in CLO documentation for the past few years. Indeed, assessing environmental and social factors can be more straightforward compared to governance, especially when dealing with private companies. The governance component often relies on publicly available information for assessment, which may not always be readily accessible. As a result, the governance aspect usually carries less weight in the ESG integration of a CLO deal document. However, as ESG practices continue to develop, we might see more clarity in how governance is addressed within these frameworks.

To summarize the ESG exclusions in CLO documentation, and the impact this had on CLO performance, we scanned the deal documentation of 1,050 outstanding USD BSL deals (Euro BSLs are excluded in this exercise due to the fact that the majority of Euro deals have language around ESG) of 2019-2023 vintages and compiled the top keywords for each ESG component for all these deals. Among them, 672 deals, or 64% of the cohort, have at least one ESG related exclusion. In the following table, we listed ESG deal counts by each category with most common ESG keywords we identified across the deal documentation language, including 10 keywords for Environmental, 9 for Social, and 4 for Governance.

Exhibit 2: Deal counts by ESG sector/category and keywords

Category	Keyword	Matching Count
Environmental	coal mining	380
	palm oil	235
	oil and gas	210
	oil sands	277
	ozone depleting substances	221
	wastes	161
	hazardous chemicals	185
	arctic drilling	186
	wildlife products	203
	coal-based	65
Social	controversial weapons	571
	tobacco	419
	pornography and prostitution	366
	child labor	12
	firearms	379
	payday lending	275
	private prisons	150
	opioids	299
	toxin	25
Governance	UN	67
	OECD	84
	ILO	26
	UNGC	1

Source: Trepp, Yield Book (June 2024)

Chapter 3 ESG and CLO Performance

Chapter 3.1 ESG and CLO Breakdown

In addition to the appearance of ESG related language in CLO documentation, the focus of ESG categories also shifted during the past few years. We summarized the number of deals in proportion of total deal count of the vintage and the % of matching keywords of each ESG category in Exhibit 3. Of note, there is a drop from 2022 to 2023, probably due to the skyrocketing interest rate and deterioration of credit fundamentals, leading to a shift in priority in deal structuring. Issuers who have a hard time maintaining their AUM and printing new CLO deals may choose to set the ESG language aside and prioritize the deal economics. Regardless of the slight drop in 2020 possibly due to the pandemic, the prevalence of ESG language in CLO deal documentation has been growing steadily and substantially since 2019.

Exhibit 3: ESG language evolution in the past four years

Vintage	% of deals having ESG language	% of Environmental	% of Social	% of Governance
2019	47.91%	30.50%	53.19%	16.31%
2020	42.76%	42.98%	52.92%	4.09%
2021	56.51%	42.11%	55.75%	2.14%
2022	90.66%	44.77%	52.26%	2.97%
2023	86.56%	45.59%	50.82%	3.58%
2019-2023 Average	63.67%	43.40%	52.79%	3.81%

Source: Trepp, Yield Book (June 2024)

We compared CLO deals with and without ESG language and found deals with ESG language are more likely to have better collateral composition (lower WARF, higher WAS, and lower Caa%) and stronger structural protection, compared to those without such provisions.

For overall rating scores, the deals with ESG language have an average WARF of 2716, lower than 2774 of the deals without ESG language. Meanwhile, the WAS for deals with ESG language averaged at 350bps, 3bps higher than the WAS level for deals without ESG language, indicating a better risk-return (i.e., higher WAS/WARF ratio) for the ESG deals. Separately, the average Caa% in deals with ESG language is 4.81% vs. 5.55% for deals without ESG language.

When it comes to the structural protection of the tranches, there is also significant difference in the two groups of deals. The Junior OC cushion for deals with ESG language averaged at 389bps, 28bps higher than the deals without ESG language.

Exhibit 4: Performance metrics for CLO deals with and without ESG language

Vintage	Deals with ESG language					Deals without ESG language				
	WAS	WARF	Caa %	Cov-lite	Jr. OC Cushion (bps)	WAS	WARF	Caa%	Cov-lite	Jr. OC Cushion (bps)
2019	348	2759	6.2%	18.0%	254	343	2770	5.9%	17.4%	287
2020	355	2578	5.0%	16.9%	400	347	2720	5.3%	12.8%	392
2021	352	2789	5.1%	17.3%	387	352	2800	5.7%	15.1%	386
2022	349	2709	4.5%	16.7%	434	325	2863	4.9%	24.5%	413
2023	347	2598	2.2%	16.3%	479	362	2777	2.9%	14.4%	492
Overall	350	2716	4.8%	17.1%	389	347	2774	5.6%	15.7%	361

Source: Trepp, Yield Book (June 2024)

Chapter 3.2 ESG Cross-Metrics Performance

A good way to evaluate deal or manager performance is through cross-metric analysis, in which two deal characteristic are plotted against one another and a scatter plot created. This approach provides a holistic assessment by evaluating multiple metrics simultaneously, avoiding the limitations of single-metric analyses. For the analysis we take the mean value for the metrics and create an average line for the x and y axis, creating four quadrants. Depending on the metric chosen we can evaluate the risk taken by the deal and the lift generated from this.

Looking at data as of mid-June 2024, we have plotted several different key performance metrics against each other, these were (X-Axis vs Y-Axis):

1. WAS (bps) vs CCC%
2. Annualized Equity Return vs Leverage.
3. Annualized Equity Return vs WARF.

We can then look at how the data is distributed in each quadrant relative to volume of ESG and Non-ESG deals, providing an indication of performance.

WAS vs CCC%

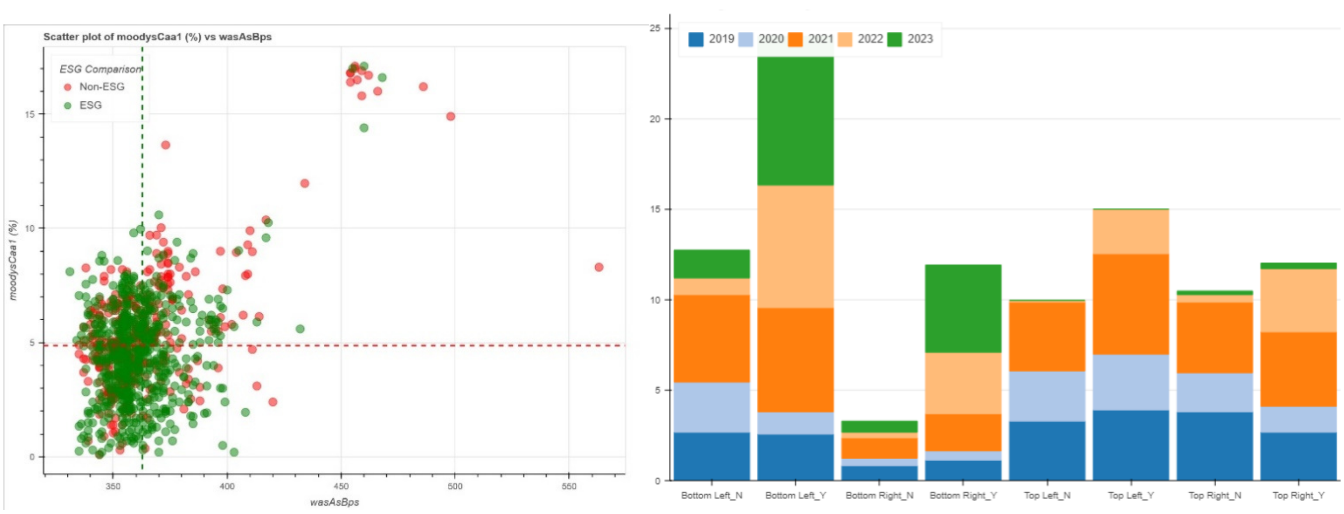
The Weighted Average Spread (WAS) is compared against the percentage of assets rated CCC or lower, in this analysis the most common occurring rating was the Moody's CCC (Caa1 or below) compared to assets rated by S&P or Fitch. Typically, a CCC-rated asset in the primary market would be expected to offer a higher spread due to the increased risk. However, may not always be the case, for example, if an asset is downgraded after being added to the collateral pool. The holding of low-rated assets can reflect a more opportunistic strategy, especially when paired with a high WAS.

Looking at WAS vs Moody's CCC distribution we can see that the main body of deals centre around the mean of both axes, though an easier way to view this would be look at the percentage distribution into each quadrant. For non-ESG deals, the highest concentrations across the vintages tend to be in the bottom-left quadrant (12.74%), which can be seen managers taking less risk for less reward. This is closely followed by the top-right quadrant, which has a greater risk for reward basis (10.48%). The top-left quadrant (9.97%) reflects poor reward for more risk, which may be driven by downgrades in the collateral pool. Similarly, ESG deals are more prominently found in the bottom-left quadrant (24.56%), followed by the top-left (15.01%), top-right (11.92%), and bottom-right (12.02%) quadrants.

Overall, ESG and non-ESG deals are performing in a relatively similar fashion, with ESG showing a slightly higher concentration in conservative and balanced risk-reward profiles. Though as noted before the data is skewed more towards ESG counts, though looking at the percentage distribution graph, we can see for non-ESG, the bottom-left (12.74%) top-left (9.97%) and top-right (10.48 %) are all relatively similar percentages. Whereas for ESG deals the bottom-left is sitting at (24.56%) of the total data, indicating a far more concentrated quadrant.

When comparing ESG versus non-ESG deals across vintages, the data reveals a clear trend towards conservative, low-risk strategies for ESG deals. 2019, ESG deals had the highest concentration in the top-left quadrant (3.91%), indicating a higher-risk approach. 2020, deals shifted to the bottom-left quadrant (1.23%), reflecting a more conservative strategy. This trend intensified in 2021, with ESG deals in the bottom-left quadrant increasing to 5.76%. The move towards low-risk investments became even more pronounced in 2022 and 2023 vintages, with ESG deals in the bottom-left quadrant rising to 6.78% and 8.22%, respectively. Non-ESG deals, on the other hand, were more balanced across quadrants, with the highest concentration in the top-right quadrant (3.80%) for 2019, indicating a preference for higher risk and potential rewards. By 2021, non-ESG deals also showed a shift towards conservatism, with 4.83% in the bottom-left quadrant, but not as prominently as ESG deals. Overall, the data shows that ESG deals have increasingly favoured conservative, low-risk strategies in recent years, demonstrating a strong shift towards stability and lower risk profiles compared to non-ESG deals.

Exhibit 5: WAS vs CCC%



Source: Trepp, Yield Book (June 2024)

Annualized Equity Return vs Leverage

Comparing annualized equity yield (life-time to date) against leverage reveals that a manager with high equity yield but low leverage is considered more balanced, while those maximizing yield with high leverage adopt a more opportunistic approach. This analysis categorizes deals into four quadrants based on these factors.

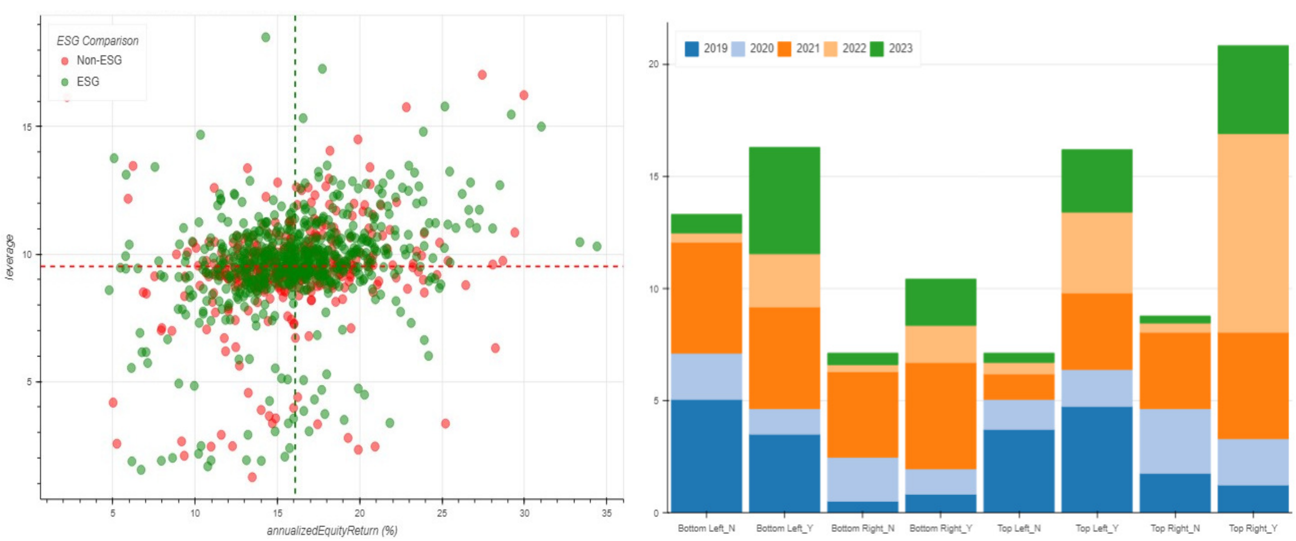
For non-ESG deals, the highest concentration is in the bottom-left quadrant (13.30%), indicating a conservative approach with low leverage and low yield, with the other quadrants similarly distributed. ESG deals, however, show a much higher presence in the top-right quadrant (20.82%), this quadrant points towards more return though with more turns on the underlying collateral.

When looking across vintages, ESG deals have shifted towards higher leverage strategies. The 2019 ESG vintage has the highest concentration in the top-left quadrant (4.74%), returning less on an annual basis than other years. For 2021 vintage bottom-right (4.74%), showing strong returns without the leverage of other vintages. For the 2022 vintage (8.87%) the deals were concentrated in the top right, showing a more aggressive strategy, and the 2023 vintage bottom-left (4.74%).

Non-ESG deals, while adopting higher leverage strategies, remain more conservative. The 2019, non-ESG vintage were concentrated in the bottom-left quadrant (5.05%). For the 2020 and 2021 vintages there was a notable presence in the top-right quadrant (2.88% and 4.94%). For the 2022 vintage the volume of deals is far lower around 0.5% or less across all four quadrants, though the top-left saw the majority of the deals (0.51%), while the 2023 vintage is concentrated in the bottom-left (0.82%).

Overall, ESG deals are increasingly favouring high leverage for maximizing returns, as evidenced by their dominant presence in the top-right quadrant. Non-ESG deals, though also adopting higher leverage strategies, continue to maintain a more balanced and conservative approach.

Exhibit 6: Annualized Equity Return vs Leverage



Source: Trepp, Yield Book (June 2024)

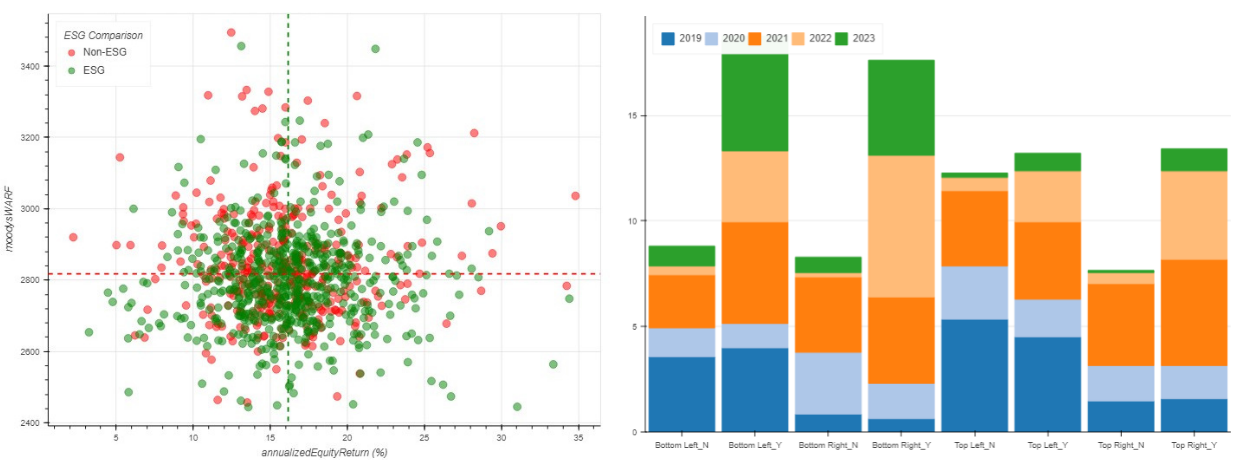
Annualized Equity Return vs WARF

WARF measures the relative credit quality within the underlying pool, with higher values indicating lower credit quality. Total equity yield is the annualized yield provided to equity holders through dividend distributions. The hypothesis is that a manager who decreases the relative credit quality in the portfolio should, in theory, produce a higher level of yield to equity investors, as they are compensated for taking additional credit risk.

For non-ESG deals, the highest concentration is in the top-left quadrant (12.26%), indicating poorer performance, with a higher rating average in the collateral pool, but with less equity returns (on an annualized basis) This is followed by the bottom-left quadrant (8.81%), again indicating lower yield, but for less risk in the collateral pool. ESG deals, however, have a much higher presence in the bottom-left quadrant (18.76%), indicating a preference for conservative, low-risk investments. ESG deals also have significant concentrations in the bottom-right (17.61%) which would be the best risk-profile trade off, maximizing return with less leverage.

Across vintages, ESG deals have shifted towards higher leverage and higher risk strategies, with the largest concentration being the 2022 vintage in the bottom right (6.71%) followed by 2023 in the bottom-left (5.45%). The 2021 vintage can be seen to have more risk in the top-right (5.03%), though the rest of the vintage goes bottom-left, bottom-right, top-left. The older vintages of 2019 and 2020 both are concentrated in the top-left (4.50% and 1.78%). For non-ESG the largest concentration was the top-left for the 2019 vintage (5.35%). Overall, ESG deals are increasingly favouring strategies whilst maximize returns.

Exhibit 7: Annualized Equity Return vs WARF



Source: Trepp, Yield Book (June 2024)

Chapter 4. ESG in loans

In addition to ESG language in CLO deal documentation, we are also interested in ESG characteristics embodied at loan level. We examined a limited pool sample of 105 outstanding sustainability-linked loans in the US (flagged by LSEG LPC) as of May 2024. Although some of these loans may not necessarily be leveraged loans, we believe their common ESG property and mechanism can be a good representative for those of CLO leveraged loans.

Unlike the exclusionary language in the CLO documentation, the ESG language in the loan documents usually comes in the form of KPI and margin ratchets. The loan borrower could be rewarded with margin reduction if they meet the KPIs or be penalized with margin increase for failing the KPIs.

To analyze the ESG related KPI provisions in the loan documents, we scanned 43 loan indentures (out of the 105 sustainability-linked loans) which are available and summarized the KPI keywords and showed total counts of keyword match incidence across those loan documents. For example, we are seeing 29 KPIs associated with “Emission”, and 5 KPIs of “Sustainability Rating”, and 3 for “Renewable Energy”. Among the loan documents we cover, there can be one or multiple KPIs in a single loan offering document, each corresponding to a different ESG perspective.

Exhibit 8: KPI counts from sample loan documents

ESG Category	KPI Determinants	Count of KPI
	Sustainability Rating	5
	S&P ESG Score	1
	Sustainability-Linked Investment Target	1
	Sustainable Investing	1
ESG	Sustainable Technology	1
	Emission	29
	Renewable Energy	3
	LEED	2
	Electric vehicle charging stations	1
	Energy Star	1
	Fleet Sustainability Score Target	1
	Green Building Certification	1
	Green Business Certification	1
	LED lightening system	1
	Non-Emitting Generation Capacity	1
	Processed Waste	1
	Recycle	1
	Recycled Water	1
	Reduction of CO2 Footprint	1
	Renewable Electricity	1
	Renewable Generation	1
	Solar	1
	Waste Recycled/Reused	1
Environmental	Water Use Intensity	1
	Diversity Supplier Spend	2
	Injury	2
	Client SBT Percentage	1
	Diverse Supplier Spend	1
	Diversity	1
	Essential Medicines	1
	Percent Global Supply Chain Spend	1
Social	the LTIF Target	1
	Women Managers	3
	Injury	2
Governance	Employee Health and Safety	1

Source: Yield Book, LSEG LPC (June 2024)

To better understand how ESG KPIs work, we illustrate by an example below using ratchet language from one loan document. There are three KPI metrics - Greenhouse Gas Emission, Plastic Recycling Program, Percentage of Women Managers and Professionals, and corresponding KPI target and margin adjustment for each ESG metric. For example, for “Greenhouse Gas Emission”, once the company meets the Greenhouse gas emission KPI in the specific fiscal year (say, >= 22.4% in FY24), the loan’s applicable margin will be reduced by 1.67bps and the commitment fee will be reduced by 0.34bps, resulting in a total reduction of 2bps in the borrowing cost per annum. On the other hand, if the company misses the greenhouse gas emission target (say, <16.9% in FY24), there will be 2bps of increase (across applicable margin and commitment fee) to the financing expense.

Exhibit 9: Sample ESG KPI ratchets

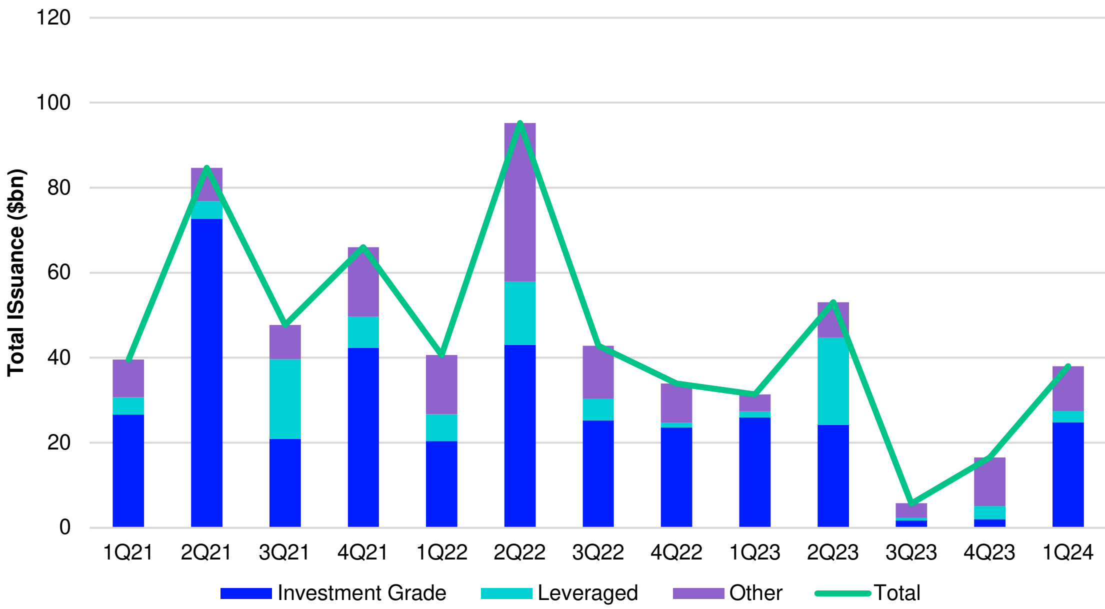
		Baseline	Sustainability Target				Sustainability Adjustment
KPI Metric A:		2017	FY23	FY24	FY25	FY26	
Greenhouse Gas Emissions	Target A	0	≥20.8%	≥22.4%	≥23.9%	≥25.4%	**Applicable Margin**: -1.67 bps **Commitment Fee**: -0.34 bps
	In between						**No adjustment**
	Threshold A		<15.4%	<16.9%	<18.4%	<19.9%	**Applicable Margin**: +1.67 bps **Commitment Fee**: +0.34 bps
KPI Metric B:		2020	FY23	FY24	FY25	FY26	
Plastic Recycling Program	Target B	9	≥147	≥220	≥250	≥250	**Applicable Margin**: -1.66 bps **Commitment Fee**: -0.33 bps
	In between						**No adjustment**
	Threshold B		<84	<148	<174	<174	**Applicable Margin**: +1.66 bps **Commitment Fee**: +0.33 bps
KPI Metric C:		2020	FY23	FY24	FY25	FY26	
Percentage of Women Managers and Professionals	Target C	36%	≥39.5%	≥41.0%	≥42.5%	≥44.0%	**Applicable Margin**: -1.66 bps **Commitment Fee**: -0.33 bps
	In between						**No adjustment**
	Threshold C		<38.0%	<39.0%	<40.0%	<41.0%	**Applicable Margin**: +1.66 bps **Commitment Fee**: +0.33 bps

Source: LSEG LPC (June 2024)

In recent years, the ESG trajectory has faced some headwinds amid geopolitical tensions and rising inflation. According to LSEG LPC data, sustainability-linked loan issuance in the BSL market saw a significant decline in 2023, down sharply by 50% from 2022, totaling just $106.6bn (vs.$212.6bn in 2022). The quarterly volume reached three-year low in 3Q23 with only $5.73bn issued. As issuers grappled with elevated interest rates and declining cash flow, many opted to pull back from ESG-related provisions in loan agreements and to soften KPI language to alleviate financial stress. The tightening of credit conditions and increased market volatility have further dampened the appeal of sustainability financing, highlighting broader challenges in maintaining ESG commitments amidst challenging economic conditions.

Entering 2024, as the market stabilized amid rate cut hopes, the sustainable finance loan issuance recovered from the 3Q23 low. In the first quarter of 2024, 28 sustainability loans were issued in the US for a total balance of $37.99 billion, more than doubled that of 4Q23. Looking ahead, as the ESG principles are increasingly recognized as being integral to sustainable investing and corporate decision-making, the future of ESG in corporate loans still appears to be promising.

Exhibit 10: US Sustainable Finance Loan Volume



Source: LSEG LPC (June 2024)

About LSEG Yield Book

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