PRIVATE DEBT FOR PUBLIC GOOD

Nakita Q. Cuttino[*]

Abstract

If "he who controls the purse makes the rules," then should corporate lenders be able to nudge borrowers to improve their societal impact? There is growing consensus that firms should mitigate environmental and social harms arising from their private business activities, yet there is little agreement on how best to ensure this end. A host of ad hoc market efforts have emerged, including public pledges to certain goals, voluntary disclosures to investors, and niche financial innovations designed to incentivize and evidence prosocial corporate activity. Despite these developments, market efforts always seem to fall short of the effective self-monitoring necessary for so-called environmental, social, and governance (ESG) outcomes. Observers often attribute these shortcomings to market failures—agency costs or information asymmetries—and negative externalities, which firm managers and investors are thought ill-equipped to manage. Yet, the unique potential of corporate lenders to address these shortcomings has been largely overlooked by the market and, consequently, the literature.

This Article analyzes an original dataset of more than 125 contracts in the emerging sustainability-linked loan market to explore the potential of lender monitoring for ESG outcomes. This six-year-old market has Dell promising to increase sustainable packaging, Lululemon committing to close the gender pay gap amongst its employees, and Hewlett-Packard

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pledging to improve the racial diversity of its executives—all in exchange for more favorable terms in novel loan agreements. As the first in-depth review of the fastest growing segment of the $5.5-trillion syndicated loan market, this Article shows how the far-reaching influence of "universal lenders," combined with the lender's toolkit and traditional relationship with borrowers, theoretically equips lenders to better overcome information asymmetries and agency costs that have undermined other market-based ESG efforts. It argues, however, notwithstanding their enhanced informational insights and commitment mechanisms, lenders are hamstrung by a predictable disregard of negative externalities, which reveals the truly nominal value of ESG to firms. But while many scholars view negative externalities as a reason to avoid such market-based ESG solutions, this Article insists on the very opposite outcome. Policy interventions that shift the burden of externalities to borrowers, lenders, or both should be used to effectively harness the clear benefits of lenders as private monitors to ensure the ESG movement has real and lasting effect.

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INTRODUCTION

"*Private lenders are not charitable institutions. They will act to maximize their rate of return when they . . . exercise their influence.*"[1]

JetBlue Airways Corp. has made significant strides to reduce its carbon footprint and recently became the first airline worldwide to join a growing list of U.S. companies giving new meaning to "put your money where your mouth is." The airline wanted to go an extra mile to show its shareholders that its sustainability goals were directly connected to its bottom line.[2] To achieve this, it turned to an unlikely source for help: its

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1. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1245 (2006).

2. Press Release, BNP Paribas USA Inc., BNP Paribas and JetBlue Partner to Close First Sustainability-Linked RCF for the Airline Industry (Feb. 24, 2020), https://www.globenewswire.com/news-release/2020/02/24/1989271/0/en/BNP-Paribas-and-JetBlue-Partner-to-Close-First-Sustainability-Linked-RCF-for-the-Airline-Industry.html [https://perma.cc/8TX3-YQ9D].

lenders.[3] Like many companies, JetBlue has long held a multi-million-dollar revolving loan facility, which functions like a credit card for the company to borrow, repay, and reborrow funds from time to time to pay for general activities.[4] The airline pays interest on borrowed amounts and commitment fees to maintain access to unused amounts.[5] In February 2020, JetBlue worked with its lenders to amend this loan facility so that the interest rate and commitment fees would adjust based on predetermined sustainability goals.[6] JetBlue and its lenders enlisted BNP Paribas as a "sustainability agent"—a loan party that helps select the appropriate performance metrics and benchmarks to assess a borrower's sustainability goals over time.[7] In JetBlue's loan, the interest rate and commitment fees were set to adjust based on the airline's environmental, social, and governance (ESG) score published annually by Vigeo Eiris, a Moody's affiliated global ESG research provider.[8] JetBlue's ESG score functions much like a traditional credit rating but reflects risks and performance along aggregated nonfinancial metrics, including environmental impact. In making these adjustments, JetBlue transformed its loan facility into an increasingly popular sustainability-linked loan—a six-year-old novelty with much promise but little proof.

Sustainability-linked loans are a rare innovation in the $5.5-trillion syndicated loan market, and they promise a "mind shift" in mainstream corporate finance that advances the public good.[9] Corporate lenders were historically agnostic with respect to a borrower's ESG performance. Instead, lenders' risk management efforts are generally aimed to limit lenders' loss risk by mandating information-sharing and aligning borrowers' economic interests with lenders' interest in minimizing loss

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3. *See id.*

4. *Id.*; Tim Vipond, *Revolving Credit Facility*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/commercial-lending/revolving-credit-facility/ [https://perma.cc/RJQ4-MCU4].

5. *See* Vipond, *supra* note 4.

6. *See* Press Release, *supra* note 2.

7. *Id.*; Kenneth Chin, *An Introduction to Sustainability Linked Loans*, KRAMER LEVIN (Apr. 15, 2021), https://www.kramerlevin.com/en/perspectives-search/An-Introduction-to-Sustainability-Linked-Loans.html [https://perma.cc/AQV5-SBSX].

8. Press Release, *supra* note 2.

9. *ING and Philips Collaborate On Sustainable Loan*, ING NEWSROOM (Apr. 19, 2017), https://www.ing.com/Newsroom/News/ING-and-Philips-collaborate-on-sustainable-loan.htm [https://perma.cc/2WXS-KVAM] ("'Creating sustainability incentives in a financing structure is a mind-shift in corporate financing and a clear innovation in the market,' said Gerro Goedhuis, ING Syndicated Finance.").

risks.[10] For example, borrowers are typically required to periodically file financial reports, and they may have limits on their ability to sell assets or take on new debt, which would impact their ability to repay a loan.[11] Such risk management tools in the lender's underwriting processes and incorporated into loan terms have long been recognized as potent means by which to influence borrower activity.[12] Yet, these tools, with a focus on financial performance, rarely targeted ESG performance unless ESG failures amounted to a violation of law with risks of significant financial penalty to the borrower that would, in turn, impact the borrower's ability to repay the loan.[13]

Corporate lenders have faced pressures from investors, deposit accountholders, and employees, as well as social activists and policymakers, who view lender apathy regarding ESG performance as a missed opportunity.[14] The predominant call to action has been divestment—curtailing or ending lending relationships with firms that contribute to certain societal risks.[15] By cutting capital access, divestment proponents aim to force contraction of the targeted industries. Such proponents have, with some success, urged corporate lenders to divest from controversial industries, such as fossil fuels,[16] private prisons,[17] and gun manufacturing.[18] However, divestment efforts can prove impracticable (if not wholly ineffective) due to long-standing business relationships, robust

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10. *See infra* Section I.A.
11. *See infra* note 53 and accompanying text.
12. *See infra* Section I.C.
13. *See infra* Section I.A.
14. *See infra* Section II.A.
15. *See infra* Section II.B.
16. *E.g.*, Lynda V. Mapes, *Climate Activists Shut Down Chase Bank Branches in Seattle; Arrests Made*, SEATTLE TIMES (May 8, 2017, 1:27 PM), https://www.seattletimes.com/seattle-news/climate-activists-shut-down-chase-bank-branches-in-seattle/ [https://perma.cc/N2KM-NELJ] ("Climate activists disrupted business at 13 branches of JPMorgan Chase bank . . . in an effort to stop loans to tar-sands oil-pipeline projects.").
17. *E.g.*, Rachel Louise Ensign, *Bank of America Cut Off Private Prisons Weeks After Lending to One*, WALL ST. J. (July 2, 2019, 5:30 AM), https://www.wsj.com/articles/bank-of-america-cut-off-private-prisons-weeks-after-lending-to-one-11562059804 [https://perma.cc/58LK-9QP2] ("At Bank of America's annual meeting in April, activists peppered executives with questions about its loans to private prisons.").
18. *Id.* (reporting that Bank of America "would stop making new loans to some gun manufacturers . . . follow[ing] discussions with employees who had been affected by mass shootings").

competition amongst lenders, and significant opportunity costs.[19]

Sustainability-linked loans, according to lenders and borrowers with like enthusiasm, represent a better alternative to divestment—financial engagement.[20] These loans refocus potent lender risk management tools to promote ESG performance, thus preserving and actively using the lender-borrower relationship to improve ESG outcomes.[21] These loans align terms, such as pricing or conditions for borrowing, with predetermined sustainability performance objectives.[22] For example, by meeting (or missing) performance targets, borrowers can reduce (or increase) loan costs, including interest rates and commitment fees.[23] In doing so, these loans, according to market proponents, can incentivize sustainable performance measured along a variety of ESG factors, such as greenhouse gas (GHG) emissions, workplace diversity, and prosocial managerial incentive structures.[24]

Sustainability-linked loans also expand the potential impact of the sustainable finance sector pioneered by green bonds. Green bonds are debt securities that condition the availability of loans on such funds being used for environmental projects, including renewable energy and building efficiency.[25] Unlike green bonds, sustainability-linked loans can be used by any borrower for any general corporate purpose.[26] Thus, sustainability-linked loans could allow firms whose primary business does not focus on sustainability to demonstrate a commitment to ESG growth.

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19. *See id.*

20. *See* CJ Clouse, *ESG Loans Broaden Access to Sustainability-Linked Financing*, GREENBIZ (Mar. 6, 2019), https://www.greenbiz.com/article/esg-loans-broaden-access-sustainability-linked-financing [https://perma.cc/LW8V-QR3V].

21. *See id.*

22. *See* Jacqueline Poh, *Lenders Seek Loans Tied to Borrowers' Sustainability Performance*, BLOOMBERG NEWS (Feb. 12, 2020, 6:07 AM), https://www.bloomberg.com/news/articles/2020-02-12/lenders-seek-loans-tied-to-borrowers-sustainability-performance [https://perma.cc/57QP-GHZ4].

23. *See, e.g.*, Press Release, *supra* note 2.

24. *See, e.g.*, *Beyond Climate: Sustainability-Linked Loans Embrace Diverse Targets*, NORDEA (May 7, 2023, 3:25 PM), https://www.nordea.com/en/news/beyond-climate-sustainability-linked-loans-embrace-diverse-targets [https://perma.cc/4GTV-D5QV].

25. *See generally* BRIDGET BOULLE ET AL., CLIMATE BONDS INITIATIVE, POST-ISSUANCE REPORTING IN THE GREEN BOND MARKET (2017), https://www.climatebonds.net/files/files/UoP_FINAL_120717.pdf [https://perma.cc/25MU-KVW].

26. Clouse, *supra* note 20.

The global sustainability-linked loan market has rapidly grown since its European debut in 2017.[27] Global loan volumes in 2021 more than tripled the prior year's issuances, exceeding $715 billion.[28] And the exponential growth in 2021 confirmed the market's stateside appeal—for the first time, the United States' sustainable lending market share matched Europe's 43% market share for the year.[29] The market's continued expansion is poised to be bolstered by several recent social and environmental pledges made by financial institutions, including multi-billion-dollar pledges to combat systemic racism and economic inequality[30] and a $130 trillion commitment by transnational banks to reach net-zero emissions in their investment and lending portfolios by 2050.[31] Sustainability-linked loans, thus, could prove instrumental in achieving these lofty environmental and social goals.

However, corporate lenders are latecomers in the market-based effort to drive ESG outcomes long led by equity investors, firm managers, and bondholders.[32] Such efforts are often met with great skepticism; they are charged as mere public relations efforts rather than generative of meaningful change.[33] Indeed, there is a rich literature critiquing market-based ESG initiatives, but scholars primarily analyze these issues through the lenses of corporate governance and investor protection. Some scholars identify information asymmetries that lead to unreliable public disclosures on ESG performance and

27. *See* REFINITIV, SUSTAINABLE FINANCE REVIEW: FULL YEAR 2021 4 (2021), https://thesource.lseg.com/thesource/getfile/index/5502b5b5-a6db-4528-bc3a-8842c7c5762e [https://perma.cc/TK84-NVVH].

28. *Id.*

29. *Id.*

30. *See, e.g.*, Press Release, The PNC Financial Services Group, PNC Commits More Than $1 Billion To Help End Systemic Racism and Support Economic Empowerment of African Americans and Low- and Moderate-Income Communities (June 18, 2020), https://pnc.mediaroom.com/2020-06-18-PNC-Commits-More-Than-1-Billion-To-Help-End-Systemic-Racism-And-Support-Economic-Empowerment-Of-African-Americans-And-Low-And-Moderate-Income-Communities [https://perma.cc/A45J-YF6M].

31. *See* Zack Colman & Lorraine Woellert, *A $130T Climate Promise Is Greeted with Suspicion*, POLITICO (Nov. 3, 2021, 6:50 PM), https://www.politico.com/news/2021/11/03/banks-climate-promises-519176 [https://perma.cc/EWX6-6EH6].

32. *See infra* Section II.C.

33. *See, e.g.*, Lori Shapiro, *The Fear of Greenwashing May Be Greater Than the Reality Across the Global Financial Markets*, S&P GLOBAL (Aug. 23, 2021, 11:51 AM), https://www.spglobal.com/ratings/en/research/articles/210823-the-fear-of-greenwashing-may-be-greater-than-the-reality-across-the-global-financial-markets-12074863 [https://perma.cc/L632-YC25].

mislabeled ESG investment products.[34] Such information disparities and inaccuracies undermine ESG monitoring and enforcement by investors and other stakeholders. Other scholars point out the lack of accountability mechanisms for firm managers.[35] Managers are free to make pledges and promises with respect to ESG performance but lack credible commitment mechanisms, such as disclosure requirements, financial incentive, or legal duty. Finally, some scholars note that ESG matters are classic negative externalities not well-suited for managerial oversight and, instead, best managed by public policy.[36]

This Article explores whether corporate lenders are uniquely positioned to remedy these persistent shortcomings of market-based ESG efforts. It conducts a systematized examination of the U.S. sustainability-linked loan market to assess the mechanisms that incentivize ESG performance. In doing so, this Article makes two primary contributions to the literature.

First, this Article synthesizes an original dataset of more than 125 loan agreements entered by U.S. public companies to reveal that sustainability-linked loans enjoy mainstream adoption, but only within select industries and with very limited ESG incentives and a primary focus on environmental outcomes. The key financial institutions in the market are mainstream financial juggernauts that dominate the broader syndicated loan market, including JPMorgan Chase Bank, Bank of America, and Wells Fargo Bank. Indeed, these three firms facilitate loan issuances, manage ongoing compliance with loan terms, and select customized ESG metrics with set benchmarks for most sustainability-linked loans. They also contribute financing funds in over 70% of loans analyzed. On the borrower side, most firms are real estate investment trusts (REITs) or utilities firms. Indeed, there is a dramatic overrepresentation of these two sectors in the sustainability-linked submarket versus the broader syndicated loan market. Conversely, though popular names such as Ford Motor, Lululemon, and BlackRock have been among the first in their respective sectors to execute sustainability-linked loans, their sectors are underrepresented.

The dataset also reveals trends in loan structures and terms. Most loans are structured as revolver loans rather than term loans. Said another way, most sustainability-linked loans can

34. *See infra* note 172 and accompanying text.

35. *See infra* note 176 and accompanying text.

36. *See infra* notes 185–91 and accompanying text.

be borrowed and repaid from time to time like a credit card, rather than a single borrowing with periodic payments like a student loan. By comparison, the broader syndicated loan market is roughly 60% revolver loans and 40% term loans, revealing a curious distortion in the sustainability-linked loan market. And because different types of lenders tend to finance different loan structures, sustainability-linked loans are financed primarily by oft public-facing relational lenders rather than non-depositary, arm's length lenders. Regarding loan terms, the data reveals a trend of incorporating ESG performance benchmarks through economic terms rather than governance terms. This means a borrower's nonperformance will exclusively impact the price of the loan but will not threaten loan cancellation or other severe financial consequences. The price impact is arguably nominal—price adjustments typically fall in the range of five to ten "basis points," or five to ten one-hundredths of one percent. For context, on a $500 million loan, that could amount to a $250,000 to $500,000 annual cost difference, but because most revolvers are not fully drawn, the cost difference could very well be $0. Moreover, a borrower could publicly celebrate the execution of a sustainability-linked loan yet fail to meet all benchmarks thereunder without any public notice. The data also reveals that ESG performance benchmarks are customized with a primary focus on environmental performance, particularly GHG emissions. Social benchmarks are included in about one-third of loans and skew toward workplace-safety and gender-equity goals. Thus, a lender advantage of customized monitoring is curtailed by a limited scope.

Second, this Article provides a descriptive account of the sustainability-linked loan market that identifies several limitations on promising innovations. On the one hand, sustainability-linked loans align stakeholder interests with shareholder interests by indirectly tying shareholder returns to ESG performance targets. And the market is dominated by what this Article calls "universal lenders"—lenders that have robust business exposure to consumer and corporate markets; they are, thus, incentivized to balance the two interest groups and prioritize ESG performance effectively. Moreover, these lenders tend to have unique informational insights for effective monitoring. On the other hand, although loan terms align shareholder and stakeholder interests, they do so nominally, which is unlikely to shift managerial priorities. And though universal lenders *could* be effective monitors, the use of

nominal economic terms over governance terms allows unbridled borrower discretion. These limitations exist because lenders lack incentives beyond reputational risks, such as regulatory compulsion, heightened default risks, or material shareholder losses. Reputational risks alone are insufficient to offset the high costs of negotiating rules-based governance terms and conducting ongoing monitoring. Thus, even assuming the sustainability-linked loan market is an honest effort by lenders to monitor ESG outcomes, the pressure to disregard externalities cannot be overcome by altruism. Consequently, this Article argues that enhanced informational insights and commitment mechanisms are essential components to drive ESG outcomes, but the "key" to start the metaphorical engine is internalized social costs.

This Article is organized as follows. Part I explores the contours of traditional lender governance, including the mechanisms by which it functions and its effect on borrower performance. Part I also documents the differences between relational lenders and arm's length lenders in character and governance approach. Part II explores the ESG movement and its recent efforts to repurpose lender governance tools to drive ESG performance, tracking a long-fought and still-ongoing battle for such repurposing in the corporate governance context. The movement presupposes that ESG risks are consequential to market participants via long-term value assessments or short-term reputational risk assessments and, thus, market-based solutions can flow from better information or public pressure. However, Part II illustrates that market-based solutions are routinely criticized by scholars as inadequate due to information asymmetries, insufficient accountability mechanisms, or negative externalities that are questionably resolvable through market forces. Part III systematically examines a select set of sustainability-linked loans entered by U.S. borrowers to assess whether lenders are the missing link to success in the ESG movement. The data reveals emerging market trends that hint at superior lender monitoring ability, but it also raises some concerns as to disparities in borrower-side representation in the market, the nominal nature of ESG performance incentives, the focus on environmental performance targets, and the disinterest of term loan lenders. Part IV contextualizes the data to argue that notwithstanding their enhanced informational insights and commitment mechanisms, lenders are hamstrung by a predictable disregard of negative externalities that reveals the truly nominal value of

ESG matters to firms. Part IV then suggests ways policymakers can reallocate the social risks of ESG failures to loan parties to actualize effective ESG monitoring.

I. LENDER GOVERNANCE

It is no secret that firm managers and equity investors drive corporate decisionmaking, often at the expense of other stakeholders.[37] But there is one nonshareholder stakeholder that has long had robust governance tools at its disposal: corporate lenders. Corporate lenders acquire governance abilities through loan agreements that impact the activities of most midsize and large firms in the United States and globally, including through syndicated loans. Syndicated loans are primarily term loan or revolver loan facilities,[38] wherein a group, or "syndicate," of lenders share in the responsibility of multi-million- or multi-billion-dollar lending obligations.[39] The flexibility to borrow large sums of funds under a single loan agreement makes syndicated loans quite popular among corporate borrowers. Indeed, the global syndicated loan market consists of more than 50,000 loans outstanding to over 40,000 individual firms in more than 200 countries. Loan issuances exceed $5.5 trillion annually,[40] and the U.S. market alone accounts for nearly 60% of this activity.[41] This Part explains how most major U.S. firms are subject to lender information gathering, ongoing monitoring, and control requirements set forth in syndicated loan agreements.

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37. *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 93–94 (2020).

38. "Revolver" loan facilities function like a credit card, while "term" loan facilities function like a student loan. In other words, revolver facilities may be borrowed, repaid, and reborrowed from time to time up to a certain dollar amount and until the maturity date of the loan. Term facilities may generally be borrowed once and repaid in installments over time or in one lump sum at maturity. *See, e.g.*, Frederick Tung, *Do Lenders Still Monitor? Leveraged Lending and the Search for Covenants*, 47 J. CORP. L. 153, 168–71 (2021) (providing a detailed explanation of the process behind forming a syndicated loan and the various types).

39. *See, e.g.*, *id.* at 168–70.

40. BLOOMBERG, GLOBAL SYNDICATED LOANS: LEAGUE TABLES 1, 1 (2021), https://www.troutman.com/a/web/295223/2021-Q4-Bloomberg-Global-Capital-Markets-Legal-Advisers-Ranke.pdf [https://perma.cc/KF5B-AHN9].

41. *See id.* at 5 (U.S. loan volumes represent $3.1 trillion in fiscal year ending 2021).

A. *The Toolkit*

Corporate lenders issue loans against the risk of nonpayment in exchange for fixed interest payments and fees rather than a share of profits. They are therefore interested in protecting their returns while mitigating borrower risk-taking and operational shortcomings.[42] Loans are designed to achieve these goals through economic and governance terms. Economic terms include loan costs and security requirements, which reflect the borrower's nonpayment risk and potential to cover renegotiation costs.[43] Governance terms aim to resolve information asymmetries and mitigate agency costs to contain borrower risks within a range contemplated by economic terms.[44] Economic terms often double as governance terms in the form of "performance pricing." These provisions automatically adjust loan costs, such as interest rates and commitment fees,[45] periodically based on some measure of the borrower's financial performance.[46] Specifically, the "margin rate," which is a component of the total interest rate negotiated by the lenders, will differ based on metrics such as debt ratings, debt levels, or asset value.[47] The applicable margin is then added to a publicly available "reference rate" to create the full

42. *See, e.g.*, Baird & Rasmussen, *supra* note 1, at 1239–42 (describing the provisions in loan agreements that give creditors a large role in corporate management); George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073, 1077–79 (1995) (discussing the role that creditors play in constraining agency costs, particularly regarding managerial slack); Tung, *supra* note 38, at 155, 157, 166 (arguing that banks and other private lenders exercise routine and significant influence over firm management, sometimes even exceeding that of shareholders and the board of directors); Joanna M. Shepherd et al., *What Else Matters for Corporate Governance?: The Case of Bank Monitoring*, 88 B.U. L. REV. 991, 994, 1001–06 (2008) (analyzing methods taken by banks to monitor borrowers and reviewing records of actions actually taken).

43. Gary Gorton & James Kahn, *The Design of Bank Loan Contracts*, 13 REV. FIN. STUD. 331, 333 (2000).

44. *See* William W. Bratton, *Bond and Loan Covenants, Theory and Practice*, 11 CAP. MKTS. L.J. 461, 464–65 (2016).

45. Commitment fees are charges for maintaining access to unused loan amounts. *See Commitment Fee*, THOMSON REUTERS: PRAC. L., https://us.practicallaw.thomsonreuters.com/6-382-3351 [https://perma.cc/5JVC-SDCZ].

46. Tung, *supra* note 38, at 162–64.

47. *See* Geoff Williams, *What is a Margin Rate, and How Does It Work?*, SMARTASSET (Dec. 15, 2022), https://smartasset.com/investing/margin-rates [https://perma.cc/8S4K-UDH2].

interest rate charged for borrowed amounts.[48] The resulting adjustments incentivize activities that improve the borrower's financial health in exchange for meaningful cost savings. Governance terms also include provisions with more specific dictates on the borrower's conduct or demands for information, in each case, with a particular focus on financial outcomes.[49]

Lenders stay abreast of detailed and often nonpublic information regarding the operations and financial health of borrowers through representations and affirmative covenants. Representations are declarations of fact made by the borrower when a loan is issued and they are updated as a prerequisite to future drawdowns in a revolver loan facility.[50] Borrowers make several representations intended to resolve information asymmetries, such as affirming the accuracy of financial disclosures and affirming their ability to conduct business activities without financial distress or litigation risk.[51] Affirmative covenants are promises made by the borrower to perform certain actions,[52] including periodic disclosures of sensitive borrower information.[53] For example, borrowers are typically required to provide financial data quarterly, including narrowly tailored, non-generally accepted accounting principles (GAAP) financial measures that better illuminate financial performance for the specified borrower.[54] Other disclosure requirements may include prompt notice of events that materially impact the borrower's business operations.[55]

Lenders shape the day-to-day operations of borrowers through negative and financial covenants.[56] Negative covenants

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48. *See CSI Loans, Base Rate and Margins*, COMPUT. SERVS., INC. (Feb. 8, 2024), https://secure.csiweb.com/csihelpdocs/lns%20help/rate_control/base_rate_and_margins.htm [https://perma.cc/AUK2-BBWX].

49. *See* Bratton, *supra* note 44, at 462–64.

50. *See Loan Agreement: Representations and Warranties*, THOMSON REUTERS: PRAC. L., https://us.practicallaw.thomsonreuters.com/1-382-7281 [https://perma.cc/XZ89-4H53].

51. *See id.*

52. Lenders also aim to preserve the borrower's value through affirmative covenants that require borrowers to maintain good business practices, such as complying with applicable laws, maintaining their assets, and keeping up with taxes. *See* Bratton, *supra* note 44, at 463–65.

53. *See id.* at 463; *see also Loan Agreement: Affirmative Covenants*, THOMSON REUTERS: PRAC. L., https://us.practicallaw.thomsonreuters.com/6-382-8184 [https://perma.cc/4FSG-2PL3].

54. *See* Tung, *supra* note 38, at 158 (discussing informativeness of EBITDA add-backs being more predictive than GAAP data).

55. *See Loan Agreement: Affirmative Covenants*, *supra* note 53.

56. *See* Tung, *supra* note 38, at 160–63.

are promises to refrain from or limit measures that diminish asset value, dilute the lender's claim to repayment or collateral assets, or extract wealth from the borrower.[57] For example, borrowers often have limitations on debt they can incur, assets they may sell, and dividends they can pay to managers and stockholders.[58] Financial covenants are promises to maintain a minimum level of financial performance.[59] Such performance is often assessed by measures of the borrower's aggregate debt levels, their ability to make periodic interest payments on debts, and their asset values.[60] These covenants serve as tripwires that signal a possible deterioration in the credit risk profile of the borrower that may require exiting the loan or adjusting its economic terms.[61] The restrictiveness of such covenants are positively correlated with the degree of agency costs and financial risks present.[62] In other words, lenders may more aggressively restrict managerial discretion through negative covenants and financial covenants where internal controls are lacking or financial performance is shaky.[63]

Lenders flex their greatest governance muscles with interventions that result from "events of default" provisions. These provisions trigger lender control rights upon specific occurrences, which typically include nonpayment, breaches of negative covenants, certain sudden deteriorations in financial health, and, usually after a cure period, violations of other loan provisions.[64] Following an event of default, corporate lenders

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57. *See* Bratton, *supra* note 44, at 465–68; *Loan Agreement: Negative Covenants*, THOMSON REUTERS: PRAC. L., https://us.practicallaw.thomson reuters.com/5-383-3077 [https://perma.cc/26GP-DTDP].

58. *See* Bratton, *supra* note 44, at 468–71; *Loan Agreements: Negative Covenants*, *supra* note 57.

59. *See* Bratton, *supra* note 44, at 464; *Loan Agreement: Financial Covenants*, THOMSON REUTERS: PRAC. L., https://us.practicallaw.thomsonreuters .com/3-384-0955 [https://perma.cc/Z2GE-RHRR].

60. *See* Bratton, *supra* note 44, at 464; *Loan Agreement: Financial Covenants*, *supra* note 59.

61. *See* Bratton, *supra* note 44, at 464.

62. Michael Bradley & Michael R. Roberts, *The Structure and Pricing of Corporate Debt Covenants*, 5 Q. J. FIN. 1, 1–4 (2015) (showing a negative correlation between the likely yield of a corporate debt arrangement and the presence and breadth of related restrictive covenants observed in a set of commercial loans made between 1993 and 2001).

63. *Id.* at 2.

64. *Glossary: Event of Default*, THOMSON REUTERS: PRAC. L., https://us.practical law.thomsonreuters.com/2-382-3447 [https://perma.cc/DP7M-A4GG].

have the right to accelerate and terminate the loan.[65] In practice, violations that do not alter the lender's risk levels are typically waived, but material violations may cause lenders to impose one-time penalty fees,[66] renegotiate economic terms to reflect heightened risks,[67] signal the borrower's financial distress to the capital markets,[68] or rein in managerial discretion through more restrictive governance terms.[69]

B. *Selective Governance: Relational & Arm's Length Lenders*

However, not all lenders rely on the lender's governance toolkit, which, in practice, makes some loan types more potent vehicles of lender influence than others. Specifically, relational lenders are more likely than arm's length lenders to exercise their governance rights.[70] Relational lenders are typically depositary financial institutions in long-term business relationships with their borrowers, which often provide services such as deposit accounts and other cash management services.[71] In the syndicated loan market, these lenders have traditionally used an "originate-to-hold" model wherein they would issue and hold loans on their balance sheets until the loans were terminated or expired five to seven years later, if not renewed.[72] This long-term, multifaceted nature of the relationship tends to give relational lenders a holistic view of the borrower's business and theoretically incentivizes relational lenders to care about the long-term performance of

65. Bo Jiang & Douglas Xu, *Covenant Amendment Fee and Value of Creditor Intervention after Covenant Violations* 1 (2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3290802 [https://perma.cc/W8CZ-XZFC].

66. *Id.* at 2–3.

67. *Id.* at 3 (asserting that payment of fees in response to covenant violations is prevalent, while less than 10% of violations result in increases to initially negotiated interest rates).

68. *See id.* at 21.

69. *See id.* at 2.

70. *See* Nitin Vishen, *Do Firms Have a Preference Order While Repaying Lender Relationship vs. Transaction Banking*, INDIAN SCH. OF BUS. 1, 17 (2018), https://www.stern.nyu.edu/sites/default/files/assets/documents/Vishen%20-%20Do%20Firms%20Have%20a%20Preference%20Order%20While%20Repaying%20Lenders_%20Relationship%20vs%20Transaction%20Banking.pdf [https://perma.cc/A3G4-STP2].

71. Will Kenton, *Understanding Relationship Banking, Its Pros and Cons*, INVESTOPEDIA (Aug. 2, 2022), https://www.investopedia.com/terms/r/relationship-banking.asp [https://perma.cc/E5GC-8ELM].

72. Vitaly M. Bord & João A.C. Santos, *The Rise of the Originate-to-Distribute Model and the Role of Banks in Financial Intermediation*, 18 FRBNY ECON. POL'Y REV. 21, 21 (2012).

their borrower. Today's relational lenders, however, concentrate their loan holdings in revolver loans while using an "originate-to-distribute" model for term loans—i.e., selling off most term loan holdings shortly after origination to arm's length lenders on the secondary loan market.[73]

Arm's length lenders are collateralized loan obligations (CLOs)[74] and other institutional investors, such as insurance companies and mutual funds, that hold loan interests directly or through CLOs.[75] These lenders purchase and trade their loan holdings in much the same way security investors purchase and trade stocks or bonds.[76] Arm's length lenders tend to lack the holistic insights enjoyed by relational lenders. The fungibility of such loans give arm's length lenders cheaper protection mechanisms to lender governance.[77] Moreover, the great number and diversity of arm's length lenders greatly increase the costs of renegotiating loans in the event of a covenant violation.[78] Thus, loans in these contexts tend to be less restrictive and lack traditional governance mechanisms. Indeed, arm's length lenders were a driving force behind a

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73. *See* Seung Jung Lee et al., *The U.S. Syndicated Term Loan Market: Who Holds What and When?*, FEDS NOTES (Nov. 25, 2019), https://www.federalreserve.gov/econres/notes/feds-notes/the-us-syndicated-term-loan-market-20191125.htm [https://perma.cc/4KNJ-6ZY2] (describing the frequency with which loans originating in a relational setting are distributed to arm's length lenders); *see also* Bord & Santos, *supra* note 72, at 30 ("Thus, for credit lines, syndicate-participant banks . . . tended to hold the credit lines to maturity (or at least for three years). For term loans, in contrast, syndicate-participant banks, like lead banks, have been decreasing the market share they retain at origination and over the years after origination."); Jeremy McClane, *Reconsidering Creditor Governance in a Time of Financial Alchemy*, 2020 COL. BUS. L. REV. 192, 213–15 (2020) (arguing that trends toward "originate-to-distribute" systems of lending impact the frequency and fastidiousness of monitoring by banks).

74. CLOs are created through "special purpose vehicles," which are companies set up solely to hold specified corporate term loans. Troy Segal, *CLO*, INVESTOPEDIA, https://www.investopedia.com/terms/c/clo.asp [https://perma.cc/E7AZ-C36E]. Generally, "the average CLO held $500 million to $600 million in principal amount of loans spread over an average of 140 borrowers." Tung, *supra* note 38, at 176 n.130. These loan bundles serve as collateral for debt securities issued by the company to institutional investors and even depository institutions. *See* Segal, *supra*.

75. *See* Laurie DeMarco et al., *Who Owns U.S. CLO Securities? An Update by Tranche*, FED. RSRV. BD. (2020), https://www.federalreserve.gov/econres/notes/feds-notes/who-owns-us-clo-securities-an-update-by-tranche-20200625.html [https://perma.cc/WZ3Y-D2YP].

76. *See* Segal, *supra* note 74.

77. *See* Mehdi Beyhaghi et al., *Institutional Investors and Loan Dynamics: Evidence from Loan Renegotiations*, 56 J. CORP. FIN. 482, 483 (2019) (showing that nonbanks are more likely to exit a syndicate than participate in renegotiation).

78. *See* Tung, *supra* note 38, at 182–85.

controversial market evolution that relaxed governance triggers for high-risk borrowers in a trend coined "covenant lite."[79] Even when borrowers trigger an event of default, researchers have observed that arm's length lenders are less likely than relational lenders to intervene or otherwise exercise influence to improve a borrower's financial position.[80]

However, this does not mean that borrowers with term loans escape lender governance altogether. To the contrary, recent scholarship aims to stem any such fears with a bird's-eye view of a given borrower's capital structure that reveals robust monitoring, and control rights are ever present for these borrowers.[81] Seemingly lenient loan covenants have instead been found to be more efficient.[82] And in a development called "split-control rights," governance tools are concentrated in one of many loan facilities maintained by the same borrower—typically a revolver loan issued by relational lenders.[83]

C. *Influence, Benefits, Costs*

The prevalence of lender governance benefits not only lenders but also borrowers and their investors. The finance literature has long documented the many ways in which lender governance fills the gaps of corporate governance and improves financial performance along the way. Following covenant violations, some lender interventions have influenced firm-level decisionmaking thought to be squarely within the purview of

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79. *See* McClane, *supra* note 73, at 221–22; Abby Latour, *Covenant-lit Deals Exceed 90% of Leveraged Loan Issuance, Setting New High*, S&P GLOB. MKT. INTEL. (Oct. 8, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/covenant-lite-deals-exceed-90-of-leveraged-loan-issuance-setting-new-high-66935148 [https://perma.cc/Z7HB-CPT5] (stating that, as of October 4, 2021, over 90% of U.S.-based leveraged loans issued in 2021 were "covenant-lite").

80. *See* McClane, *supra* note 73, at 259–64 (finding that higher rates of CEO turnover and fiscal conservatism correlates with loans held by relational lenders versus loans held by CLOs).

81. *See* Mitchell Berlin et al., *Concentration of Control Rights in Leveraged Loan Syndicates*, 37 J. FIN. ECON. 249, 250 (2020) (finding that, although the leveraged loan market has evolved in recent years, the vast majority of loan agreements include covenants resulting in traditional bank monitoring); *see also* Tung, *supra* note 38. *But see* Leo E Strine, Jr., *Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1924 (2017) ("With the advent of terms like 'covenant lite' to describe diminution in credit protection, reason exists to suspect that the risk-taking voice of equity has been amplified in part because the voice of creditors has reduced its volume.").

82. Berlin et al., *supra* note 81; Tung, *supra* note 38, at 158–59.

83. Berlin et al., *supra* note 81; Tung, *supra* note 38, at 158.

management and shareholders, including corporate investments,[84] day-to-day business operations,[85] acquisitions,[86] CEO compensation and termination,[87] and board appointments.[88] Such interventions often have documented positive effects on the borrower's operating performance and stock price performance.[89] Indeed, when compared to mere penalty fees for waivers, lender interventions were found to have a greater positive impact on borrower financial performance.[90]

Even absent covenant violations, lender governance tools are unique and consequential. Periodic updates of both public and nonpublic information afford lenders monitoring advantages that can be superior to that of investors[91] and even firm-level directors.[92] The longer the lending relationship, the more idiosyncratic and valuable the lender's informational advantages become.[93] Additionally, where agency costs

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84. *See, e.g.*, Nuri Ersahin et al., *Creditor Control Rights and Resource Allocation within Firms*, 139 J. FIN. ECON. 186, 186 (2019) (finding that covenant violations lead to reductions in employment and investment as well as increases in establishment closures in nonproductive and noncore business lines); Sudheer Chava & Michael R. Roberts, *How Does Financing Impact Investment? The Role of Debt Covenants*, 63 J. FIN. 2085, 2087 (2007).

85. *See* Ersahin et al., *supra* note 84.

86. *See generally* David Becher et al., *Creditor Control of Corporate Acquisitions*, 35 REV. FIN. STUD. 1897 (2022).

87. *See generally* Steven Balsam et al., *Creditor Influence and CEO Compensation: Evidence from Debt Covenant Violations*, 93 ACCT. REV. 23 (2018); Mark Maremont & Rick Brooks, *Once-Hot Krispy Kreme Ousts Its CEO Amid Accounting Woes*, WALL ST. J. (Jan. 19, 2005), https://www.wsj.com/articles/SB110605594997928805 [https://perma.cc/GBY7-QE7C] (reporting on the firing of beloved donut-maker Krispy Kreme's CEO following pressure from lenders).

88. *See* Daniel Ferreira et al., *Creditor Control Rights and Board Independence*, 73 J. FINANCE 2385, 2386 (2018) (finding that board expansion of up to 24% often follows covenant violations).

89. *See*, *e.g.*, Greg Nini et al., *Creditor Control Rights, Corporate Governance, and Firm Value*, 25 REV. FIN. STUD. 1713, 1717 (2012) (finding that stock prices often increase following a violation and subsequent intervention); Ferreira et al., *supra* note 88, at 2387 (finding that firms decrease operational risk and executive compensation following a violation).

90. Bo Jiang & Douglas Xu, *Covenant Amendment Fee and Value of Creditor Intervention after Covenant Violations* 5–6 (Nov. 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3290802 [https://perma.cc/286C-Y7J3].

91. Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 125 (2009).

92. *Id.* at 129.

93. *See* Carola Schenone, *Lending Relationships and Information Rents: Do*

between firm managers and shareholders are particularly high, lender governance operates as an effective disciplining substitute.[94] Thus, despite existing shortcomings of corporate governance, lenders have frequently used their toolkit to influence firm level decisions that generate positive wealth effects and financial performance. Moreover, investors appreciate the lender's unique governance capabilities as distinct from their own. When borrowers announce bank loans, they often enjoy documented increases to their stock prices[95] and reductions to their public debt costs.[96]

However, potent lender governance tools are not without costs. Lender monitoring and intervention deplete lender resources and constrain the operational flexibility of borrowers to make potentially value-adding investments.[97] Particularly, restrictive covenants heighten the risk of renegotiations, imposing *ex post* costs that increase with the number of lenders, the presence of arm's length lenders, and the degree of unpredictability of the future.[98] Lenders also risk exposure to fiduciary obligation if they influence borrower activities too

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Banks Exploit Their Information Advantages?, 23 REV. FIN. STUD. 1149, 1149–50 (2010).

94. *See* Steven S. Byers et al., *Are Corporate Governance and Bank Monitoring Substitutes: Evidence from the Perceived Value of Bank Loans*, 14 J. CORP. FIN. 475, 476 (2008) (suggesting that placing the burden of monitoring on banks is efficient); Ioannis Spyridopoulos, *Tough Love*: *The Effects of Debt Contract Design on Firms' Performance*, 9 REV. CORP. FIN. STUD. 44, 44–47 (2020) (finding that the implementation of strict covenants correlates with increased firm efficiency in firms with significant agency conflicts, regardless of whether violations of those covenants occur); Sungyoon Ahn & Wooseok Choi, *The Role of Bank Monitoring in Corporate Governance: Evidence from Borrowers' Earnings Management Behavior*, 33 J. BANKING & FIN. 425, 426 (2009) (discussing findings that indicate the advantages of banks monitoring borrowers, including the low costs).

95. *See* Christopher James, *Some Evidence on the Uniqueness of Bank Loans*, 19 J. FIN. ECON. 217, 219 (1987) (showing a positive and statistically significant stock price response for the public announcement of bank loans, a nonpositive response for publicly placed straight debt issues, a negative and statistically significant response for debt privately placed with insurance companies, and private placements and straight debt issues used to repay bank loans).

96. Sudip Datta et al., *Bank Monitoring and the Pricing of Corporate Public Debt*, 51 J. FIN. ECON. 435, 437 (1999). *See generally* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209 (2006) (observing that banks lending to a corporation possess a much higher level of control over its board and management decisions than public bondholders, allowing them to make creditor-friendly decisions).

97. Thomas P. Griffin et al., *Losing Control? The Two-Decade Decline in Loan Covenant Violations* 2 (Sept. 2023) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3277570 [https://perma.cc/4JF9-C99B].

98. *Id.* at 2, 12 n.10; Bradley & Roberts, *supra* note 62, at 3.

explicitly.[99] Consequently, both borrowers and lenders are incentivized to draft loan terms that are efficient—i.e., that are flexible to unpredictable but reasonable shocks[100] and that trigger lender intervention only when persistent or extreme financial failures heighten lender risk of loss.[101] In doing so, lender governance operates to more effectively influence positive financial outcomes.

II. The ESG Conundrum

In recent years, there have been market-based efforts to repurpose the lender's toolkit to similarly influence positive sustainable outcomes. Yet, these efforts are just the latest trend in the ESG movement—a long line of market attempts to alter corporate decisionmaking to prioritize environmental and social impact. The ESG movement has traditionally focused on corporate governance tools—the influence of firm managers and investors—to incentivize sustainable performance, but this focus has had questionable success and has faced robust criticism in the legal literature. This Part describes the ESG movement, its recent foray into the loan market, and its persistent shortcomings.

A. *The ESG Movement: Market-Based Pressures*

The ESG movement attempts to harmonize once-competing, centuries-old schools of thought regarding the purpose of the firm: maximizing value for shareholders versus balancing

99. *See, e.g.*, Brian Tomlinson, *ESG and Fiduciary Duties: A Roadmap for the US Capital Market*, HAR. L. SCH. F. ON CORP. GOVERNANCE (Nov. 1, 2016), https://corpgov.law.harvard.edu/2016/11/01/esg-and-fiduciary-duties-a-roadmap-for-the-us-capital-market/ [https://perma.cc/6TRE-ZHNY] (describing investors' potential duty to evaluate ESG factors in a matter similar to the rest of their fiduciary duties).

100. *See* Anne Beatty et al., *The Role and Characteristics of Accounting-Based Performance Pricing in Private Debt Contracts* 3–4 (June 2002) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=318399 [https://perma.cc/49LE-8QXG]; Houman B. Shadab, *Performance-Sensitive Debt: From Asset-Based Loans to Startup Financing*, 16 U. PA. J. BUS. L. 1077, 1080–81 (2014).

101. Adam B. Badawi et al., *Contractual Complexity in Debt Agreements: The Case of EBITDA*, DUKE L. SCH. P. L. & LEGAL THEORY SERIES NO. 2019-67, at 27 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455497 [https://perma.cc/G7ED-BTQT] (analyzing the market effect of more permissive EBITDA definitions); Thomas P. Griffin et al., *Losing Control? The Two-Decade Decline in Loan Covenant Violations* 36 (Sept. 2023) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3277570 [https://perma.cc/4JF9-C99B] (finding that more permissive financial covenants allow for more efficient lender reaction and intervention).

broader social welfare goals.[102] The ESG movement draws inspiration from market metrics of financial performance to create metrics of sustainable performance that assess a company's prosocial activity that more directly concerns the noninvestor stakeholders, such as customers, local communities, and the environment.[103] These metrics are intended to be used like financial data for investment and research purposes.[104] The factors considered for an ESG metric are not universally established; rather, the contours of any ESG analysis may differ across business sectors and geographic regions.[105] However, there are reasonable generalizations to make regarding the type of factors that may fall under any ESG-related assessment.

Environmental factors concern business practices that impact the natural environment or pose climate change risk.[106] Such factors include energy efficiency, GHG emissions, and water consumption.[107] With the climate crisis as a scientifically

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102. *See* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2612–15 (2021) (discussing the origins of the ESG movement in corporate social responsibility and original debates on corporate purpose); *see also* A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (stating that all powers granted to a corporation are "exercisable only for the ratable benefit of all the shareholders"); E. Merrick Dodd, Jr., *For Whom Are Corporate Mangers Trustees?*, 45 HARV. L. REV. 1145, 1153 (1932) (explaining that the sole function of managers "is to work for the best interests of the stockholders as their employers or beneficiaries"); MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (U. Chi. Press) (40th Anniversary ed. 2002) (1962) (calling social responsibility outside of stockholder interest a "fundamental misconception" of a free economy).

103. UNITED NATIONS GLOB. COMPACT, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD, at v (2017), https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf [https://perma.cc/4UB2-B84H] (outlining several financial institutions' collaborative recommendations to add ESG responsibilities to financial institutions, which leads to better investment markets and more sustainable societies).

104. *See generally* UNITED NATIONS GLOB. COMPACT, INVESTING FOR LONG-TERM VALUE: INTEGRATING ENVIRONMENTAL, SOCIAL AND GOVERNANCE VALUE DRIVERS IN ASSET MANAGEMENT AND FINANCIAL RESEARCH (2005), https://missioninvestors.org/resources/investing-long-term-value-who-cares-wins-2005-conference-report [https://perma.cc/R634-MFPY] (highlighting the importance of obtaining ESG data).

105. *See* Elizabeth Pollman, *The Making and Meaning of ESG* 29 (Eur. Corp. Governance Inst., Working Paper No. 659, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857 [https://perma.cc/XBC4-TYT5].

106. *See* Lisa M. Fairfax, *Dynamic Disclosures: An Exposé on the Mythical Divide Between Voluntary and Mandatory ESG Disclosure*, 101 TEX. L. REV. 273, 281 (2022).

107. *Id.*

established "existential threat" to society,[108] environmental factors have long held the spotlight for ESG proponents and transnational firms with great exposure to climate risks.[109] However, the once-silent "S," social factors, was nudged center stage in the midst of the COVID-19 pandemic and simultaneous social unrest.[110] Social factors concern business practices that impact people and communities, including human capital management, human rights, workplace diversity, and product safety.[111] Throughout the pandemic, firms faced significant criticism for workplace health risks,[112] sparse employee benefits,[113] and racial inequities.[114] Each public fallout focused attention on the reputational and economic importance of

108. Christine Sgarlata Chung, *Rising Tides and Rearranging Deckchairs: How Climate Change is Reshaping Infrastructure Finance and Threatening to Sink Municipal Budgets*, 32 GEO. ENV'T L. REV. 165, 212 (2020).

109. *See* Stephen Kim Park, *Investors as Regulators: Green Bonds and the Governance Challenges*, 54 STAN. J. INT'L L. 1, 8–9 (2018) (providing an explanation of "universal owner" theory).

110. *See* Swati Pandey et al., *Pandemic Stirs Wall Street's Social Conscience*, REUTERS (May 15, 2020, 7:50 AM), https://www.reuters.com/article/us-health-coronavirus-esg-analysis-idUSKBN22R0LF [https://perma.cc/93NP-CBJS] ("Someone the other day said 'has environment taken a back seat?['] And my reply was 'no, it's more the "S" has climbed into the front seat.'"); Neesha-ann Longdon et al., *Why Corporations' Responses to George Floyd Protests Matter*, S&P GLOB. (July 23, 2020, 10:24 AM), https://www.spglobal.com/ratings/en/research/articles/200723-environmental-social-and-governance-why-corporations-responses-to-george-floyd-protests-matter-11568216 [https://perma.cc/4FPN-DS5U] ("This year, social issues have taken the spotlight, starting with the COVID-19 pandemic and moving to social injustice.").

111. *See* Fairfax, *supra* note 106.

112. *See, e.g.*, *Amazon Faces Backlash Over Covid-19 Safety Measures*, BBC NEWS (June 17, 2020), https://www.bbc.com/news/technology-53079624 [https://perma.cc/DQN2-MQ6Q] (reporting a lawsuit brought against Amazon by union workers who demanded improved leave policies and contact tracing); Sapna Maheshwari, *REI Faces Staff Backlash Over Response to Covid-19 Cases*, N.Y. TIMES (July 19, 2020), https://www.nytimes.com/2020/07/19/business/coronavirus-rei-staff.html, [https://perma.cc/LG8N-TB4V] (reporting employee criticisms over an employer's handling of positive COVID-19 cases).

113. *See, e.g.*, Kim Parker & Juliana Menasce Horowitz, *Majority of Workers Who Quit a Job in 2021 Cite Low Pay, No Opportunities for Advancement, Feeling Disrespected*, PEW RSCH. CTR. (Mar. 9, 2022), https://www.pewresearch.org/fact-tank/2022/03/09/majority-of-workers-who-quit-a-job-in-2021-cite-low-pay-no-opportunities-for-advancement-feeling-disrespected/ [https://perma.cc/4U36-7CCP].

114. *See, e.g.*, Valerie Rawlston Wilson, Ph.D., Inequities Exposed: How COVID-19 Widened Racial Inequities in Education, Health, and the Workforce, Testimony before the U.S. House of Representatives Committee on Education and Labor (June 22, 2020) (discussing disparities along racial lines in access to healthcare, paid sick leave, and work-from-home benefits, which contribute to a heightened risk of COVID-19 for black employees).

mitigating risks related to social factors.[115] Finally, governance factors cover firm management practices that impact environmental and social factors, including board structure and accountability, shareholder disclosure, and corruption.[116] For example, firms have faced backlash for lacking managerial diversity[117] and experienced financial losses for mismanaging environmental risks.[118] In short, ESG factors frame prosocial (or antisocial) business activity as integral to assessing firm value, much like traditional financial metrics.[119]

Though the empirical foundations for linking isolated ESG metrics to financial performance are shaky,[120] the link has

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115. *See, e.g.*, Pandey et al., *supra* note 110 (describing an investor letter sent to portfolio companies, urging them to "prioriti[z]e workers' welfare amid the pandemic, both for humanitarian concerns and also 'the systemic risk it pose[d] to [their] portfolios'").

116. *See* Fairfax, *supra* note 106.

117. *See, e.g.*, Michal Barzuza et al., *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1248 (2020) ("[A]fter State Street announced its objection to all-male boards in its portfolio firms, the index fund voted against 400 of the 476 firms in its portfolio that did not have any female directors.").

118. *See, e.g.*, Margaret Cronin Fisk et al., *Volkswagen Confirms $4.3bn Payment Over Diesel Emissions*, GUARDIAN (Jan. 10, 2017, 6:08 PM), https://www.theguardian.com/business/2017/jan/10/volkswagen-confirms-43-billion-us-payment-over-diesel-emissions [https://perma.cc/PX92-2GXP] (noting that Volkswagen Group's stock price suffered as it paid billions in criminal and civil penalties for programming vehicles to cheat on emissions tests).

119. *See* Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647, 693 (2016); *see also* Alexander T. Kraik, *Environmental, Social and Governance Issues: An Altered Shareholder Activist Paradigm*, 44 VT. L. REV. 493, 535 (2020).

120. *Compare* Tensie Whelan et al., *ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published Between 2015-2020* 1, 5 (2021) (reviewing over 1,000 studies showing a "positive relationship between ESG and financial performance," including higher firm values), Mark Fulton et al., *Sustainable Investing: Establishing Long-Term Value and Performance* 1, 29 (2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2222740 [https://perma.cc/VD29-WR7F] (finding a positive relationship between ESG performance and superior financial outcomes, including higher risk-adjusted returns, and lower downside risks in times of crisis), Beiting Cheng et al., *Corporate Social Responsibility and Access to Finance*, 35 STRATEGIC MGMT. J. 1, 4 (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1847085 [https://perma.cc/2WSE-TDCA] ("The results confirm that firms with superior [corporate social responsibility] performance face lower capital constraints."), Guido Giese et al., *Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk and Performance*, J. PORTFOLIO MGMT. 1, 1–2 (2019), https://www.msci.com/documents/10199/03d6faef-2394-44e9-a119-4ca130909226 [https://perma.cc/A3W8-5GVQ], *and* Karl V. Lins et al., *Social Capital, Trust, and Firm Performance: The Value of*

seemingly made the ESG movement, from a market perspective, more palatable than some earlier movements for corporate social responsibility.[121] And shifting public sentiments permeating workforces,[122] customer bases,[123] and investor groups[124] bolster concerns of real financial hits for poor ESG outcomes.[125] These risks are particularly acute in the modern era with the ease of information sharing and information organizing online.[126]

Corporate Social Responsibility During the Financial Crisis, 72 J. FIN. 1785, 1797 (2017), *with* Whelan et al., *supra*, at 5 (describing a recent meta-study reviewing more than 1,000 studies that found mixed evidence of ESG performance being significantly determinative of financial performance, including studies that found ESG performance to be immaterial as a standalone metric or comparable or inferior to financial metrics).

121. *See, e.g.*, Dorothy S. Lund, *Corporate Finance for Social Good*, 121 COLUM. L. REV. 1617, 1620 (2021).

122. Timothy J. McClimon, *The Impact of Environmental, Social and Governance (ESG) Issues on Companies Today*, FORBES (June 29, 2020), https://www.forbes.com/sites/timothyjmcclimon/2020/06/29/the-impact-of-environmental-social-and-governance-esg-issues-on-companies-today/#189ff2f25d2a [https://perma.cc/JB2X-2K75].

123. *See* Sarah Landrum, *Millennials Driving Brands To Practice Socially Responsible Marketing*, FORBES (Mar. 17, 2017, 12:17 PM), https://www.forbes.com/sites/sarahlandrum/2017/03/17/millennials-driving-brands-to-practice-socially-responsible-marketing [https://perma.cc/FS8J-CDAE] (explaining that millennials are more likely to do business with corporations that have "pro-social messages, sustainable manufacturing methods and ethical business standards"); *see also* Dante Disparte & Tim Gentry, *Corporate Activism is on the* Rise, INT'L POL'Y DIG. (July 6, 2015), https://intpolicydigest.org/corporate-activism-is-on-the-rise/ [https://perma.cc/7D4U-JG2K] (reporting that ninety million Americans identify as "conscious consumers," and 72% of consumers will actively seek brands that align with their values); Robert Safian, *Facebook, Airbnb, Uber, and the Struggle to Do the Right Thing*, FAST CO. (Apr. 11, 2017), https://www.fastcompany.com/40397294/facebook-airbnb-uber-and-the-struggle-to-do-the-right-thing [https://perma.cc/VX29-4NZW] ("[C]ompanies are increasingly seeking to align their commercial activities with larger social and cultural values—not just because it makes them look good, but because employees and customers have started to insist on it.").

124. *See* Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1404 (2020); Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey* 2–4 (July 2017) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925310 [https://perma.cc/BLZ4-NZPC].

125. *See* Tom C.W. Lin, *Incorporating Social Activism*, 98 B.U. L. REV. 1535, 1561–62 (2018) ("One can effectuate change on important social issues like green energy, religious freedom, or gender equality by changing laws and public policies, *and* by changing the institutional practices and priorities at major corporations. . . . Given the gridlock in the federal government, change via corporate social activism can prove to be much more appealing and effective.").

126. *See* Fairfax, *supra* note 106, at 329–30; Hillary A. Sale, *The New "Public"*

In the corporate loan market, there have been protests at bank branches and employee complaints lodged against financial institutions that lend to the fossil fuel, gun manufacturing, and private prison sectors.[127] Investors have disrupted annual meetings and divested from banks for failing to prioritize ESG metrics to curtail lending practices.[128] Stakeholders have even pressured the U.S. Federal Reserve Bank to curtail its quantitative-easing practices for fossil fuel debt in order to discourage lending to the industry.[129] Investment capital is increasingly conditioned on ESG considerations for its allocation.[130] There is also growing (albeit mixed) evidence of a positive correlation between ESG performance and loan performance.[131]

B. *Lenders' Market-Based Solutions*

In response, corporate lenders have taken two distinct approaches to address poor ESG outcomes among existing and would-be borrowers: divestment and engagement. But practical

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Corporation, 74 L. & CONTEMP. PROBS. 137, 137–38 (2011) (discussing corporate pressures to address public sentiments); Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1013 (2013); Daniel C. Esty & Quentin Karpilow, *Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation*, 36 YALE J. REGUL, 625, 633–34; Robert G. Eccles et al., *Reputation and Its Risks*, 85 HARV. BUS. REV. 104, 110, 113 (2007).

127. *See, e.g.*, Laura J. Keller, *BofA Says 151 Employees Were Affected by Mass Shootings in U.S.*, BLOOMBERG (Apr. 25, 2018, 1:05 PM), https://www.bloomberg.com/news/articles/2018-04-25/bofa-says-151-employees-were-affected-by-mass-shootings-in-u-s [https://perma.cc/JJ76-BJ34].

128. *See, e.g.*, Laura Alix, *What's Pushing U.S. Banks Deeper into ESG*, AM. BANKER (Jan. 13, 2020, 9:30 PM), https://www.americanbanker.com/news/whats-pushing-us-banks-deeper-into-esg [https://perma.cc/35AG-BFLK]; Ensign, *supra* note 17.

129. Collin Rees, *Sixty-Nine Organizations Tell the Federal Reserve to Stop Buying Fossil Fuel Debt*, OILCHANGE INT'L (July 30, 2020), http://priceofoil.org/2020/07/30/fed-letter-fossil-fuel-debt/ [https://perma.cc/QD5G-MDUB].

130. Eric Rosenbaum, *Bank of America CEO Says Clients Want to Invest in Companies 'Doing Right by Society,'* CNBC (Jan. 21, 2020, 7:57 AM), https://www.cnbc.com/2020/01/21/bank-of-america-ceo-all-clients-are-becoming-esg-investors.html [https://perma.cc/WA8K-WWPG] ("We have $25 billion in ESG Funds, and more is going there . . . . All investors are saying, 'I want you to invest in companies doing right by society.'").

131. Allen Goss & Gordon S. Roberts, *The Impact of Corporate Social Responsibility on the Cost of Bank Loans*, 35 J. BANKING & FIN. 1794, 1807 (2010) (finding a significant positive correlation between corporate social responsibility risks and loan risks); Florian Barth et al., *ESG and Corporate Credit Spreads* 3 (May 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3179468 [https://perma.cc/4LZT-FVAS] (finding that higher ESG performance mitigates credit risks).

challenges with divestment have led to a rise in popularity of engagement.

1. Divestment vs. Engagement

Corporate lenders increasingly consider ESG data when making credit decisions[132] and commit to negative screens or divest from industries with high ESG risk.[133] To facilitate lender diligence on ESG matters, loan-market trade associations have introduced novel ESG disclosure tools.[134] An increasing number of lenders have agreed to disclose the ESG impact of their loan portfolios.[135] And several U.S. and international financial firms have made a $130 trillion commitment to reach net-zero emissions in investment and lending portfolios by 2050.[136] Yet, efforts to remove borrowers with high ESG risks from loan portfolios are challenging. For starters, there are high opportunity costs. JPMorgan's oil and gas lending business is alone worth over $40 billion.[137] Moreover, it is difficult to unwind long-standing relationships

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132. Kristin Broughton, *Banks Taking a Closer Look at ESG Risks in Credit Underwriting*, WALL ST. J. (Jan. 7, 2020, 6:03 PM), https://www.wsj.com/articles/banks-taking-a-closer-look-at-esg-risks-in-credit-underwriting-11578438224 [https://perma.cc/BE46-2XNT] ("Sixty-seven percent of banks screen their loan portfolios for environmental, social and governance risks.").

133. *See, e.g.*, Ensign, *supra* note 17 (Bank of America promising to end lending to a private prison); David Benoit, *JPMorgan Pledges to Push Clients to Align with Paris Climate Agreement*, WALL ST. J. (Oct. 6, 2020, 5:04 PM), https://www.wsj.com/articles/jpmorgan-pledges-to-push-clients-to-align-with-paris-climate-agreement-11602018245 [https://perma.cc/2RDL-DQGV] (JPMorgan promising to end lending to the coal industry).

134. Press Release, LSTA, The LSTA Issues First ESG Disclosure Tool for Corporate Loan Market Participants (Feb. 3, 2020), https://www.lsta.org/content/the-lsta-issues-first-esg-disclosure-tool-for-corporate-loan-market-participants-press-release/ [https://perma.cc/32T8-RV6B].

135. *See, e.g.*, Laura Alix, *Citi, BofA to Disclose How Loans Contribute to Climate Change*, AM. BANKER (July 29, 2020, 4:00 PM), https://www.americanbanker.com/news/citi-bofa-to-disclose-how-loans-contribute-to-climate-change [https://perma.cc/RE2Q-2ZAJ].

136. Julie Bos & Yili Wu, *How Banks Can Accelerate Net-Zero Emissions Commitments*, GREENBIZ (Oct. 27, 2021), https://www.greenbiz.com/article/how-banks-can-accelerate-net-zero-emissions-commitments [https://perma.cc/YU8T-3TRP]; Jill Baker, *Mark Carney's Ambitious $130 Trillion Glasgow Finance Alliance for Net-Zero*, FORBES (Nov. 8, 2021, 10:50 PM), https://www.forbes.com/sites/jillbaker/2021/11/08/mark-carneys-ambitious-130-trillion-glasgow-financial-alliance-for-net-zero/?sh=70112dd43a31 [https://perma.cc/MLX6-52ZC].

137. Benoit, *supra* note 133.

and contracts.[138] And these costs would likely be incurred to no avail, because corporate borrowers tend to have many credit options.[139]

Corporate lenders and their borrowers—equally eager to demonstrate a commitment to ESG—have proffered an alternative to negative screens and divestment: financial engagement. Financial engagement reframes the lender–borrower relationship as a means to incentivize and preserve not only financial performance but also ESG performance.[140] The concept borrows from investor engagement on the equity side of the capital structure and attempts to harness lender governance to drive ESG outcomes. Lenders negotiate loan terms to direct capital to sustainable projects and nudge prosocial decisionmaking across their borrowers through green loans,[141] social loans,[142] and, the most popular development, sustainability-linked loans.

2. Sustainability-Linked Loans

With sustainability-linked loans, corporate lenders claim to use their influence to nudge borrowers to achieve ambitious ESG performance goals.[143] According to the Sustainability-Linked Loan Principles (SLL Principles), sustainability-linked loans are any type of loan instrument or contingent facility that incentivizes borrowers to achieve ambitious,

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138. *See, e.g.*, Ensign, *supra* note 17 (reporting that Bank of America's divestment announcement regarding the private prison industry came weeks after it refinanced a $90-million loan commitment through 2024 to an industry juggernaut).

139. *See, e.g.*, Polly Mosendz & Hannah Levitt, *Wells Fargo, the NRA's Bank, Doubles Down on Gun Industry*, BLOOMBERG (Oct. 5, 2018, 2:25 PM), https://www.latimes.com/business/la-fi-wells-fargo-sturm-ruger-20181005-story.html [https://perma.cc/88YV-XMHQ] (reporting that Wells Fargo swiftly replaced Bank of America as lender for Sturm Ruger & Co).

140. *See* CJ Clouse, *ESG Loans Broaden Access to Sustainability-Linked Financing*, GREENBIZ (Mar. 6, 2019), https://www.greenbiz.com/article/esg-loans-broaden-access-sustainability-linked-financing [https://perma.cc/6XPR-2C8M].

141. "Green loans" include environment-focused terms, often in accordance with frameworks laid out by groups such as the Loan Syndications & Trading Association. *See, e.g.*, *Green Loan Principles*, LOAN SYNDICATIONS & TRADING ASS'N Feb. 2023, at 1, https://www.lsta.org/content/green-loan-principles/ [https://perma.cc/5ECN-EFSX].

142. *See, e.g.*, *Understanding Social Loans*, THOMSON REUTERS: PRAC. L., https://anzlaw.thomsonreuters.com/w-032-1575?transitionType=Default&contextData=(scDefault)&firstPage=true [http://perma.cc/LUX3-2YRD].

143. *See* Clouse, *supra* note 140.

predetermined sustainability-performance objectives.[144] The incentive structure can take many forms so long as it aligns the borrower's economic or governance terms with one or more predetermined sustainability-related performance targets.[145] However, sustainability-linked loans often align economic terms with performance terms. By meeting (or missing) performance targets, borrowers can reduce (or increase) loan costs, including interest rates and commitment fees.

The performance targets, or ESG benchmarks, are typically negotiated by the borrower and a "sustainability agent."[146] The sustainability agent is a new agent type that emerged with the rise of sustainability-linked loans. These agents are often the same, or an affiliate of, the financial institutions that act as the "administrative agents," which are ongoing monitors and administrators of the loan. Sustainability agents also tend to have stakes in the loan as lenders. The sustainability agent's narrow duties include reviewing the borrower's operations in coordination with the borrower to select ESG goals to benchmark for the loan.[147] The sustainability agent may also have an ongoing duty to select new ESG benchmarks if the underlying metric is no longer available.[148]

ESG benchmarks may be based on an ESG score from a third-party rating agency or relate to a specific ESG factor such as, for example, GHG emissions.[149] This structure is a notable departure from prior sustainable loan structures that tied "use of proceeds" provisions—which specify how loan funds may be used—to sustainable projects.[150] Such limited uses of proceeds, which could qualify the loan as a "green loan" or "social loan," are not determinative of whether a loan is "sustainability-linked."[151] In most cases, the proceeds of sustainability-linked loans are more flexibly used to fund the borrower's general corporate activities.[152]

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144. *Sustainability-Linked Loan Principles: Supporting Environmentally and Socially Sustainable Economic Activity*, LOAN SYNDICATIONS & TRADING ASS'N, Feb. 2023, at 2, https://www.lsta.org/content/sustainability-linked-loan-principles-sllp/ [https://perma.cc/D8B2-PBXB] [hereinafter SLL Principles].

145. *Id.*

146. *See* Clouse, *supra* note 140.

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

Advocates believe sustainability-linked loans represent a sea change in corporate finance.[153] Lenders can repurpose their governance toolkit to influence ESG outcomes, demonstrating their ESG commitments and preserving lucrative lending relationships.[154] Borrowers can potentially reduce their credit costs and demonstrate their ESG commitments to their stakeholders.[155] Indeed, sustainability-linked loans are said to have "clear reputational impact" that likely outweighs even their cost benefits[156]—a potential win-win(-win) for lenders, borrowers, and stakeholders, which has been the ultimate goal of the ESG movement. And because loan proceeds may be used for general corporate activities, sustainability-linked loans have broad applicability across a wide range of firms[157]—namely, the more than 40,000 firms in over 200 countries that use syndicated loans.[158]

Unsurprisingly, sustainability-linked loans are the hottest innovations in the syndicated loan market and broader sustainable finance segment. When compared to the sixteen-year-old green bond market, which hit a record issuance of over $480 billion in 2021,[159] the impressive momentum of the sustainability-linked loan market is apparent. Sustainability-linked loan volumes grew more than sixty-fold from the market's inception in 2017 with $10 billion in loan issuances to over $700 billion in issuances in 2021.[160]

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153. *See* Natcha Tulyasuwan & Radtasiri Wachirapunyanont, *ESG-Linked Loans: A Game Changer for the Future of Corporate Sustainability?*, RESPONSIBLE BUS. (Oct. 29, 2018), https://www.responsiblebusiness.com/news/asia-pacific-news/esg-linked-loans-game-changer-future-corporate-sustainability/ [https://perma.cc/XLN4-R6AX].

154. *Id.* ("For lenders, ESG-linked loans help them as sustainable finance leaders, which enhances their value proposition to their customer base, sharpens their competitive differentiation, and reduces loan default rates.").

155. *Id.*

156. *Id.*

157. *See* Bhakti Mirchandani, *Scaling Corporate Sustainability: Innovations in Sustainability-Linked Loans at Brookfield Renewable Partners, International Seaways, WSP Global, and Neuberger Berman*, FORBES (Feb. 17, 2020, 10:45 PM), https://www.forbes.com/sites/bhaktimirchandani/2020/02/17/how-us-and-canadian-companies-are-scaling-corporate-sustainability-recent-innovations-in-sustainability-linked- loans/#fa4866416a6a [https://perma.cc/9CBP-FAFU].

158. BLOOMBERG, GLOBAL SYNDICATED LOANS: LEAGUE TABLES (2020), https://enterprise.press/wp-content/uploads/2020/04/Bloomberg-Global-Syndicated-Loans-League-Tables-Q1-2020.pdf [https://perma.cc/PE62-Z23E].

159. Patturaja Murugaboopathy, *Global Issuance of Sustainable Bonds Hits Record in 2021*, REUTERS (Dec. 23, 2021, 7:55 AM), https://www.reuters.com/markets/commodities/global-markets-esg-2021-12-23/ [https://perma.cc/A944-ZWGD].

160. *See* SUSTAINABLE FINANCE REVIEW, *supra* note 27, at 4.

C. *Market-Based Shortcomings*

However, the sustainability-linked loan market's exuberance precedes any real evidence of its effectiveness. And the ESG movement's track record with similar market-based efforts have had questionable success at best.[161] A rich and dynamic literature explores the shortcomings of such market-based efforts but does so primarily through the lenses of corporate governance and investor protection. Common pitfalls identified in these contexts are information asymmetries, agency costs, and negative externalities.

1. Prior Efforts

Several market-based ESG efforts have been prevalent at the firm level and in investor markets. First, firms have taken a liking to public pledges. Firm executives have pledged to shift decisionmaking priorities away from shareholder value and toward broader stakeholder interests. Countless firms have made public pledges to reduce or eliminate carbon emissions, to make monetary donations to resolve racial wealth gaps, or to support social movements, including Black Lives Matter and the LGBTQ+ rights movement.[162]

Second, many firms have voluntarily disclosed ESG performance information. Indeed, more than 75% of the S&P 500 firms issue separate sustainability reports, and more than 90% provide ESG-related disclosures in their SEC filings.[163] And several standard-setters cropped up to help streamline the information sharing.[164] Third, a dynamic market of data aggregators has emerged to distill ESG performance data into

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161. *See, e.g.*, Soohun Kim & Aaron Yoon, *Analyzing Active Fund Managers' Commitment to ESG: Evidence from the United Nations Principles for Responsible Investment*, 69 MGMT. SCI. 741 (2022), https://doi.org/10.1287/mnsc.2022.4394 [https://perma.cc/7S4J-MZJR].

162. Tracy Jan et al., *Corporate America's $50 Billion Promise*, WASH. POST (Aug. 24, 2021, 7:03 PM), https://www.washingtonpost.com/business/interactive/2021/george-floyd-corporate-america-racial-justice/ [https://perma.cc/58AS-SJH3].

163. Dan Harris, *99% of the S&P 500 is Reporting on ESG and 65% are Obtaining ESG Assurance*, BDO USA (July 21, 2023), https://www.bdo.com/insights/sustainability-and-esg/99-of-the-s-p-500-is-reporting-on-esg-and-65-are-obtaining-esg-assurance [https://perma.cc/ZW25-E3E7].

164. Global standard setters such as the Global Reporting Initiative and Sustainability Accounting Standards Board have developed several ESG reporting guidelines to help standardize firm disclosures in such reports and filings. *See, e.g.*, *Exploring Materiality*, SASB STANDARDS, https://materiality.sasb.org [https://perma.cc/3XD3-BHHF] ("Materiality Finder makes it easy to both look up companies or industries and compare industries side-by-side.").

corporate reports, rankings, ratings, and/or indices based on varying methodologies.[165] Finally, innovative investment products based on ESG data, including ESG-focused equity and fixed-income funds, have flourished to the tune of $2 trillion in assets under management globally.[166]

2. Common Criticisms

Notwithstanding, market observers have advanced several criticisms of these market-based efforts.[167] One common criticism challenges many of these efforts as vulnerable to information asymmetries. Voluntary disclosures are often deemed inconsistent, incomplete, and unreliable.[168] In the absence of auditing and oversight, selective disclosures operate more like "public relations" documents rather than rigorous, objective disclosures of ESG performance.[169] Rating agencies potentially exacerbate opacity with inconsistent scoring models that result in varied assessments of the same firms.[170] In turn, ESG investment products are charged with being mislabeled as sustainable or falling short of expected ESG-related engagement.[171] As a result, monitoring and capital allocation

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165. *See, e.g.*, *Framework & Disclosure Management*, NASDAQ, https://www.nasdaq.com/solutions/corporate-esg-solutions/metrio/framework-disclosure-management [https://perma.cc/KU2J-NZT6] (showing that Nasdaq's Framework & Disclosure Management tool reports ESG's ratings and ranking organizations).

166. *See Global Sustainable Fund Flows: Q1 2021 in Review, ESG Fund Assets Climb to Shy of USD 2 Trillion Boosted by Record Inflows*, MORNINGSTAR (Apr. 30, 2021), https://www.bakeryoung.com.au/wp-content/uploads/2021/07/global-esg-q1-2021-flow-report.pdf [https://perma.cc/2KYC-57V9].

167. *See* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 385 (2020); Michal Barzuza et al., *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1275 (2020).

168. Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923, 926–27 (2018); Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 411 (2018); Andy Green, *Making Capital Markets Work for Workers, Investors, and the Public: ESG Disclosure and Corporate Long-Termism*, 68 CASE W. RSRV. L. REV. 909, 911 (2019); Cynthia Williams & Donna Nagy, *ESG and Climate Change Blind Spots*, 99 TEX. L. REV. 1453, 1454 (2021).

169. *See* Fisch, *supra* note 168, at 944.

170. *Id.* at 949.

171. Rachel Evans, *How Socially Responsible Investing Lost Its Soul*, BLOOMBERG BUSINESSWEEK (Dec. 18, 2018, 1:47 PM), https://www.bloomberg.com/news/articles/2018-12-18/exxon-great-marlboros-awesome-how-esg-investing-lost-its-way [https://perma.cc/26PK-AQR6]; *see also* Zachary Barker, Note, *Socially Accountable*

by investors and other stakeholders are burdensome and costly and, therefore, rendered ineffective. For information critics, ESG outcomes, monitoring, and enforcement can be improved by enhanced information disclosures.[172] Mandatory SEC disclosures and information auditing are central solutions according to some critics,[173] while others call for broader disclosure requirements that capture private firms as well.[174]

Another common criticism asserts that some market-based efforts lack mechanisms for accountability. The accountability critics account for prior empty promises to prioritize stakeholder interests or achieve specific social and environmental goals.[175] Such promises often prove to be trendy at best with no real evidence of follow-through. In the absence of "credible commitments," or clear and enforceable obligations, firm pledges and promises will inevitably fall short.[176] For some critics, enhanced public disclosures can also mitigate accountability issues.[177] This is because disclosures inform corporate boards, shareholders, stakeholders, and regulators, who can each then better police firm managers around disclosed

Investing: Applying Gartenberg v. Merrill Lynch Asset Management'*s Fiduciary Standard to Socially Responsible Investment Funds*, 53 COLUM. J.L. & SOC. PROBS. 283, 286 (2020); Michal Barzuza et al., *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1246–48, 1275 (2020). *But see* Quinn Curtis et al., *Do ESG Mutual Funds Deliver on Their Promises?*, 120 MICH. L. REV. 393, 394 (2021) (asserting that stronger or special regulations for ESG are not needed).

172. *See* Ho, *supra* note 168, at 437 (noting that mandatory disclosures generally improve shareholder monitoring); Green, *supra* note 168, at 911–12; Allison Herren Lee, Comm'r, SEC, Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation, Keynote Remarks at PLI's 52nd Annual Institute on Securities Regulation (Nov. 5, 2020), https://www.sec.gov/ news/speech/lee-playing-long-game-110520 [https://perma.cc/LM83-27VV].

173. *See* Ho, *supra* note 168.

174. Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE L.J. ON REG. 499, 501 (2020).

175. Lisa M. Fairfax, *Stakeholderism, Corporate Purpose, and Credible Commitment*, 108 VA. L. REV. 1163, 1173 (2022); Nell Minow, *Six Reasons We Don't Trust the New "Stakeholder" Promise from the Business Roundtable*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 2, 2019), https://corpgov.law.harvard.edu/2019/09/02/six-reasons-we-dont-trust-the-newstakeholder-promise-from-the-business-round table/ [https://perma.cc/2U58-DJSK].

176. *See* Fairfax, *supra* note 175, at 1225–26; Martin Lipton et al., *Corporate Purpose: Stakeholders and Long-Term Growth*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 29, 2019), https://corpgov.law.harvard.edu/2019/05/29/corporate-purpose-stakeholders-and-long-term-growth/ [https://perma.cc/7CWK-KYWG].

177. *See* Fairfax, *supra* note 175, at 1213.

issues.[178] In this vein, some critics have called for public disclosures around diversity and racial equity to incentivize real outcomes aligned with public pledges.[179] Critics have also called for enhanced disclosures from asset managers to inform mutual fund investors and enable better investor monitoring.[180] Other critics advocate for firm managers to enter into contractual commitments to make ESG efforts more credible,[181] while others suggest linking executive compensation to ESG goals to incentivize adherence to meeting such goals.[182] Finally, some advocate for a fiduciary duty to stakeholders, which would make firms responsible for certain ESG failures.[183]

However, a final common criticism references some of the foregoing shortcomings to assert that the market is fundamentally ill-equipped to address ESG matters because such matters are negative externalities.[184] Firm managers have little or negative incentive to prioritize ESG matters beyond their traditional profit maximization calculus.[185] Moreover,

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178. *Id.*

179. Veronica Root Martinez & Gina-Gail S. Fletcher, *Equality Metrics*, 130 YALE L.J. F. 869, 875 (2021), https://www.yalelawjournal.org/pdf/FletcherMartinezEssay_8vxh887p.pdf [https://perma.cc/HDB5-ECQ3].

180. *See* Green, *supra* note 168, at 925.

181. John Armour et al., *Green Pills: Making Corporate Climate Commitments Credible* 40 (Eur. Corp. Governance Inst., Working Paper No. 657, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4190268 [https://perma.cc/U28M-EQSC] (proposing "green pills" by which management agrees to a financial penalty—e.g., direct payment or discounted commercial paper—for nonperformance of its ESG commitment).

182. *See* Mark Roe et al., *The Sustainable Corporate Governance Initiative in Europe*, 38 YALE J. ON REG. BULL. 133, 149–50 (2021); Minow, *supra* note 175; Bebchuk & Tallarita, *supra* note 37, at 141, 149; Seymour Burchman, *A New Framework for Executive Compensation*, HARV. BUS. REV. (Feb. 6, 2020), https://hbr.org/2020/02/a-new-framework-for-executive-compensation [https://perma.cc/TW3Y-5VBE].

183. Leo E. Strine, Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy: A Reply to Professor Rock*, 76 BUS. LAW. 397, 412–15 (2021); David Hess, *Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness*, 25 J. CORP. L. 41, 66–67 (1999); A.A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 44 (1991).

184. Bebchuk & Tallarita, *supra* note 37, at 92.

185. *See, e.g.*, *id.* at 100 ("[W]ith corporate leaders having incentives not to benefit stakeholders at shareholders' expense, an attempt to benefit stakeholders by delegating the guardianship of their interests to corporate leaders would not be supported, but rather impeded, by the force of economic incentives."); Lund, *supra* note 121, at 1620; Jonathan R. Macey, *ESG Investing: Why Here? Why Now?*, 19 BERK. BUS. L.J. 258, 264 (2022) (suggesting that mechanisms related to board

firm managers are poorly positioned to determine which stakeholder interests to prioritize or how to balance the interest of various stakeholders in the face of trade-offs.[186] These externality critics disagree on the effectiveness of investment instruments to alter the incentive structures for firm managers.[187] Others assert that altering incentive structures would be too challenging and costly to implement.[188] Some believe market-based efforts heighten risks of managerial self-dealing and distract from more effective public policy reforms.[189] These externality critics would typically dispense with market-based efforts in favor of direct public policy interventions, such as more restrictive labor, consumer protection, and environmental laws.[190]

* * * *

In sum, the ESG movement has set its sights on the corporate loan market, encouraging lenders to either divest from or engage with antisocial borrowers. These efforts aim to repurpose the tools of lender governance to improve ESG outcomes. Yet, similar efforts have fallen short by many accounts, raising doubts as to the effectiveness of market-based efforts in the loan market. Prior shortcomings (real or predicted) are often debated in the literature as consequences of information asymmetries, a lack of accountability, or negative externalities not reasonably within the purview of market-based governance. These lines of analyses tend to generate dichotomic solutions—self-regulation fixes or deference to public policy. Yet, the literature's focus on corporate governance leaves underexplored questions regarding whether the lender's unique toolkit offers new insights into the efficacy of market-based efforts and the interplay between private ordering and public policy.

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elections would negate concerns about insincere ESG initiatives); Lucian A. Bebchuk et al., *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467, 1519 (2021).

186. Bebchuk & Tallarita, *supra* note 37, at 115.

187. *Compare* Lund, *supra* note 121, *with* Macey, *supra* note 185.

188. *See, e.g.*, Benjamin T. Seymour, *Corporate Politics: ESG and the First Amendment*, 19 N.Y.U. J.L. & BUS. 309, 332 (2023) (arguing that companies will ultimately dismiss ESG initiatives believed to interfere with profit-maximization).

189. *See, e.g.*, Ho, *supra* note 168.

190. Bebchuk & Tallarita, *supra* note 37, at 94.

III. SUSTAINABILITY-LINKED LOANS: A QUANTITATIVE REVIEW

To begin exploring these open questions, this Part synthesizes a quantitative review of the sustainability-linked loan market.[191] Whether corporate lenders add novelty to, or resolve the shortcomings of, market-based ESG efforts, they can only be reasonably assessed in conjunction with a close examination of one of their first mainstream loan attempts. In summary, the quantitative review reveals that sustainability-linked loans (1) are primarily issued by relational lenders through revolver loans; (2) rely exclusively on performance-pricing mechanisms with relatively limited incentives for ESG performance; and (3) use customized ESG metrics that prioritize environmental outcomes. These emerging trends suggest that sustainability-linked loans indeed repurpose some important lender governance tools to incentivize ESG outcomes, but, comparatively, the tools are blunted when used in this context.

A. *Data Collection & General Characteristics*

This quantitative review focuses on the U.S. market because its volumes are wholly market driven, unlike the European market, which has some regulatory pressures.[192] Because trends in European loan product may not be representative of what has occurred or will occur in the United States, they have not been aggregated with a U.S. market assessment. Accordingly, the data analysis described in this Part targets sustainability-linked loan agreements entered into by U.S. corporate borrowers. To identify loans as sustainability-linked, I targeted loans that include one or more "sustainability coordinators," "sustainable agent[s]," or "sustainability structure agents." Because these agents exclusively serve to set ESG-related performance benchmarks, they are typically party to a sustainability-linked loan but not a traditional syndicated loan. To hone in on loans that met the definition established by the SLL Principles, I also focused on loans with terms that set forth performance benchmarks relating to nonfinancial activity and that were incorporated into loan provisions other than the "use of proceeds" provision. In particular, I reviewed the definitions, fee provisions, representations, covenants, and

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191. The review and analysis in this Article are limited to the sustainability-linked loan market's early development through 2021.

192. *See generally* Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921 (2020) (providing an overview of European regulations pertaining to ESG).

events of default of loan agreements or third-party summaries of those provisions.

To gather sustainability-linked loans for analysis, I relied on exhibit 10 searches via EDGAR, a public database by the U.S. Securities and Exchange Commission (SEC). An EDGAR search enables a review of U.S. public company filings. Under Regulation S-K of the Securities Act of 1933 (Securities Act),[193] public companies are required to publicly report "material contracts" and file such contracts as an exhibit 10 to the report.[194] Material contracts are contracts "not made in the ordinary course of business that [are] material" to the filing company's business.[195] Materiality turns on whether the average prudent investor would require information relating to the contract to be reasonably informed in a decision to purchase the company's securities.[196] Given their size, it is generally understood that most corporate loans, especially syndicated loans, constitute "material contracts." Therefore, I intended the exhibit 10 search to yield syndicated corporate loans entered into by U.S. public companies and their subsidiaries.

To collect loan agreements from the EDGAR exhibit 10 filings, I entered the following search into the Westlaw "Edgar Exhibits" database: (sustainab! /3 agent coordinator) & DA(aft 03-31-2017 & bef 04-01-2022) & NDT(EX-10). I designed this search to find material contracts filed by U.S. public companies between April 1, 2017, and March 31, 2022, that referenced a sustainability coordinator, sustainable agent, or sustainability structuring agent. The search yielded 197 results. I selected the broad date range to identify all sustainability-linked loan agreements executed by December 31, 2021. Such agreements would have been filed no earlier than when the first sustainability-linked loan was executed, April 2017, and no later than when most annual reports for the fiscal year ending 2021 are filed on Form 10-K, March 2022. Each filing was reviewed to confirm that a sustainability agent was referenced, whether in title or duties; ESG benchmarks were incorporated into the economic or governance terms or anticipated for future incorporation by amendment; each agreement was executed by December 31, 2021; and one or more borrowers were U.S. firms. Documents that were removed either were not loan agreements; did not contain agents with such titles or

193. Regulation S-K, Item 601, 17 C.F.R. § 229.601 (2024).

194. *Id.* § 229.601(b)(10).

195. *Id.*

196. *See* 17 C.F.R. § 270.8b–2(g) (2024).

sustainability-related duties; did not include ESG benchmarks; were executed after December 31, 2021; involved an amendment that removed sustainability provisions; or only concerned non-U.S. borrowers. Also, separately filed amendments to identified sustainability-linked loan agreements were read together with the loan agreement. Loan agreements that were filed multiple times by different co-borrowers were treated as a single filing, and co-borrowers were treated as a single borrower. As a result, I was left with 131 loan agreements.

The loan agreements analyzed represent over $145 billion in 78 sustainability-linked loans, and over $50 billion in 53 "sustainability-flex" loans (defined below). These loans were issued in the United States to more than 100 corporate borrowers from June 2018 to December 2021. Most loans emerged from an explosion of market activity in 2021: just over 87% of the sustainability-linked loans and over 95% of the sustainable-flex loans were issued in 2021. Individual loan amounts for sustainability-linked loans ranged from $175 million to $13.5 billion.

Before conducting the quantitative analysis, I independently read and coded each loan agreement for a number of features, including loan type (revolver or term loan), identities of loan parties, focus of ESG performance benchmarks (environmental, social, both, or aggregated metric), performance pricing adjustments, ESG-related mechanisms in governance terms, financial covenants, sustainability agent duties, whether the loan was secured, whether sustainability features were publicly disclosed, and borrower industry. This in-depth review revealed several characteristics not readily apparent in the data. Most notably, the market has begun to coalesce around two sets of form provisions—one for sustainability-linked loans and the other for sustainability-flex loans. In 2021, the relevant language increasingly begins to track near identically across different administrative agents and sustainability agents and across different borrower types. Key features of the sustainability-linked-loan form include standard mechanics around when price adjustments based on ESG performance benchmarks will commence and end. Price adjustments typically commence five business days after delivery of a pricing certificate and terminate automatically by the due date of the next pricing certificate. The form dictates that one pricing certificate may be delivered annually and adjustments cannot be cumulative. It specifies the borrower's duties if a material

inaccuracy in the ESG disclosure results in underpayment of loan costs. Such underpayment shall become due within ten days after written notice. The form disclaims any duty of the sustainability agent or administrative agent to review or audit ESG disclosures. Some forms may note a duty for the sustainability agent to renegotiate ESG benchmarks if the original benchmarks are not available. The variability in the form occurs around ESG benchmarks, price adjustment rates, due dates of pricing certificates (which occur 90 to 240 days after the end of the fiscal year), consequences for non-delivery of pricing certificates, the use of ESG auditors, and whether the sustainability agent has a duty to renegotiate ESG benchmarks. With ESG benchmarks, there is substantial diversity in the specifics of the performance requirements even though there are categorical similarities.

For sustainability-flex loans, key features include mechanics dictating the flexibility to amend the loan agreement to incorporate ESG benchmarks and convert the loan to a sustainability-linked loan with limited voting rights from the lender group. This form sets a ceiling on the possible price adjustments that could be established, requires mutual agreement of the borrower and sustainability agent, and mandates that the future amendment align with the SLL Principles. There is variability only around voting requirements to approve the amendment (e.g., majority lender consent, negative consent, or no consent at all), the maximum allowable rate adjustment, and the number of required ESG benchmarks.

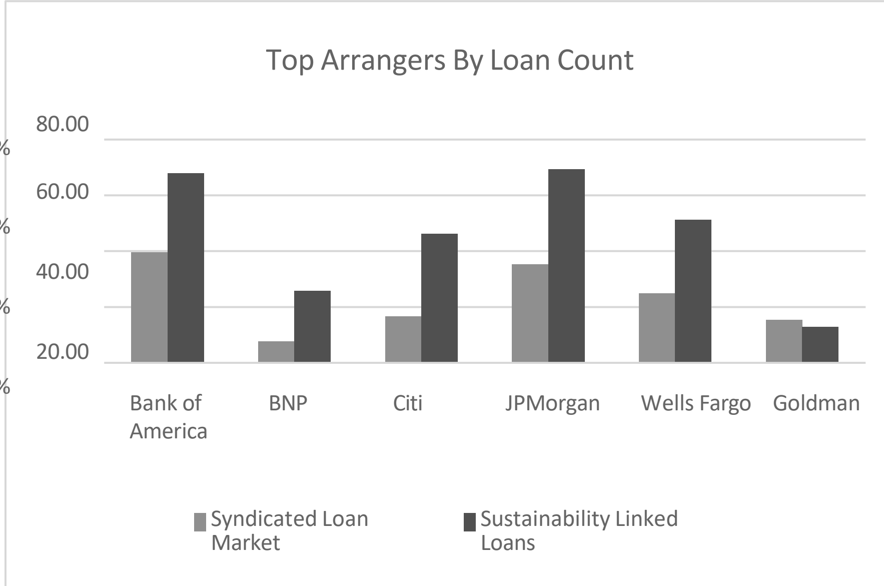
B. *Market Participants*

1. Agents & Lenders

For sustainability-linked loans, the quantitative review begins with the loan agents and lenders because one might expect viable market-based efforts to be driven by financial firms with the most expansive reach in the marketplace. Indeed, financial institutions with the largest market shares in the broader syndicated loan market are the primary participants in the sustainability-linked loan submarket.

Table 1

Note: multiple lenders can serve as an arranger in any given transaction.



JPMorgan and Bank of America are the two leading arrangers and lenders in the broader syndicated loan market,[197] and that dominance is mirrored in the sustainability-linked loan market. For loans executed in 2021, the top five arrangers in the broader market—JPMorgan, Bank of America, Wells Fargo, Citi, and Goldman—mirror the top five in the syndicated loan market with one exception. BNP Paribas jumps from its fifteenth position in the broader market to replace Goldman as a top-five arranger in the sustainability-linked loan context. In fact, Goldman is not even a top-ten arranger for sustainability-linked loans.

Most administrative agent roles go to JPMorgan, Bank of America, Citibank, and Wells Fargo, who collectively monitor the ongoing obligations in nearly 75% of sustainability-linked loans. This too tracks closely with their dominant presence in the broader market. There is slight variation in the leading firms to serve as sustainability agents. JPMorgan and Bank of

197. BLOOMBERG, GLOBAL SYNDICATED LOANS LEAGUE TABLES 1–2 (2019), https://data.bloomberglp.com/professional/sites/10/Bloomberg-Global-Syndicated-Loans-League-tables-FY-2019.pdf [https://perma.cc/QCV2-PD7K].

America lead as sustainability agents, or co-agents, in 22% and 18% of the loans, respectively. BNP Paribas takes the third spot as sustainability agent in 10% of sustainability-linked loan agreements, followed by Wells Fargo in 9% of those loans. Notably, the sustainability agent is typically the same as, or an affiliate of, the administrative agent. One exception is BNP Paribas, which always appears as sustainability agent in coordination with an unaffiliated administrative agent.

JPMorgan, Bank of America, and Wells Fargo are the biggest repeat lenders by loan volume, each having lending commitments in nearly 75% of the loan agreements. Other routine lenders in the sustainability-linked market, lending in more than half of the loan agreements, include U.S. Bank, Citibank, and PNC Bank. Yet, the more critical observation relates less to which firm is lending and more to what *type* of firm is lending. In this respect, the sustainability-linked loan market reflects a meaningful departure from the broader syndicated loan market. In more than 90% of the loan agreements, the loans are issued and maintained by relational lenders rather than arm's length lenders. As a consequence, or maybe as the driving cause, there is an overrepresentation of revolver loans in the sustainability-linked loan market when compared to the broader syndicated loan market. Although revolver loans make up 60% of the broader syndicated loan market, revolver loans are accounted for in 96% of sustainability-linked loan agreements. And while term loans make up 40% of the broader syndicated loan market, they are represented in only 14% of sustainability-linked loan agreements. The intentional avoidance of sustainability-linked term loans is clear when looking at loan agreements that simultaneously issue both revolver and term loans. In seven loan agreements (9%), ESG-related provisions were explicitly carved out of term loans and applied exclusively to revolver loans. In eight loan agreements (10%), ESG-related provisions were applied to both term loans and revolver loans, and just three loan agreements (4%) applied ESG-related provisions to only term loans.

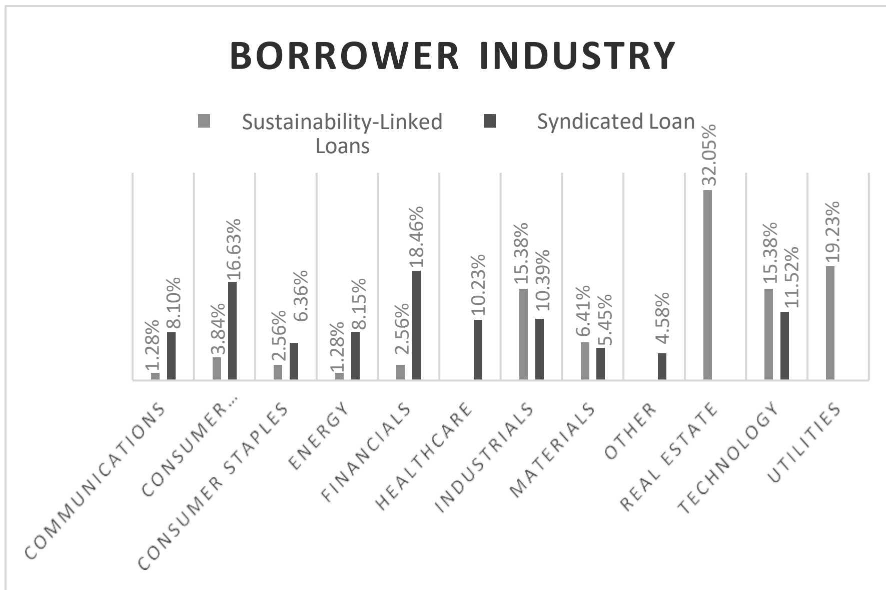
This mix of agents and lenders suggests that relational lenders are motivated to engage borrowers on ESG outcomes, or at least motivated to signal a desire to do so through sustainability-linked loans. And, arguably consistent with their usual disinclination to engage in meaningful lender governance, arm's length lenders that typically fund term loans

may not be motivated to engage borrowers through sustainability-linked loans.

2. Borrowers

This review turns next to borrower demographics because viable market-based efforts might expect to engage borrowers from a variety of industries for broad-reaching influence. There is indeed a mix of industries participating in the sustainability-linked loan market. However, some industries are overrepresented, and others are underrepresented when compared to the broader syndicated loan market. And many borrowers have positive ESG profiles before executing their loans.

Table 2



There are several household names from an array of industries that have entered sustainability-linked loans, including Dell, General Mills, and JetBlue. The largest single U.S. sustainability-linked loan, a $13.5 billion revolver, was executed by Ford Motor.[198] Notwithstanding, most borrowers emerge from industries with less direct retail consumer

198. Benjamin Stango et al., *ESG in the Credit Agreement: A Closer Look at Sustainability-Linked Loan Mechanics*, REUTERS (June 10, 2022, 5:39 AM), https://www.reuters.com/legal/legalindustry/esg-credit-agreement-closer-look-sustainability-linked-loan-mechanics-2022-06-14/ [https://perma.cc/6GMR-AS5T].

interaction. REITs were borrowers in over 30% of the loan agreements. These borrowers are in the business of commercial real estate development, residential leases, and commercial leases to small businesses, governmental agencies, hospital systems, and retailers, such as PetSmart, Giant grocery stores, and Tanger Outlets.[199] Yet, as illustrated in Table 2, the outsized popularity among real estate firms and even utilities firms (19.23%) reflects a more than three-fold increase in representation in the broader market, where Bloomberg League Tables lumps them together with "Other" nominally represented borrowers. An industry overrepresentation, though less extreme, is also observable with respect to borrowers in the technology (15.38%) and industrials (15.38%) sectors. At the opposite extreme, the relatively paltry uptake by borrowers in the consumer discretionary (3.84%) and financial (2.56%) sectors belie their majority representation in the broader market. This mix of borrowers suggests that there may be some industry-specific pressures (or lack thereof) causing the variance in popularity of sustainability-linked loans, which is inconsistent with the broader market.

C. *Loan Terms*

The most critical consideration for assessing the viability of market-based efforts is to ascertain which tools of lender governance are used and how. This Section distills how the sustainability-linked loan market exclusively relies on performance pricing to influence ESG outcomes in a manner that is distinct from customary uses of performance pricing. With one exception,[200] sustainability-linked loans to date have

199. *See, e.g.*, James Chen, *Real Estate Investment Trust (REIT): How They Work and How to Invest*, INVESTOPEDIA (Dec. 22, 2023), https://www.investopedia.com/terms/r/reit.asp [https://perma.cc/SCE7-KL3P] (suggesting that borrowers should choose REITs from fast-growing sectors such as healthcare).

200. The outlier loan was one of two sustainability-linked loans entered into by Dominion Energy Inc., a public utility company, as a borrower. This loan conditions any discount in the economic terms on the use of loan proceeds. If Dominion Energy wants to receive a 0.5 basis point reduction in the interest rate applied to its borrowings, then it must designate such borrowings as "sustainability loans" and subsequently allocate borrowed amounts to "green investments," such as solar or wind projects, or "social investments," such as small and mid-size enterprises or historically black colleges and universities. A failure to provide an annual report itemizing such expenditures would result in the removal of any discount rather than in default. In many respects, Dominion Energy has the flexibility to convert this loan facility into green or social loans. *See* Dominion Energy, Inc., Current Report (Form 8-K) (June 9, 2021).

followed the same basic form. Specifically, loan interest rates and commitment fees are adjustable based on certain ESG benchmarks disclosed in annual pricing certificates delivered to the administrative agent.

1. Performance Pricing

Recall performance pricing is a common practice in syndicated loans wherein economic terms are converted into governance terms by adjusting loan costs based on financial performance.[201] Indeed, of the seventy-three sustainability-linked loan agreements that had unredacted pricing terms, seventy loans had traditional performance pricing while the remaining three had fixed pricing terms. Among those with performance pricing, such pricing was tied to a debt rating (77.1%), a custom leverage ratio that measured the borrower's debt levels (18.6%), both (2.9%) or, in one instance, a calculation of the borrower's liquidity (1.4%). However, in the sustainability-linked loan context, these traditional performance pricing mechanics are supplemented by ESG performance pricing. As a result, the loans offer cogent evidence of the extremely different values loan parties place on financial performance versus ESG performance.

Each sustainability-linked loan included a pricing adjustment to the "margin" rate—a component of the interest rate charged for outstanding borrowings.[202] In the unredacted loan agreements, such margin adjustments varied between one basis point to five basis points. In most loan agreements (54.2%), borrowers could earn a further deduction of five basis points (0.05%) after determining the applicable margin based on financial performance if they successfully achieved their ESG benchmark. However, in nearly half of the loans, this maximum discount could only be earned by meeting two or more benchmarks. For example, Lululemon Athletica may receive a maximum discount of five basis points, but only if it reaches both carbon-emission and pay-equity goals.[203] In one-fourth of the loans, borrowers could earn a more modest one-basis-point (0.01%) deduction to the applicable margin. The remaining quarter of loans varied between a 2– and 4.5–basis-point deduction.

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201. *See supra* Section I.A.

202. Rebecca Lake, *What Are Margin Rates?*, SOFI LEARN (Nov. 11, 2023), https://www.sofi.com/learn/content/margin-rates. [https://perma.cc/5EHR-TUTL].

203. Lululemon Athletica Inc., Current Report (Form 8-K) (Dec. 14, 2021).

In just over two-thirds of the loan agreements, borrowers faced an equivalent penalty adjustment, or increase to the applicable margin, if they failed to meet applicable ESG benchmarks. For multiple ESG benchmarks, the penalty kicks in only if all benchmarks are missed. In most of the remaining loan agreements (32.9%), there is no penalty for failing to reach a benchmark; rather, the margin reverts to the original rate otherwise based solely on financial performance. One loan agreement uniquely frames the adjustment as a penalty-only adjustment. That is, the standard margin will be increased if the ESG benchmark is not met (rather than discounted if the ESG benchmark is met). The combined effect of the penalty and discount adjustment in some loan agreements doubles the range of the margin adjustment. Thus, in the 51% of loan agreements that have a five-basis-point discount and penalty adjustment, the maximum margin adjustment is best understood as ten basis points.

Table 3

Index Debt Ratings:	ABR Spread (bp)	Term Benchmark and RFR Spread (bp)
Category 1 Rating of A3/A-/A- or greater	0.0	100.0
Category 2 Rating of Baa1/BBB+/BBB+	12.5	112.5
Category 3 Rating of Baa2/BBB/BBB	25.0	125.0
Category 4 Rating of Baa3/BBB-/BBB-	37.5	137.5
Category 5 Rating of Ba1/BB+/BB- or lower	62.5	162.5

By contrast, the traditional performance pricing in these loans based on financial performance offers greater cost savings with a singular metric. For example, Table 3 shows Hewlett Packard's pricing adjustments based on the company's debt rating. Notice how there is a distinct price incentive at 5 different rating levels with each incremental improvement offering a 12.5-basis-point adjustment to the margin rate. Consequently, Hewlett Packard's debt rating offers a maximum adjustment of 62.5 basis points to its margin rate—more than six times greater than the maximum change for the company's ESG benchmark. This disparity is not an outlier. Indeed, nearly

75% of the unredacted loans with performance pricing had margin adjustments for financial performance between 60 to 100 basis points. Thus, the margin adjustment for ESG performance appears relatively nominal when compared to financial performance.

There is a similar story when observing the use of pricing adjustments for commitment fees. Because revolver loans tend to remain largely unused, the most significant costs arise from commitment fees, which are also commonly adjusted based on financial performance. Indeed, 93% of the unredacted loan agreements have adjustable commitment fees based on financial performance. However, significantly fewer loan agreements (52%) further adjusted commitment fees based on ESG performance. In other words, even without outstanding loan balances, financial performance remains incentivized by cost savings in most loans, but ESG performance is incentivized in only half of the loans. Moreover, sustainability-linked loan agreements offer adjustments of 0.5 to 1 basis point for ESG performance. In most agreements, the adjustment is applied as a discount for achieving the ESG benchmark and as a penalty for missing the benchmark. As a result, the maximum commitment fee adjustment in 45% of the loan agreements was 2 basis points. Yet, in contrast, the pricing adjustment based on financial performance is at least 10 basis points in 87% of the loan agreements, with most adjustments in the range of 15 to 20 basis points. Thus, even when adjustments are based on ESG performance, such adjustments are a mere fraction of those a borrower would enjoy for financial performance.

This review confirms that lenders are indeed using performance pricing provisions to incentivize ESG performance. However, these provisions tend to offer substantially lower cost savings for ESG performance compared to financial performance. Such dramatically different valuations for ESG and financial performance may readily disincentivize the former in the face of tradeoffs with financial considerations.

2. Missing Governance Terms

One of the most distinctive features of sustainability-linked loans is that ESG performance is not required by any other governance term. By contrast, the traditional performance provisions are backstopped by financial covenants. Indeed, all the sustainability-linked loans with traditional performance

pricing have at least one financial covenant, and over 50% of such loans have two or more financial covenants. The most popular is a maximum leverage covenant, which puts a ceiling on the level of debt a borrower can incur relative to certain asset values.[204] If the borrower exceeds that level of debt, the loan is in default.[205] The second most common covenant is the minimum fixed charge coverage ratio (FCCR), which sets a floor on the amount of cash a borrower must maintain relative to its fixed charges, such as debt payments, interest expenses, and lease expenses.[206] If the FCCR falls below the covenant requirement, the loan is in default.[207] Consequently, notwithstanding the significant costs that can be incurred from poor financial performance through the pricing provisions, there is still a point at which extremely poor financial performance allows the lenders to terminate or, more plausibly, renegotiate the loan. There is no equivalent covenant in place for extremely poor ESG performance. This review suggests that while there may be some incentives for ESG performance, they are relatively and intentionally weaker than those for financial performance.

3. ESG Benchmarks

This review next assesses the types of ESG benchmarks used in sustainability-linked loans because one might expect viable market-based efforts to manage the breadth of environmental and social risks intended by the ESG framework. While a potentially ambitious task given the innumerable issues that fall under the ESG umbrella, sustainability-linked loans have a notably narrow focus on environmental risks.

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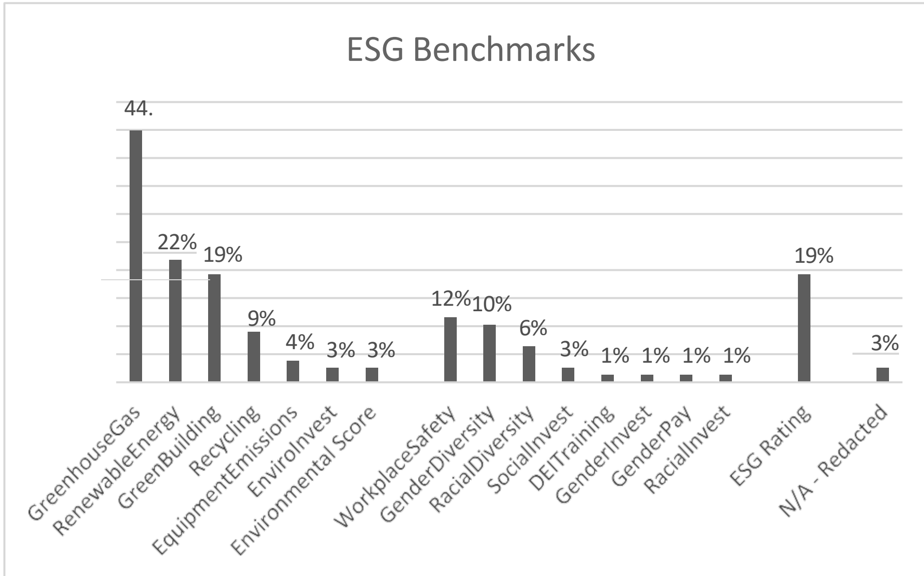
204. *Maximum Leverage Ration*, FASTERCAPITAL, https://fastercapital.com/keyword/maximum-leverage-ratio.html [https://perma.cc/K9TR-9BV2].

205. *Id.*

206. Adam Hayes, *Fixed-Charge Coverage Ratio (FCCR): Examples, Formula, Meaning*, INVESTOPEDIA, https://www.investopedia.com/terms/f/fixed-chargecoverageratio.asp [https://perma.cc/YS95-A3SV].

207. *Managing Cash Flow and Loan Facilities During Difficult Economic Times*, U. CIN. NEWS (July 12, 2023), https://www.uc.edu/news/articles/2023/07/n21182477.html [https://perma.cc/9LVY-BDGX].

Table 4



Note: a single loan agreement may have one to three ESG benchmarks.

Over 85% of sustainability-linked loans use environmental-specific metrics—metrics that exclusively focus on the borrower's environmental impact. These metrics include GHG emissions, renewable energy generation, green building certification, and aggregate ESG ratings. As shown in Table 4, the most popular metric included in nearly half of the loan agreements is one of the primary drivers of climate change—GHG emissions.[208] This metric is used for companies across a variety of industries, including apparel; REITs; energy, food & beverage; financial services; and technology.[209]

GHG emissions as an ESG benchmark take many different forms. For example, Lululemon's loan agreement measures the "Scope 3" emissions from its global operations in accordance with GHG Protocol.[210] These emissions result from the goods and services purchased by the company and its subsidiaries, as

208. *See, e.g.*, *The Causes of Climate Change*, NASA GLOBAL CLIMATE CHANGE (Aug. 20, 2022, 1:08 PM), https://climate.nasa.gov/causes/ [https://perma.cc/JX2S-QY3F] (explaining that scientists attribute global warning to human expansion of the greenhouse effect).

209. *See, e.g.*, Maria Loumioti & George Serafeim, *The Issuance and Design of Sustainability-Linked Loans* 42 (Harv. Bus. Sch., Working Paper No. 23-027, 2022) (providing an excerpt of a GHG metric provision in a loan agreement between Jabil Inc., an electronic manufacturing company, and its lenders).

210. *See generally* Lululemon Athletica, *supra* note 203.

well as its upstream transportation and distribution activities.[211] Lululemon's total emissions are then divided by its net revenues to come up with a GHG intensity rate.[212] The company and its lenders agreed on a baseline intensity rate (i.e., the intensity rate recorded for 2018) and established specific percentages by which the baseline rate should be reduced each year as ESG benchmarks.[213] Lululemon will receive a discount (or penalty premium) if the benchmark for a given year is (or is not) reached.[214]

Some loan agreements more rigorously condition pricing adjustments on multiple measures, or "Scopes," of GHG emissions to target the environmental impact of broader aspects of the company's business activities. S&P Global Inc. measures three "Scopes" as defined in its pricing certificate. S&P Global will receive a discount (or penalty premium) only if it achieves (or fails to achieve) benchmarks related to all three measures. In all other instances, no discount or premium will be applied. Other loan agreements, such as that for Ford Motor, establish two-tier benchmarks with the more rigorous targets at the second level, receiving steeper discounts if achieved.

Renewable energy metrics are the next most used environmental-specific benchmarks. Some loan agreements measure the company's renewable energy generation. For example, Dominion Energy's loan agreement measures the capacity generated from its wind and solar facilities and sets annual benchmarks including both a baseline capacity and target capacity that increases over time.[215] Dominion Energy will receive a discount (or penalty premium) if it achieves (or falls below) its target capacity.[216] If it reaches the baseline capacity, there will be no adjustment to its economic terms. Other loan agreements, such as those for General Mills and Ford Motor, have benchmarks to increase renewable energy consumption over time. General Mills is poised to receive a discount (or penalty) if it reaches (or misses) its benchmarks relating to renewable energy consumption across its operations.[217] Ford Motor established a baseline benchmark similar to Dominion Energy such that it may avoid a penalty

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211. *Id.*
212. *Id.*
213. *Id.*
214. *Id.*
215. Dominion Energy, Inc., *supra* note 200.
216. *Id.*
217. General Mills, Inc., Current Report (Form 8-K) (Apr. 12, 2021).

even if it does not reach its target, so long as it does not fall short of the threshold.[218] Finally, some loan agreements have benchmarks to support renewable energy use, including benchmarks for the number of solar panels or electric vehicle chargers installed by public utility borrowers or purchased for properties owned by REIT borrowers.

Over 30% of the sustainability-linked loans use social-specific metrics—metrics that focus exclusively on the borrower's social impact. These include metrics related to gender equity, workplace safety, racial equity, and diversity and inclusion training. Social-specific metrics concerning workplace safety are included in 12% of sustainability-linked loans. These metrics are used primarily by public utilities and manufacturing firms. They rely on an "incident rate" defined as the number of work-related injuries by a given number of full-time workers and calculated in accordance with industry standards.[219] In each loan, baseline and target incident rates are established for each year. The borrowers will receive a discount (or penalty) if they reach the target rate (or miss the baseline rate) for a given year or over a multiyear period. Borrowers typically maintain their original economic terms if they only meet the applicable baseline rate.

Gender equity metrics are included in 12% of sustainability-linked loans. Lululemon's loan agreement includes a rare benchmark for "gender pay equity," which requires the "average annual earnings of employees . . . that identify as female" to be at least equal to the "average annual earnings of employees . . . that identify as male at the same job level and performing similar work with similar experience."[220] The company will receive a discount (or penalty) if it reaches (or misses) the benchmark.[221]

Three loan agreements measure workforce gender diversity. The loan agreement for Autodesk, Inc., a software development firm, measures the percentage of employees identifying as female who specifically work in technical roles and establishes annual baseline and target benchmarks for increasing such percentage.[222] Autodesk will receive a discount (or penalty) if it reaches the target benchmarks (or misses the baseline

218. Ford Motor, Co., Current Report (Form 8-K) (Dec. 8, 2021).

219. Amanda Ernst, *Workplace Safety Indicators*, ANVL (July 25, 2023), https://anvl.com/safety/workplace-safety-indicators-2/ [https://perma.cc/3PDB-GL8S].

220. Lululemon Athletica, *supra* note 203.

221. *Id.*

222. Autodesk, Inc., Current Report (Form 8-K) (Sept. 30, 2021).

benchmark).[223] If it meets only the baseline benchmark, the original economic terms will apply without discount or penalty.[224]

Three loan agreements measure managerial-level gender diversity, whether independently or in combination with racial diversity. The loan agreement for BlackRock measures its "female leadership rate" as the ratio percentage of employees in a capacity as director or managing director of the company and its subsidiaries who identify as female.[225] The loan agreement familiarly sets baseline and target benchmarks for each year.[226] BlackRock will receive a discount (or penalty) if it reaches the target benchmark (or misses the baseline benchmark) in a given year.[227] Also, if it meets only the baseline benchmark, the original economic terms will apply without discount or penalty.[228]

Racial equity metrics are included in 7% of sustainability-linked loans. In each case, the borrower will receive a discount, penalty, or will maintain its original economic terms according to whether it reaches a target rate, baseline rate, or misses both. Two loan agreements include target and benchmark rates related to workforce racial diversity. Dominion Energy's loan agreement measures the percentage of new hires identifying as women or minorities.[229] BlackRock's loan agreement measures the percentage of employees who are "Black, African American, Hispanic or Latino."[230] The remaining two loan agreements include target and baseline rates related to managerial-level racial diversity. The loan agreement for Portland General, a public utility, measures the combined percentage of employees in a managerial or higher position who identify as women or black, Indigenous, or people of color.[231] The loan agreement for HP Inc. measures the percentage of black and African American employees in a capacity as a U.S.-based executive.[232]

Aggregate metrics that aim to evaluate the borrower's overall ESG performance are included in 19% of sustainability-linked loans. In these loans, the borrower receives a discount

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223. *Id.*
224. *Id.*
225. BlackRock, Inc., Current Report (Form 8-K) (Dec. 13, 2021).
226. *Id.*
227. *Id.*
228. *Id.*
229. Dominion Energy, Inc., *supra* note 200.
230. BlackRock, Inc., *supra* note 225.
231. Portland General Elec. Co., Current Report (Form 8-K) (Sept. 10, 2021).
232. HP Inc., Current Report (Form 8-K) (May 26, 2021).

(or premium penalty) if he obtains (or falls short of) a specific ESG score provided by a third-party rating agency. Loan agreements rely on aggregate ESG scoring models from ISS QualityScore, Sustainalytics, Vigeo Eiris, the Responsible Business Alliance, MSCI, and S&P. However, the most popular model, driven by REIT borrowers, is the GRESB score.[233] The GRESB score is designed specifically for real estate investors and provided by a third-party rating agency based on self-reported company data.[234] The GRESB score is software-generated and it measures three components of a company's business: management, performance, and development.[235] The management component evaluates leadership and strategy, policies and processes, risk management, and stakeholder engagement.[236] The performance component evaluates the environmental performance of operational real estate assets, including energy consumption, GHG emissions, water consumption, and waste management.[237] The development component evaluates ESG considerations in real estate design, construction, and renovation phases.[238]

This review illustrates the breadth of issues that lenders have attempted to address through sustainability-linked loans. Consistent with the broader ESG movement, there is a heavy focus on environmental performance. However, there are provocative efforts to advance complex racial and gender equity issues. Moreover, these loans rely more on company-specific data than on third-party ratings, which have faced much scrutiny. This suggests that lender's informational advantages are being used even if not evenly across ESG issues.

4. Information Disclosures

Notwithstanding, the informational advantages that appear in sustainability-linked loans are also substantially muted when used for ESG performance as compared to financial performance. To receive a pricing discount, borrowers are generally required to disclose the past year's ESG performance

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233. Nicole Funari, *REITs Continue to Improve GRESB Scores*, NAREIT (Feb. 23, 2024), https://www.reit.com/news/blog/market-commentary/reits-continue-improve-gresb-scores [https://perma.cc/S7PG-GSTP].

234. *Id.*

235. *Real Estate Reference Guide,* GRESB REAL ESTATE (2022), https://documents.gresb.com/generated_files/real_estate/2022/real_estate/reference_guide/complete.html [https://perma.cc/N3YS-8TK8].

236. *Id.*

237. *Id.*

238. *Id.*

in a pricing or sustainability certificate delivered to the administrative agent annually. In just over half of loan agreements (52%), such disclosures must be certified by a third-party auditor, typically an accounting firm or sustainability assurance provider. No one firm dominates in this role, but repeat providers include Deloitte, Ernst & Young, and DNV Group. The absence of third-party auditors in the remaining half of loans may be partly explained by the type of ESG benchmarks used. Nearly half of the remaining loans (or 20% of overall loans) use sustainability scores or green building certifications for ESG benchmarks. In each case, the benchmark is provided by a third-party rating agency or certifying entity, which eliminates the need for an auditor. Indeed, a contemporaneous economics study observed that third-party auditing is generally required for particularly technical ESG benchmarks such as carbon emissions and renewable energy assessments.[239] However, the remaining one-fourth of loans rely on internal calculations, including technical calculations such as emissions and renewable energy assessments, as well as calculations for workplace injuries, diversity statistics, and social investments. And in all loans, the sustainability agent and administrative agent disclaim responsibility to audit or otherwise verify the accuracy of ESG performance disclosures. Thus, this review may raise concerns regarding the quality or validity of borrower disclosures in limited instances.

An additional limitation of ESG disclosures is their permissive nature. In some loan agreements, the ESG reporting requirement appears in the primarily descriptive "accounting terms" section of the loan agreements rather than under a covenant provision that contemplates defaultable conduct. And in all loan agreements, regardless of the provision's location, the failure to comply with an ESG reporting requirement will not trigger a default under the loan agreement. Even when the requirement appears in an affirmative covenant provision, it is explicitly carved out from the covenant and/or the events of default provision to avoid triggering default under the loan. Instead, as shown in Appendix A4, borrowers in 55% of unredacted loan agreements would incur a penalty equal to the maximum adjustment applicable if they had failed to achieve the established ESG benchmarks. In 45% of unredacted loans,

239. *See* Richard Carrizosa & Aloke Ghosh, Sustainability-Linked Loan Contracting 35 (Aug. 15, 2023) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4103883 [https://perma.cc/7SVN-9TYT].

borrowers would see their economic terms revert to the original rates as if the sustainability adjustments were never incorporated—without discount or further penalty. By contrast, failure to deliver other notices, including financial reports, under the loan agreements can *technically* result in a default, even if default is highly unlikely as a practical matter.

There is only one instance where a default may arise concerning ESG disclosures. If a miscalculation in any ESG performance or pricing adjustment results in an erroneous reduction in the applicable economic terms, then the borrower will typically have ten days following notice and demand to pay the arrears. A failure to timely pay such arrears would result in a payment default under the loan agreement. The borrower and/or lenders are responsible for identifying and reporting any such error.

This review reinforces the impression that there is significant optionality for, and limited scrutiny of, ESG performance. While the missing governance provisions suggest lenders have limited interest in direct intervention, the optional disclosure suggests they might have limited interest in monitoring altogether.

D. *Sustainability-Flex Loans*

A bonus observation found while conducting the review for sustainability-linked loans was the emergence of amendment provisions to create sustainability-flex loans. These provisions reduce or eliminate the burden of obtaining lender consent for a future loan amendment intended to incorporate sustainability-linked loan provisions. Typically, adjustments to the interest rate or other loan costs require the consent of all lenders in the syndicate or all lenders whose loans are impacted. In sustainability-flexed loans, the approval of lenders holding over 50% of loan value will suffice. In nearly half of the loans, a higher burden of negative consent is required. That is, the amendment will pass unless lenders holding more than 50% of the loan value affirmatively reject the amendment.

These loans leave the details of the ESG benchmark and price adjustments to the future amendment, but they typically set caps on possible price adjustments. Maybe unsurprisingly, most loans cap margin adjustments at five basis points and commitment fee adjustments at one basis point. This review suggests these maximum price adjustments may reflect the market standard and are levels at which lenders are comfortable being indifferent.

E. *Limitations*

To be sure, there are certain limitations inherent to an empirical review of public participants in a nascent market. This dataset is a snapshot in the early development of the sustainability-linked loan market, which means shifts in market trends may plausibly arise as the market continues to develop. Additionally, due to the exclusive focus on publicly filed loan agreements, this dataset does not capture potential idiosyncrasies in sustainability-linked lending to private firms. Accordingly, the findings in this Article invite, and are foundational to, further research of this developing market. Notwithstanding, these findings offer rich insights beyond loan market innovations to critically advance discourse on the perplexing public policy issues regarding ESG risks and market providers.

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The potency of lender governance has recently been pushed by the ESG movement, as advocates have pressured lenders to divest from antisocial firms, and lenders and borrowers have proffered innovative instruments said to incentivize and evidence prosocial activity, including sustainability-linked loans. This rare, in-depth look at how the sustainability-linked loan market operates offers a sobering perspective on broader questions regarding whether lenders have unique characteristics to overcome past shortcomings and effectively advance market-based efforts to improve ESG outcomes.

IV. THE (IN)ESCAPABLE EXTERNALITIES OF ESG

The inner workings of the sustainability-linked loan market reveal a tension between the theory and reality of lender governance of ESG outcomes. Lenders have tools to overcome information asymmetries and accountability shortcomings that have undermined market-based ESG efforts pursued by firm managers and investors. Indeed, lenders now have ESG-specific insights afforded through customized benchmarks and reporting requirements, and they can ensure accountability by conditioning the terms of credit on some degree of ESG performance. Yet, the preceding data review suggests that lenders use their tools narrowly and nominally. Assuming the market was established as a good faith effort at ESG monitoring, why have lenders muted the impact of their toolkit? This Part argues that this is because, notwithstanding

enhanced informational insights and commitment mechanisms, lenders are hamstrung by a predictable disregard of negative externalities to reveal the truly nominal value of ESG matters to firms. Still, given lenders' demonstrated monitoring advantages, these would-be inescapable externalities should be addressed by public policy interventions that shift costs onto loan parties if private debt is to effectively serve the public good.

A. *Lenders' Commitment Mechanism*

The notion that corporate loans can serve as credible commitments for borrowers implicitly relies on lenders having their *own* commitment mechanisms that effectively incentivize lender governance. But lender governance is typically incentivized by bank regulation or bank profit interests, neither of which are meaningfully at stake with respect to borrowers' ESG risks.

1. Regulatory Incentives

To date, U.S. bank regulation does not provide any incentive for lenders to monitor borrower ESG risks. This is in stark contrast to the U.S. regulations regarding borrower financial risks. For example, the Federal Reserve, the Financial Stability Oversight Council, and the Office of the Comptroller of the Currency subject national banks, including those serving the sustainability-linked loan market, to stringent risk-management assessments and compel disclosures that focus on the degree and impact of default risks in the banks' loan portfolios. Following the Great Recession, such regulatory oversight shifted loan monitoring norms toward more effective and conservative practices. However, U.S. regulators do not require comparable assessments or disclosures of ESG risks in loan portfolios. By contrast, peer international regulators incentivize lenders to monitor borrower ESG risks. For example, in March 2021, European Union (EU) regulations went into effect compelling financial firms to, among other things, disclose their sustainability risk management practices and specify how certain financial products satisfy ESG label requirements.[240]

240. *See* Sustainable Finance Disclosure Regulation (EU) 2019/2088 (SFDR); Danny Busch, *Sustainable Finance Disclosure in the EU Financial Sector* 5 (European Banking Inst., Working Paper No. 70, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3650407 [https://perma.cc/K9LD-M5TD]; Katrin Hummel

In the absence of such regulatory incentives stateside, the U.S. sustainability-linked loan market has some notable shortcomings when compared to the European market. First, the U.S. market had a later and slower development than the European market that innovated the sustainability-linked loan in 2017. Second, the U.S. market offers significantly lower interest rate discounts for ESG performance. While U.S. margin discounts do not exceed five basis points, European margin discounts can be up to fifteen basis points.[241] While an assessment of the market impact of this distinction is reserved for future research,[242] it is plausible to correlate internalized regulatory costs with the higher valuation of ESG performance by EU lenders. Finally, U.S. borrowers may have more stringent ESG goals for their EU operations than for their U.S. operations. Indeed, Ford Motor has an ESG benchmark to reduce its vehicular emissions only for its European fleet, not its U.S. fleet. In sum, sustainability-linked lenders lack regulatory incentives to monitor ESG risks.

2. Market Incentives

The absence of regulatory incentives would not be problematic if lenders had sufficient market incentives, but such incentives appear limited to reputational risks. This is evidenced in part by the fact that only relational lenders provide sustainability-linked loans. If borrowers' ESG risks meaningfully impacted lenders' profit interests, then one might expect to see pricing adjustments in both revolver loans and term loans. Although arm's length lenders do not actively monitor loans, successful trading on secondary markets compels them to be price sensitive. Such price sensitivity has resulted in "corrections" on the secondary market that reduce a

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& Dominik Jobst, The Current State of Corporate Sustainability Regulation in the European Union 1 (Dec. 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3978478 [https://perma.cc/UG5F-BWAK].

241. Jeremy Duffy et al., *2021: The Year of the Sustainability-Linked Loan*, WHITE & CASE (Dec. 8, 2021), https://www.whitecase.com/insight-alert/2021-year-sustainability-linked-loan [https://perma.cc/NM4H-9Q8G].

242. However, recent research has been critical of EU lenders engagement on ESG performance, thus a study of the comparative effectiveness of U.S. versus EU lenders may reveal alike failures of lender commitment mechanisms notwithstanding different regulatory landscapes. *See generally* Parinitha (Pari) Sastry et al., *Business as Usual: Bank Climate Commitments, Lending and Engagement* (European Central Bank, Working Paper No. 2921, 2024), https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2921~603e225101.de.pdf?f3854e151126bea03711149d197b37353 [https://perma.cc/UYN5-KBYU].

loan's trading value when its terms do not properly address borrower risks. Thus, at least in theory, sustainability-linked loans align with the risk management strategies of arm's length lenders because such loans can automatically adjust pricing upon ESG failures without the type of lender intervention required by governance terms. By not adopting sustainability-linked term loans, arm's length lenders send a clear signal that ESG performance does not benefit lender returns or borrower risks to the extent of the discount offered.

In contrast to arm's length lenders, relational lenders have unique reputational risks that require them to calculate additional costs to preserve their goodwill with the public and customers, including corporate borrowers.[243] A CLO does not have to face angry deposit account holders protesting at a local branch, but Bank of America does. Indeed, Bank of America explicitly discloses in its annual report that its ESG practices and those of its customers may pose a reputational risk.[244] Some relational lenders further signal their sustainability commitments to the public and their investors with updates on their sustainable financing activities.[245] Additionally, a CLO does not routinely engage with corporate borrowers, but relational lenders do. Consequently, relational lenders distinctly value serving unique customer needs for their own long-term gain. This may explain why certain sectors—real estate and utilities—are overrepresented in the market. If lenders had a meaningful economic interest in ESG risks, one might expect a more even distribution of sustainability-linked loans across sectors because all corporate borrowers pose some degree of ESG risks. Instead, the concentration in real estate and utilities sectors suggests that the market might be driven by borrowers facing preexisting regulatory and public pressures. In sum, the sustainability-linked loan market relies on lenders' exposure to reputational risks to effectively monitor ESG performance.[246] But the absence of arm's length lenders in the market suggests such risks may not be material to lender returns or borrower default risks.

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243. *See* Julie Andersen Hill, *Regulating Bank Reputation Risk*, 54 GA. L. REV. 523, 538 (2020).

244. Bank of America, Annual Report 19 (Form 10-K) (Mar. 31, 2023) ("Our reputation may also be negatively impacted by our ESG practices and disclosures, and those of our customers and third parties.").

245. *See id.* at 82; Citigroup Inc., Annual Report 54 (Form 10-K) (Feb. 27, 2023).

246. *See* Poh, *supra* note 22; Tulyasuwan & Wachirapunyanont, *supra* note 153.

B. *Limitations of Commitment Mechanism*

As a lender commitment mechanism, reputational risk is inadequate for effective ESG monitoring. First, it results in pricing values that are insufficient to offset ESG compliance costs and incentivize borrowers to prioritize ESG outcomes. Second, it leads to an exclusive reliance on low-cost lender tools that on their own make lender governance illusory and exacerbate market myopia on ESG matters. Finally, it fails to shift the social costs of ESG risks to loan parties for influential lender governance.

1. Nominal Pricing

The pricing adjustments offered by lenders for ESG performance are too low to align stakeholder and shareholder interests, which in turn fails to incentivize borrowers to prioritize ESG goals. The corporate governance literature often highlights the tension between shareholder and stakeholder interests as a fatal flaw to market-based ESG efforts.[247] Market forces pressure firm managers to forego stakeholder interests even when shifting norms and permissive laws allow for more pluralistic governance approaches.[248] Such market forces include compensation packages tied to shareholder profits and director/CEO appointment prospectives linked to serving shareholder interests.[249] Changing such market forces would not, however, advance stakeholder interests.[250] Instead, doing so would impose significant costs and only give firm managers expanded discretion for self-enrichment, which would be a disservice to both shareholders and stakeholders.[251]

In the sustainability-linked loan market, the innovative link between ESG performance and economic terms in loan agreements offers a low-cost market reform that aligns shareholder and stakeholder interests. Shareholders are directly impacted by a firm's borrowing costs because debt servicing obligations, such as interest rates and commitment fees, cut into a firm's net profits. And because firm managers

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247. *See generally* Kishanthi Parella, *Contractual Stakeholderism*, 102 B.U. L. REV. 865, 868–70 (2022) (discussing the competing interests between shareholder-focused capitalism and stakeholder-focused capitalism and their impacts on the environment, society, and corporate regulation).

248. Bebchuk & Tallarita, *supra* note 37, at 139.

249. *Id.* at 141.

250. *Id.* at 159.

251. *Id.* at 164.

are typically compensated in equity,[252] they, too, have an interest in keeping the firm's debt servicing obligations low. Thus, sustainability-linked loans can align once-pluralistic ESG goals with a firm's bottom line to effectively incentivize firm managers to prioritize such goals.

However, the cost savings offered by sustainability-linked lenders are too low to overcome market forces against stakeholder interests. Consider, for illustrative purposes, JetBlue's $550 million revolver loan.[253] Assuming a five-basis point discount (penalty) for obtaining (missing) target ESG scores, JetBlue could have annual interest savings of $275,000 to $550,000.[254] For a firm of JetBlue's size, this maximum savings is nominal. Such an amount would not even cover five days of JetBlue's daily average advertising expense.[255] It represents less than 0.02% of the firm's total market capitalization—i.e., it is likely too immaterial to impact any shareholder value assessment or shift managerial decisionmaking.[256] What's more, the cost savings in a more practical hypothetical would be even lower because most revolver loans are rarely fully drawn. If JetBlue had an undrawn revolver, as would be more typical, the company would enjoy a maximum annual savings of $100,000 under the most generous commitment fee terms. Yet, it takes multi-million-dollar annual investments to enhance airline emissions for improved ESG performance.[257] Though illustrative, the example is representative of the broader sustainability-linked loan market. In the absence of alternative motivations, borrowers are not likely to be incentivized by such nominal

252. *Id.* at 141.

253. Press Release, *supra* note 2.

254. *See* Tommy Wilkes & Isla Binnie, *Loans Linked to ESG Face Overhaul by Under-Pressure Banks*, REUTERS (Nov. 10, 2023, 11:53 AM), https://www.reuters.com/sustainability/sustainable-finance-reporting/loans-linked-esg-face-overhaul-by-under-pressure-banks-2023-11-10 [https://perma.cc/Z9Y9-46WF] (noting that the typical discount for sustainability-linked loans is "2.5[–]10 basis points").

255. *See* JetBlue Airways Corp., Annual Report 72 (Form 10-K) (Feb. 22, 2022) ("Advertising expense was . . . $45 million in 2021.").

256. *Market Capitalization of JetBlue Airways,* COMPANIESMARKETCAP.COM, https://companiesmarketcap.com/jetblue-airways/marketcap/ [https://perma.cc/M7QJ-JGFX] (recording JetBlue's 2022 end of year market capitalization at $2.09 billion).

257. *See* JetBlue Airways, *supra* note 255, at 48 (noting capital expenditures of $637 million in 2021 for fifteen new fuel-efficient aircrafts).

pricing in a sustainability-linked loan that hardly offsets ESG compliance costs.[258]

2. Optional Compliance

The optionality of ESG compliance and disclosure robustly preserves managerial discretion, which allows borrowers to evade meaningful ESG investments and perpetuate market myopia. The corporate governance literature often points to the limitations of dispersed shareholders to rein in managerial discretion that is resistant to ESG objectives.[259] Scholars have suggested that institutional investors with exposure across competing firms and diverse sectors, or "universal owners," are best positioned to overcome such resistance and effectively monitor firms.[260] Their large portfolios uniquely expose them to an aggregation of ESG risks,[261] and their significant holdings uniquely afford them influence over managerial decisions.[262] However, the universal owner's Achilles heel is its limited firm-level informational insight.[263] Without such insights, universal owners are arguably unable to properly price or effectively manage the unique ESG risks of each firm.[264] And

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258. *See* Tanger Factory Outlet Centers, Inc., Annual Report 20 (Form 10-K/A) (Nov. 28, 2022) (noting that the company "may experience increased costs in order to execute upon our sustainability goals . . . , which could have an adverse impact on our business and financial condition").

259. *See* Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 3–4 (2020).

260. *See id.* at 5–6; Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism* 2–3 (U. Pa. L. Sch. Inst. for L. & Econ., Research Paper No. 19-39, 2019); JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM 3–5, 170–72 (2000). *But see* Michelle Edkins et al., *Index Investing and Common Ownership Theories*, BLACKROCK 11 (Mar. 2017), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-index-investing-and-common-ownership-theories-eng-march.pdf [https://perma.cc/QY24-HMBB] (arguing that uniform ownership does not automatically produce uniform shareholder goals and decisionmaking).

261. *See* Condon, *supra* note 259, at 63–64.

262. *Id.* at 50–54 (noting that institutional investors' influence is derived from their voting rights, direct communications with management, and ability to influence executive compensation).

263. Dorothy Lund, *Corporate Finance for Social Good*, 121 COLUM. L. REV. 1617, 1657 (2021) (noting that, due to their focus on implementing governance reforms at scale, universal owners are "not well positioned to solve problems that have generated substantial debate among informed researchers, such as how companies can minimize risks from climate change. They might not even be able to identify the worst offenders").

264. *See id.*; Madison Condon, *Market Myopia's Climate Bubble*, 1 UTAH L. REV. 63, 115 (2022).

for their part, firms have perverse incentives to avoid accurate ESG disclosures to preserve share prices.[265]

In the sustainability-linked loan market, lenders have benefits similar to universal owners with the further advantage of enhanced informational insights. Like universal owners, sustainability-linked lenders are broadly exposed to an aggregation of ESG risks at the level of their loan and broader business portfolios. Indeed, the top five arrangers in the sustainability-linked loan market not only arrange more than one-third of the global syndicated loan market[266] but also hold more than half of all U.S. bank assets, including U.S. household deposits.[267] JPMorgan alone boasts direct business relationships with more than 90% of Fortune 500 companies, sixty-six million U.S. households representing more than 75% of banked households, and five million small businesses.[268] In many ways, lenders have broader ESG exposure than universal owners because lenders may be directly impacted by retail consumers and small businesses. Also, like universal owners, sustainability-linked lenders may exercise influence over managerial decisions through loan agreements. Indeed, the vast literature on lender governance reflects numerous instances of lender influence over business activities, often with the benefit of enhanced firm value. Yet, unlike universal owners, sustainability-linked lenders have access to private firm-level information for enhanced ESG insights. For example, sustainability-linked lenders have obtained information often not publicly disclosed to investors, including controversial "Scope 3" GHG emissions data and sensitive workplace diversity data.[269] In many ways, sustainability-linked lenders may be called "universal lenders" with potent monitoring capabilities to drive ESG outcomes.

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265. Condon, *supra* note 264.

266. BLOOMBERG, GLOBAL SYNDICATED LOANS: LEAGUE TABLES 1, 1 (2021), https://www.troutman.com/a/web/295223/2021-Q4-Bloomberg-Global-Capital-Markets-Legal-Advisers-Ranke.pdf [https://perma.cc/KF5B-AHN9].

267. Adam McCann, *Bank Market Share by Deposits and Asset,* WALLET HUB (Sept. 6, 2023), https://wallethub.com/edu/sa/bank-market-share-by-deposits/25587 [https://perma.cc/KS4N-N59B].

268. *2021 Annual Report*, JPMORGAN CHASE & CO. 1, 8 (2021), https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/investor-relations/documents/annualreport-2021.pdf [https://perma.cc/HE6D-YYY9].

269. Maria Loumioti & George Serafeim, The Issuance and Design of Sustainability-Linked Loans 42 (Harv. Bus. Sch., Working Paper No. 23-027, 2022), https://www.hbs.edu/ris/Publication%20Files/23-027_4b09d278-4051-468e-a5d9-eb0e7c50c25d.pdf [https://perma.cc/S96H-76BP].

Yet, sustainability-linked loans preserve unbridled managerial discretion by tying ESG performance exclusively to economic terms and exempting ESG reporting requirements from default provisions. Borrowers are free to opt out of ESG performance if the related costs exceed pricing adjustments.[270] As the prior Subsection suggests, such nominal adjustments create a very low bar for nonperformance. From a contract-drafting perspective, such flexibility is efficient. The choice between pricing adjustments and governance terms is tantamount to the choice between standards and rules. Like standards, pricing adjustments are less costly to negotiate *ex ante* than rule-like governance terms.[271] Such flexibility also prevents costly opportunism that can arise in the event of a minor default.[272] In the context of novel loan requirements, limited lender costs, and innumerable uncertainties regarding future compliance, lenders probably lack incentives and a credible bargaining position to negotiate for more robust governance terms.

However, efficient contracting principles do not readily explain the complete discretion borrowers retain with respect to ESG reporting. Nor do those principles justify the credible concerns associated with ESG disclosures in the 25% of loan agreements that are not subject to third-party auditing.[273] The complete discretion afforded by sustainability-linked loans

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270. Jacqueline Poh, *How a Downturn in ESG-Linked Loans Prompted a Rethink,* WASH. POST (Aug. 31, 2023), https://www.washingtonpost.com/business/energy/2023/08/31/how-to-explain-the-drought-in-esg-linked-loans/2bdff12e-4860-11ee-b76b-0b6e5e92090d_story.html [https://perma.cc/F33J-VG63].

271. *See* Elizabeth de Fontenay, *Complete Contracts in Finance*, 2020 WIS. L. REV. 533, 538 (2020).

272. *See* Houman B. Shadab, *Performance-Sensitive Debt: From Asset-Based Loans to Startup Financing*, 16 U. PA. J. BUS. L. 1077, 1102 (2014) ("[A] major force driving the widespread adoption of performance pricing provisions in the 1990s was to save on the transaction costs of renegotiating loan contracts."); de Fontenay, *supra* note 271; Renae Merle, *How One Hedge Fund Made $2 Billion from Argentina's Economic Collapse*, WASH. POST (Mar. 29, 2016), https://www.washingtonpost.com/news/business/wp/2016/03/29/how-one-hedge-fund -made-2-billion-from-argentinas-economic-collapse/ [https://perma.cc/3RFT-AXQU]. *But see* Michael R. Roberts & Amir Sufi, Contingency and Renegotiation of Financial Contracts: Evidence from Private Credits Agreements 3 (July 31, 2008) (unpublished manuscript), http://ssrn.com/abstract=1017629 [https://perma.cc/VF88-XY5Y] (noting that "the presence of ex ante contingencies, such as performance pricing grids and borrowing bases, are largely unrelated to whether or not a renegotiation takes place").

273. Mark Segal, *75% of Companies Not Ready for Pending ESG Data Assurance Requirements: KPMG Survey*, ESG TODAY (Oct. 2, 2023), https://www.esgtoday.com/75-of-companies-not-ready-for-pending-esg-data-assurance-requirements-kpmg-survey/ [https://perma.cc/R7P2-J3UD].

exacerbates what some scholars deem the "market's myopia" on ESG matters.[274] When borrowers disclose a sustainability-linked loan to the market, they may reasonably signal that corporate lenders are monitoring their ESG performance. Like traditional loans, such monitoring may prove valuable to the market and enhance stock value. However, unlike traditional loans, which signal a borrower's financial distress to the market in the event of a default, sustainability-linked loans provide no comparable market signal for ESG failures because such performance is optional. Thus, notwithstanding the monitoring potential of "universal lenders," sustainability-linked loans allow borrowers to both publicly disclose the existence of sustainability-linked loans as a reflection of their commitment to ESG performance and hide ESG-related failures in perpetuity so long as they pay the low fee (if any) associated with such nonperformance.

3. Limited Risk Shifting

The foregoing limitations likely are symptomatic of the fact that reputational risks do not fully shift the social costs of ESG failures to loan parties. Despite assertions that ESG risks impact a borrower's long-term financial performance, such risks embody the classic market conundrum that is negative externalities. The corporate governance literature often asserts (hopes) that with enhanced informational access and commitment mechanisms, market forces can incentivize firms to improve ESG outcomes.[275] In doing so, the literature arguably suggests that ESG-related externalities are merely the result of myopic perceptions as opposed to such externalities being a more fundamental market feature. As a result, some scholars focus their reform efforts on information asymmetries and agency costs.[276]

However, the sustainability-linked loan market dispels the notion that externalities are misperceptions and makes plain that the long-term consequences of ESG risks are too remote for the market to care today. Notwithstanding informational advantages and a toolkit of credible commitment mechanisms,

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274. Condon, *supra* note 264.

275. George Serafeim, *Social-Impact Efforts That Create Real Value*, HARV. BUS. REV. (2020), https://hbr.org/2020/09/social-impact-efforts-that-create-real-value [https://perma.cc/5YR6-E8Y4].

276. Seda Bilyay-Erdogan et al., *ESG Performance and Investment Efficiency: The Impact of Information Asymmetry*, 91 J. INT'L FIN. MKTS., INSTS. & MONEY 1, 17 (2024).

sustainability-linked lenders do not offer borrowers incentives that would rationally incentivize ESG performance. This is because informed lenders estimate that the value of any given ESG performance is no more than 0.05% of the borrowings on a rarely used corporate loan.[277] Thus, the sustainability-linked loan market issues a gut check to the ESG movement: ESG outcomes serving long-term financial performance have extremely low value to the marketplace.

C. *Solution: Making Credible Monitors*

For real and lasting effects, the ESG movement must seek more potent risk-shifting mechanisms than reputational risks. While some critics argue that the foregoing deficiencies suggest that ESG issues should be left to public policy,[278] the very existence of entrenched, pervasive, and otherwise effective private monitors suggests otherwise. What is missing from the sustainability-linked loan market is an effective mechanism of private–public coordination. Policymakers should enlist universal lenders as ESG monitors for regulatory efficiency. Conscripting universal lenders to serve as ESG monitors would allow the government to harness the unique information insights and monitoring efficiencies already established by lenders. And these lenders are already subject to robust public monitoring and regulation; therefore, allowing them to serve as ESG monitors would preserve governmental resources to monitor bank compliance with ESG obligations rather than to monitor the thousands of corporate borrowers in countless industries.[279] Moreover, the sustainability-linked loan market is rapidly growing despite its clear superficiality.[280] Policymakers should intervene to right the market's course

277. Sehoon Kim et al., *Sustainability-Linked Loans: A Strong ESG Commitment or a Vehicle for Greenwashing?*, PRI BLOG (July 20, 2022), https://www.unpri.org/pri-blog/sustainability-linked-loans-a-strong-esg-commitment-or-a-vehicle-for-green washing/10243.article [https://perma.cc/LJ4G-4QW7].

278. Indep. Point Advisors, *Why Aligning Your ESG & Public Policy Approaches Is Just Good Business (Part 2)*, LINKEDIN (July 25, 2022), https://www.linkedin.com/pulse/why-aligning-your-esg-public-policy-approaches-?trk=organization_guest_main-feed-card_feed-article-content [https://perma.cc/WR39-C47L].

279. *See* Rory Van Loo, *The New Gatekeepers: Private Firms as Public Enforcers*, 106 VA. L. REV. 467, 475 (2020) (noting that business influence comes from the market, rather than the government).

280. Niels Bodenheim & Jovita Razauskaite, *Opportunities in the Fast-Growing Market for Sustainable Corporate Loans*, GOLDMAN SACHS ASSET MGMT. (Sept. 13, 2023), https://www.gsam.com/content/gsam/us/en/institutions/market-insights/gsam-insights/2023/sustainable-corporate-loans.html [https://perma.cc/EF57-MU2F].

before it gets too big to fix. The public would greatly benefit from lenders serving as ESG monitors, and the long-term cost savings to the government may be significant under a proper incentive structure. This Section explores solutions that can marry much-needed regulatory risk-shifting with the unique benefits of lenders as private monitors and explores the possible implications of these proposals.

1. Mandatory Disclosure

To enhance loan party incentives with minimal market intervention, policymakers should consider mandatory disclosure requirements for ESG benchmark failures. Public company borrowers disclose sustainability-linked loans as material agreements and often specify that the loans include ESG performance goals.[281] Yet, borrowers do not have to disclose any subsequent failures to reach ESG benchmarks because such failures do not trigger any risk of default.[282] This disclosure framework allows borrowers and lenders to signal an ESG commitment to the marketplace without revealing the illusory nature of that commitment. Reputational risks related to ESG may thereby be mitigated prematurely or for longer than warranted. Mandating periodic disclosures could be an effective incentive potentially as potent as incorporating ESG benchmarks into the governance terms but without the high risks of forfeiture.[283]

2. Sustainability Agent Certification

To ensure optimal benchmarking and pricing adjustments, a neutral third-party agent should serve as a sustainability coordinator. Currently, this role is typically filled by an affiliate

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281. *What is a Sustainability-Linked Loan, and Should my Company Get One?*, FOLEY HOAG (July 8, 2021), https://foleyhoag.com/news-and-insights/publications/alerts-and-updates/2021/july/what-is-a-sustainability-linked-loan-and-should-my-company-get-one/ [https://perma.cc/2F2R-9WMU].

282. McCarthy Tértrault LLP, *ESG Loan Financing: Key Observations and Trends to Watch for in 2023*, LEXOLOGY (Mar. 6, 2023), https://www.lexology.com/library/detail.aspx?g=35d6bf83-fa3f-421e-b62d-2dc7efea9488 [https://perma.cc/E3FP-NP2U].

283. *Cf.* Sneha Pandya and Eric L. Talley, *Debt Textualism and Creditor-on-Creditor Violence: A Modest Plea to Keep the Faith* (European Corp. Gov. Inst. Working Paper No. 673, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4317353 [https://perma.cc/9ZVS-YPKC] (discussing how textualist readings of corporate loan agreements have incentivized parties to exploit contract terms to opportunistically hold up counterparties).

of one or more of the lenders.[284] Consequently, despite rich information insights, the sustainability agent is not incentivized beyond reputation risks to optimize the borrower's ESG outcomes. A neutral third-party agent might undergo a certification process through which he learns how to select the socially optimal, rather than popular, ESG benchmark. He may also learn to investigate and/or confer with some of the borrower's stakeholders to ensure that marginalized or minority perspectives are heard. As a result, various ESG stakeholders would be empowered to benefit from the potential of sustainability-linked loans and use the debt instruments for broader systemic improvements.

3. Lender Incentives

Finally, policymakers could shift market incentives to cause lenders to internalize the aggregate costs of ESG risks or to nudge lenders to offer steeper discounts and solicit ESG performance. Policymakers could achieve cost internalization through a taxing mechanism that increases the cost of capital for noncompliant loans. Such loans would include both traditional syndicated loans (i.e., loans without ESG benchmarks) and nonperforming sustainability-linked loans (i.e., loans with ESG shortcomings). The taxing mechanism could be an increase to lender reserve requirements for non-compliant loans in excess of a certain threshold.

The corollary to the taxing mechanism would be a portfolio discount for compliant loans in excess of a certain threshold. The discount could be a reduction in the lender reserve requirements or a direct government subsidy to simultaneously incentivize the lenders and allow more generous discounts in the loan pricing adjustments as an incentive to borrowers. Additionally, bank lenders in particular could be incentivized by granting lenders credit under the Community Reinvestment Act for compliant loans in excess of a certain threshold. Such policy reforms would provide more significant incentives to lenders that tie to their rate of return and, thus, would more naturally compel their engagement in loan documentation.

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284. Jacqueline Poh, *How ESG-Linked Loans Help to Hold Firms Accountable*, BLOOMBERG PRO. SERV. (Sept. 14, 2022), https://www.bloomberg.com/professional/blog/how-esg-linked-loans-help-to-hold-firms-accountable/ [https://perma.cc/G2BS-VZSG].

CONCLUSION

This Article undertakes a rare empirical assessment of the sustainability-linked loan market to examine governance mechanisms that aim to enhance the public good. In so doing, it provides a rigorous analysis of an understudied emerging market and deepens the robust ESG discourse with a critical lender governance perspective.

The sustainability-linked loan market has the potential to drive ESG outcomes that have long been elusive on the equity side of corporate governance structure. Lenders have access to impressive informational insights that allow customized ESG risk management and can negotiate loan mechanisms aligning the interests of managers, shareholders, and stakeholders. However, these market advantages are hollow without adequate lender incentives. Policymakers should view the unique advantages of lender governance as a rich opportunity for public–private coordination to tackle pressing social concerns. By shifting the social costs of ESG risks to loan parties, policymakers can effectively repurpose private debt monitoring for the public good.

APPENDIX

This Appendix provides further tabular detail on the sources of data used in the empirical analysis in Part III of this Article.

Table A.1: Publicly Filed Sustainability-Linked Loan Agreements dated June 2018–December 2021

	Filer Name	**Reporting Form**	**Filing Date**	**Loan Date**	**Borrower Industry**	**Loan Type**	**Loan Amount**
1	Eagle Bulk Shipping Inc.	10-K	3/14/22	10/1/21	[Industrials][Trans]	[REV][TERM]	$400,000,000.00
2	Hewlett Packard Enterprise Co.	10-Q	3/3/22	12/10/21	[Technology]	[REV]	$4,750,000,000.00
3	Digital Realty Trust, Inc.	10-K	2/25/22	11/18/21	[Real Estate][REIT]	[REV]	$3,000,000,000.00
4	Eastman Chemical Co.	10-K	2/25/22	12/3/21	[Materials - Chemicals]	[REV]	$1,500,000,000.00
5	Hudson Pacific Properties, L.P.	8-K	12/27/21	12/21/21	[Real Estate][REIT]	[REV]	$1,000,000,000.00
6	Paramount Group, Inc.	8-K	12/21/21	12/17/21	[Real Estate][REIT]	[REV]	$750,000,000.00
7	Lululemon Athletica Inc.	8-K	12/17/21	12/21/21	[ConsumerDiscretion ary][Apparel]	[REV]	$400,000,000.00
8	Agree Realty Corp.	8-K	12/16/21	12/15/21	[Real Estate][REIT]	[REV]	$1,000,000,000.00
9	Occidental Petroleum Corp.	8-K	12/13/21	12/10/21	[Energy]	[REV]	$4,000,000,000.00
10	SL Green Realty Corp.	8-K	12/8/21	12/6/21	[Real Estate]	[REV-LTD]	$1,250,000,000.00
11	Covanta Holding Corp.	8-K	11/30/21	11/30/21	[Industrials]	[TERM-LTD]	$1,435,000,000.00
12	Avangrid, Inc.	8-K	11/24/21	11/23/21	[Utilities]	[REV]	$4,000,000,000.00
13	Charah Solutions, Inc.	8-K	11/10/21	11/9/21	[Industrials]	[REV]	$30,000,000.00
14	Oncor Electric Delivery CLLC	8-K	11/9/21	11/9/21	[Utilities]	[REV]	$2,000,000,000.00
15	Dell Technologies Inc.	8-K	11/1/21	11/1/21	[Technology]	[REV]	$5,000,000,000.00
16	Essex Property Trust, Inc.	10-Q	10/27/21	9/30/21	[Real Estate][REIT]	[REV]	$1,200,000,000.00

17	Chart Industries, Inc.	10-Q	10/21/21	10/18/21	[Industrials]	[REV]	$1,000,000,000.00
18	Valmont Industries, Inc.	8-K	10/19/21	10/18/21	[Industrials][Prods]	[REV]	$800,000,000.00
19	Autodesk, Inc.	8-K	10/4/21	9/30/21	[Technology]	[REV]	$1,500,000,000.00
20	Ford Motor Co.	8-K	9/29/21	9/29/21	[ConsumerDiscretionary][Auto]	[REV]	$13,500,000,000.00
21	Ford Motor Co.	8-K	9/29/21	9/29/21	[ConsumerDiscretionary][Auto]	[REV]	$2,000,000,000.00
22	Physicians Realty Trust	8-K	9/28/21	9/24/21	[Real Estate][REIT]	[REV-LTD]	$1,000,000,000.00
23	UDR, Inc.	8-K	9/15/21	9/15/21	[Real Estate][REIT]	[REV][TERM]	$1,650,000,000.00
24	Portland General Electric Co.	8-K	9/14/21	9/10/21	[Utilities]	[REV]	$650,000,000.00
25	Evergy, Inc.	8-K	8/31/21	8/31/21	[Utilities]	[REV]	$2,500,000,000.00
26	PS Business Parks, Inc.	8-K	8/24/21	8/24/21	[Real Estate][REIT]	[REV]	$400,000,000.00
27	Cabot Corp.	10-Q	8/9/21	8/6/21	[Materials] [Chemicals]	[REV]	$1,000,000,000.00
28	Hawaiian Electrical Industries Inc.	10-Q	8/9/21	5/14/21	[Utilities]	[REV]	$200,000,000.00
29	Hawaiian Electrical Industries Inc.	10-Q	8/9/21	5/14/21	[Utilities]	[REV]	$175,000,000.00
30	Pinnacle West Capital Corp.	10-Q	8/5/21	5/28/21	[Utilities]	[REV]	$500,000,000.00
31	Pinnacle West Capital Corp.	10-Q	8/5/21	5/28/21	[Utilities]	[REV]	$500,000,000.00
32	Pinnacle West Capital Corp.	10-Q	8/5/21	5/28/21	[Utilities]	[REV]	$200,000,000.00
33	Vornado Realty Trust	10-Q	8/2/21	4/15/21	[Real Estate][REIT]	[REV]	$1,250,000,000.00
34	United States Steel Corp.	10-Q	7/30/21	7/23/21	[Materials][Steel]	[REV]	$350,000,000.00
35	United States Steel Corp.	10-Q	7/30/21	7/23/21	[Materials][Steel]	[REV]	$1,750,000,000.00
36	Easterly Government Properties, Inc.	8-K	7/29/21	7/23/21	[Real Estate][REIT]	[REV][TERM]	$650,000,000.00
37	Prudential Financial Inc.	8-K	7/29/21	7/28/21	[Financials]	[REV]	$4,000,000,000.00
38	S&P Global Inc.	10-Q	7/29/21	4/26/21	[Technology] [Services]	[REV]	$1,500,000,000.00

39	Tanger Factory Outlet Centers Inc.	8-K	7/14/21	7/13/21	[Real Estate][REIT]	[REV]	$500,000,000.00
40	First Industrial Realty Trust Inc.	8-K	7/13/21	7/7/21	[Real Estate][REIT]	[TERM]	$200,000,000.00
41	First Industrial Realty Trust Inc.	8-K	7/13/21	7/7/21	[Real Estate][REIT]	[REV]	$750,000,000.00
42	SB Communication Corp.	8-K	7/9/21	7/7/21	[Communications]	[REV]	$1,500,000,000.00
43	Phillips Edison & Company Inc.	8-K	7/2/21	7/2/21	[Real Estate][REIT]	[REV][TERM]	$980,000,000.00
44	Eastgroup Properties Inc.	8-K	7/1/21	6/29/21	[Real Estate][REIT]	[REV]	$425,000,000.00
45	Ingredion Inc.	8-K	7/1/21	6/30/21	[ConsumerStaples] [Food]	[REV]	$1,000,000,000.00
46	Micron Technology Inc.	10-Q	7/1/21	5/14/21	[Technology] [Semiconductors]	[REV]	$2,500,000,000.00
47	Micron Technology Inc.	10-Q	7/1/21	5/14/21	[Technology] [Semiconductors]	[TERM]	$1,190,000,000.00
48	Trane Technologies plc	8-K	6/24/21	6/18/21	[Industrials] [Electrical Equip]	[REV]	$1,000,000,000.00
49	Analog Devices, Inc.	8-K	6/23/21	6/23/21	[Technology] [Semiconductors]	[REV]	$2,500,000,000.00
50	Crown Castle International Corp.	8-K	6/22/21	6/18/21	[Real Estate][REIT]	[REV][TERM]	$7,000,000,000.00
51	LAM Research Corp.	8-K	6/21/21	6/17/21	[Technology][Semico nductors]	[REV]	$1,500,000,000.00
52	Boston Properties Inc.	8-K	6/16/21	6/15/21	[Real Estate][REIT]	[REV]	$1,500,000,000.00
53	Dominion Energy South Carolina, Inc.	8-K	6/10/21	6/9/21	[Utilities]	[REV]	$6,000,000,000.00
54	Dominion Energy, Inc.	8-K	6/10/21	6/9/21	[Utilities]	[REV]	$900,000,000.00
55	WellTower Inc.	8-K	6/8/21	6/4/21	[Real Estate][REIT]	[REV-LTD]	$4,000,000,000.00
56	HP Inc.	8-K	6/1/21	5/26/21	[Technology]	[REV]	$5,000,000,000.00
57	Cisco Systems, Inc.	8-K	5/14/21	5/13/21	[Technology]	[REV]	$3,000,000,000.00
58	Jabil Inc.	8-K	5/4/21	4/28/21	[Technology]	[REV]	$3,200,000,000.00
59	Kilroy Realty Corp.	10-Q	4/29/21	4/20/21	[Real Estate][REIT]	[REV]	$1,250,000,000.00

60	Montrose Environmental Group, Inc.	8-K	4/29/21	4/27/21	[Industrials][Eng]	[REV][TERM]	$300,000,000.00
61	American Homes 4 Rent	8-K	4/19/21	4/15/21	[Real Estate][REIT]	[REV]	$1,250,000,000.00
62	Apartment Income REICorp.	8-K	4/16/21	4/14/21	[Real Estate][REIT]	[REV][TERM]	$1,400,000,000.00
63	General Mills Inc.	8-K	4/15/21	4/12/21	[ConsumerStaples] [Food]	[REV]	$2,700,000,000.00
64	AECOM	8-K	4/13/21	2/8/21	[Industrials][Eng]	[REV-LTD]	$1,150,000,000.00
65	BlackRock Inc.	8-K	4/6/21	3/31/21	[Financials]	[REV]	$4,400,000,000.00
66	Evoqua Water Technologies Corp.	8-K	4/1/21	4/1/21	[Industrials] [Machinery]	[REV-LTD]	$350,000,000.00
67	Newmont Corp.	8-K	3/31/21	3/30/21	[Materials]	[REV]	$3,000,000,000.00
68	Alexandria Real Estate Equities Inc.	10-K	2/1/21	10/6/20	[Real Estate][REIT]	[REV]	$3,000,000,000.00
69	Flex Ltd.	8-K	1/13/21	1/7/21	[Technology]	[REV]	$2,000,000,000.00
70	Invitation Homes Inc.	8-K	12/9/20	12/8/20	[Real Estate][REIT]	[REV-LTD]	$1,000,000,000.00
71	Dorian LPG Ltd.	10-K	6/12/20	4/29/20	[Industrials][Trans]	[REV][TERM]	$180,805,698.24
72	JetBlue Airways Corp.	10-Q	5/8/20	2/20/20	[Industrials][Trans]	[REV]	$550,000,000.00
73	KIMCO Realty Corp.	8-K	3/2/20	2/27/20	[Real Estate][REIT]	[REV]	$2,000,000,000.00
74	NRG Energy, Inc.	10-Q	11/7/19	5/28/19	[Utilities]	[REV-LTD]	$2,600,000,000.00
75	Xylem Inc.	8-K	3/5/19	3/5/19	[Industrials] [Machinery]	[REV]	$800,000,000.00
76	Avangrid, Inc.	8-K	6/29/18	6/29/18	[Utilities]	[REV]	$2,500,000,000.00
77	CMS Energy Corp.	8-K	6/5/18	6/5/18	[Utilities]	[REV]	$550,000,000.00
78	CMS Energy Corp.	8-K	6/5/18	6/5/18	[Utilities]	[REV]	$850,000,000.00
						Total Amount:	**$145,265,805,698.24**

Table A.2: ESG Benchmarks & Type with Sample Provision Excerpts

ESG Benchmark	ESG Category	No. of Loan Agreements	Example(s)
DEITraining	Social	1	"[W]ith respect to calendar year 2021, (a) negative 2.5 basis points if a D&I Program has been established and documented or (b) positive 2.5 basis points if such D&I Program has not been developed, or if a copy of such D&I Program has not been delivered to the Administrative Agent. Whereas, with respect to any subsequent calendar year, it means (a) positive 2.5 basis points if the [*% of employee participants*] for such calendar year as set forth in the Sustainability Report is less than 85% for such calendar year, (b) zero basis points if the [*% of employee participants*] for such calendar year as set forth in the Sustainability Report is more than or equal to 85% for such calendar year but less than the 95% for such calendar year and (c) negative 2.5 basis points if the D&I Program Beneficiaries for such calendar year as set forth in the Sustainability Report is more than or equal to 95% for such calendar year." - Montrose Environmental Group, Inc.
EnviroInvest	Environmental	2	If "(ii) the Green Spending Performance is less than the Green Spending Target set forth in such Sustainability Certificate delivered in any applicable year, the Applicable Margin (as it may have been adjusted by any previous Sustainability Pricing Adjustment) shall be increased by 0.05 percentage points per annum

			for a period of four (4) consecutive fiscal quarters . . ." and if "(ii) the Green Spending Performance is equal or superior to the Green Spending Target set forth in such Sustainability Certificate delivered in any applicable year, the Applicable Margin (as it may have been adjusted by any previous Sustainability Pricing Adjustment) shall be decreased by 0.05 percentage points per annum for a period of four (4) consecutive fiscal quarters . . . ." "Green Spending Target" means "the lower of (i) $2,000,000 or (ii) $37,735 per fleet vessel spent on Green Spending Categories," including "investments in energy efficiency improvements, decarbonization, and other ESG related initiatives . . . ." - Eagle Bulk Shipping Inc
EquipmentEmissions	Environmental	3	The applicable interest rate and commitment fee will be adjusted by "(a) positive [Redacted] if the Ford Europe CO2 Tailpipe Emissions [*i.e., the average tailpipe emissions of Ford's European Fleet of passenger vehicles*] as set forth in the Sustainability Pricing Certificate is greater than the Neutral Threshold for such calendar year, (b) [Redacted] if the Ford Europe CO2 Tailpipe Emissions as set forth in the Sustainability Pricing Certificate is equal to or less than the Neutral Threshold and is greater than the Overperformance Target for such calendar year and (c) negative [Redacted] if the Ford Europe CO2 Tailpipe Emissions as set forth in the Sustainability Pricing Certificate is equal to or less than the Overperformance Target for

			such calendar year." - Ford Motor Co.
GenderDiversity	Social	8	The applicable interest rate will adjust by "(a) positive 0.025%, if the Women's Employment Rate for such fiscal year . . . is less than the Women's Employment Rate Threshold B for such fiscal year, (b) 0.000%, if the Women's Employment Rate for such fiscal year . . . is more than or equal to the Women's Employment Rate Threshold B for such fiscal year but less than the Women's Employment Rate Target B for such fiscal year, and (c) negative 0.025%, if the Women's Employment Rate for such fiscal year . . . is more than or equal to Women's Employment Rate Target B for such fiscal year." The "Women's Employment Rate" means "the ratio . . . of (i) the aggregate number of regular employees . . . on a global basis who identify as women . . . to (ii) the aggregate number of regular employees . . . on a global basis." - AECOM The applicable interest rate and commitment fee will be adjusted based in part on the Borrower reaching redacted threshold and target rates for its "Female Leadership Rate," which is the percentage of "the aggregate number of employees in a capacity as Director or Managing Director . . . on a global basis who identify as female [*as reported in*

			the SASB Aligned Report] as a component of 'the aggregate number of employees in a capacity as Director or Managing Director . . . on a global basis.'" - BlackRock Inc.
GenderInvest	Social	1	The applicable interest rate will be adjusted by "(a) a negative [*margin adjustment*] if the Diverse Supplier Spend for such calendar year is greater than the Diverse Supplier Spend Target for such calendar year, (b) zero basis points if the Diverse Supplier Spend for such calendar year is less than or equal to the Diverse Supplier Spend Target for such calendar year and greater than or equal to the Diverse Supplier Spend Threshold for such calendar year, and (c) a positive [margin adjustment], if the Diverse Supplier Spend for such calendar year is less than the Diverse Supplier Spend Threshold for such calendar year." "Diverse Supplier Spend" means . . . the percentage of Borrower spending with "Minority-owned, Woman-owned, LGBT+ owned, or Veteran-owned businesses, or business located in a Historically Underutilized Business Zone" as a component of the Borrower's "aggregate sourceable supply-chain spend." - Evergy, Inc.
GenderPay	Social	1	The applicable interest rate will be adjusted by "(a) positive 2.50 basis points, if the Gender Pay Equity Target for such fiscal year . . . is not met and (b) negative 2.50 basis points, if the Gender Pay Equity Target for such fiscal year . . . is met." The "Gender Pay Equity Target" means "the average annual earnings of

			employees . . . that identify as female is at least equal to the average annual earnings of employees . . . that identify as male at the same job level and performing similar work with similar experience." - Lululemon Athletica Inc.
GreenhouseGas	Environmental	35	the applicable interest rate will be adjusted by "(a) positive 0.05%, if each of the KPI 1, KPI 2 and KPI 3 for such period as set forth in the KPI Metrics Report is more than the KPI 1 Target A, KPI 2 Target B and KPI 3 Target C, respectively, for such period, (b) negative 0.05%, if each of the KPI 1, KPI 2 and KPI 3 for such period as set forth in the KPI Metrics Report is less than or equal to KPI 1 Target A, KPI 2 Target B and KPI 3 Target C, respectively, for such period and (c) 0.00% in all other instances." "KPI 1," "KPI 2," and "KPI 3" respectively mean the "Scope 1 Emissions," "Scope 2 Emissions," and "Scope 3 Emissions" as each are defined based on the "Science Based Targets" initiative. - S&P Global Inc.
GreenBuilding	Environmental	15	The applicable interest rate will be further discounted if "the Borrower delivers a [*certificate*] . . ., certifying that the Sustainability Metric... was no less than the Sustainability Metric Election Threshold." "Sustainability Metric" means the percentage of property measured in square footage that is "(a) LEED® and/or ENERGY STAR® certified or (b) the subject of a proprietary certification whose methodologies have been validated by either

			Green Business Certification, Inc. (GBCI) or the Center for Active Design (CfAD) (or a similarly recognized rating system)" as a component of total square footage of select property owned and controlled by Borrower. - Tanger Factory Outlet Centers, Inc.
RacialDiversity	Social	5	The applicable interest rate will be adjusted by "(a) positive 0.025%, if the Diversity and Inclusion Rate for such period . . . is less than the Diversity and Inclusion Rate Threshold B for such period, (b) 0.000%, if the Diversity and Inclusion Rate for such period . . . is less than the Diversity and Inclusion Rate Target B for such period but more than or equal to the Diversity and Inclusion Rate Threshold B for such period, and (c) negative 0.025%, if the Diversity and Inclusion Rate for such period . . . is more than or equal to Diversity and Inclusion Rate Target B for such period." The "Diversity and Inclusion Rate" means "the percentage of Black and African Americans among US-Based Executives at the Company." - HP, Inc. The applicable interest rate and commitment fee will be adjusted based in part on the Borrower reaching redacted threshold and target rates for its "Black, African American, Hispanic and Latino Employment Rate," which is the percentage of "the aggregate number of employees . . . in the United States who are Black, African American, Hispanic or Latino" [*as reported in the SASB Aligned Report*] as a component of "the aggregate number of

			employees . . . in the United States." - BlackRock Inc.
RacialInvest	Social	1	The applicable interest rate will be adjusted by "(a) a negative [*margin adjustment*] if the Diverse Supplier Spend for such calendar year is greater than the Diverse Supplier Spend Target for such calendar year, (b) zero basis points if the Diverse Supplier Spend for such calendar year is less than or equal to the Diverse Supplier Spend Target for such calendar year and greater than or equal to the Diverse Supplier Spend Threshold for such calendar year, and (c) a positive [margin adjustment], if the Diverse Supplier Spend for such calendar year is less than the Diverse Supplier Spend Threshold for such calendar year." "Diverse Supplier Spend" means the percentage of Borrower spending with "Minority-owned, Woman-owned, LGBT+ owned, or Veteran-owned businesses, or business located in a Historically Underutilized Business Zone" as a component of the Borrower's "aggregate sourceable supply-chain spend." - Evergy, Inc.
Recycling	Environmental	7	The applicable interest rate will be adjusted by "(a) positive 1.67 basis points if the Waste Diversion . . . is less than the Partially Successful Completion Threshold for such calendar year, (b) zero basis points if the Waste Diversion . . . is less than the Successful Completion Threshold and is greater than or equal to the Partially Successful Completion Threshold for such calendar year; and (c) negative 1.67 basis points

				if the Waste Diversion . . . is equal to or greater than the Successful Completion Threshold for such calendar year." "Waste Diversion" means the percentage of "hazardous and non- hazardous waste represented in kilograms diverted from landfill through on-site reuse, off-site reuse, recycling, composting, and recovery . . ." as a component of "total waste represented in kilograms." - Micron Technology Inc.
Redacted	N/A	2		
RenewableEnergy	Environmental	17		The applicable interest rate will be adjusted "(a) positive 2.00 basis points, if the Renewable Electricity for such fiscal year as set forth in the applicable KPI Metrics Report is less than the Renewable Electricity Target for such fiscal year and (b) negative 2.00 basis points, if the Renewable Electricity for such fiscal year as set forth in the applicable KPI Metrics Report is more than or equal to Renewable Electricity Target for such fiscal year." "Renewable Electricity" means the "percentage of Company['s] . . . total electricity consumption for all owned operations that is renewable electricity" - General Mills, Inc.

			The applicable interest rate will be adjusted "(i) negative 2.25 basis points if the Renewable Energy Usage for such Annual Period is greater than or equal to the Renewable Energy Usage Target for such Annual Period, (ii) 0 basis points if the Renewable Energy Usage for such Annual Period is greater than or equal to the Renewable Energy Usage Threshold and less than the Renewable Energy Usage Target for such Annual Period, and (iii) positive 2.25 basis points if the Renewable Energy Usage for such Annual Period is less than the Renewable Energy Usage Threshold for such Annual Period." "Renewable Energy" means "any type of electricity generation that does not directly emit carbon dioxide, including solar, wind, geothermal, hydropower, nuclear, sustainable biomass, and (to the extent all direct carbon dioxide emissions are captured) electricity generation that utilizes carbon capture and storage." – Analog Devices Inc.
SocialInvest	Social	2	The applicable interest rate will be adjusted by "(a) positive 1.25 basis points (1.25%) if the Social Impact for such fiscal year as set forth in the Sustainability Report is less than the Threshold A for such fiscal year, (b) zero basis points (0.0%) if the Social Impact for such fiscal year as set forth in the Sustainability Report is more than or equal to the Threshold A for such fiscal year but less than the Target A for such fiscal year, (c) negative 1.25 basis points (-1.25%) if the Social Impact for such fiscal year as set forth in the

			Sustainability Report is more than or equal to Target A for such fiscal year.” “Social Impact” means “number of individuals positively impacted” by “(a) social impact grants made by the Borrower and its subsidiaries and (b) the Borrower’s signature programs, each as calculated in good faith by the Borrower.” Positive impact includes addressing “food insecurity, economic empowerment, and education.” - Cisco Systems Inc.
Score	Environmental	2	“if the Fleet Sustainability Score... in any applicable year is equal to or less than the Fleet Sustainability Score . . . for the prior calendar year," the applicable interest rate “shall be decreased by five (5) basis points per annum;” and “if the Fleet Sustainability Score . . . in any applicable year is greater than the Fleet Sustainability Score . . . for the prior calendar year,” the applicable interest rate “shall be increased to the [*interest rate*] which would otherwise apply without giving effect to any Sustainability Pricing Adjustment . . . .” The “Fleet Sustainability Score” means the weighted average of the Vessel Sustainability Scores of all of the Borrower’s vessels, which is the “percentage difference between a vessel’s average efficiency ratio and the AER trajected value,” in each case as calculated using the Poseidon Principles and evidenced by a fleet carbon intensity certificate. - Dorian LPG Ltd.

	"[I]f at the end of any Fiscal Year the Borrower meets the Sustainability Metric Percentage for such Fiscal Year, then from and after the date the Parent or the Borrower provides to the Administrative Agent notice (including supporting calculations in reasonable detail) that the Sustainability Metric Percentage for such Fiscal Year was satisfied, the Applicable Margin shall decrease by one basis point (but not to below zero percent per annum) from the Applicable Margin that would otherwise be applicable; provided, however, that on each annual anniversary of such change to the Applicable Margin, the Applicable Margin shall revert to the original grid set forth above unless and until the Parent or the Borrower notifies the Administrative Agent that the Sustainability Metric Percentage for the immediately preceding Fiscal Year was satisfied." "Sustainability Metric Percentage" means "a 10% (ten percent) or more improvement in either (a) the overall raw score Sustainability Rating for the Borrower or (b) two or more subcategory Sustainability Rating scores for the Borrower." The "Sustainability Rating" means "the overall environmental score (or a subcategory of the environmental score, as applicable) within the E&S Disclosure Quality Score issued by Institutional Shareholder Services (ISS)." - Easterly Government Properties, Inc.

Score	ESG	15	"If (i) the Sustainability Rating Change [i.e., *percentage change of Sustainability Rating from year to year*] . . . shall be equal to or greater than five percent (5.0%) or (ii) the Sustainability Rating . . . shall be equal to or greater than 96," the applicable interest rate adjustment "shall be a one basis point reduction . . ."; and (b) if (i) the Sustainability Rating Change . . . shall be less than five percent (5.0%) or (ii) the Borrower shall have elected in its sole discretion to not report a Sustainability Rating Adjustment in the applicable Compliance Certificate," the applicable interest rate adjustment "shall be zero . . . ." "Sustainability Rating" means the "'GRESB Score,' as calculated and assigned to the Borrower from time to time by [GRESB, B.V., a wholly owned subsidiary of Green Business Certification, Inc.]" - Invitation Homes Inc.
			"(i) At any time the most recently published Sustainability Rating is 81 or higher (subject to clause (ii) below), the Spreads will be reduced by 0.025% at each Category; (ii) At any time the most recently published Sustainability Rating is 84 or higher, the Spreads will be reduced by 0.050% at each Category; (iii) At any time the most recently published Sustainability Rating is 75 or lower (subject to clause (iv) below), the Spreads will be increased by 0.025% at each Category; and (iv) At any time the most recently published Sustainability Rating is 72 or lower, the Spreads will be increased by 0.050% at each

			Category;" "Sustainability Rating" means "the overall score in respect of environment, social and governance factors (the ESG Score), as calculated and assigned to the Company from time to time by Sustainalytics B.V." - Xylem Inc.
WorkplaceSafety	Social	9	The applicable interest rate will be adjusted by "(a) an increase of 2.50 basis points if the DART Rate . . . is greater than the DART Rate Threshold for such calendar year, (b) no reduction or increase if the DART Rate . . . is less than or equal to the DART Rate Threshold for such calendar year and greater than or equal to the DART Rate Target for such calendar year, and (c) a reduction of 2.50 basis points, if the DART Rate . . . is less than the DART Rate Target for such calendar year." The "Dart Rate" means "the 3-year historical average of the Annual Dart Rate[--i.e., '(i) total number of [OSHA recordable workplace injur[ies] or illness[es]] times 200,000 divided by (ii) the total number of hours worked by all employees'--]for the three most recently completed calendar years." - ONCOR Electric Delivery Co LLC

Table A.3: Sustainability-Linked Pricing Adjustments

Interest Rate Adjustment	Adjustment Type	No. of Loan Agreements
5 bp (.05%)	Discount Only	2
5 bp (.05%)	Discount-Penalty	37
4 bp (.04%)	Discount-Penalty	5
4.5 bp (.045%)	Discount-Penalty	1
3 bp (.03%)	Discount-Penalty	1
2.5 bp (.025%)	Discount Only	2
2.5 bp (.025%)	Penalty Only	1
2.5 bp (.025%)	Discount-Penalty	2
2 bp (.02%)	Discount Only	1
2 bp (.02%)	Discount-Penalty	2
1 bp (.01%)	Discount Only	18
Redacted	Redacted	6

Commitment Fee Adjustment	Adjustment Type	No. of Loan Agreements
1 bp (.01%)	Discount Only	3
1 bp (.01%)	Discount-Penalty	33
.5 bp (.005%)	Discount-Penalty	2
No Adjustment	N/A	34
Redacted	Redacted	6

Table A.4: Effect of Nondisclosure of ESG Performance with Sample Provision Excerpts

Consequence	No. of Loan Agreements	Example(s)
penalty rate	39	Section 2.24(c): "In the event the Company fails to deliver a Pricing Certificate in accordance with Section 5.01(c) with respect to a particular fiscal year, the Sustainability Rate Adjustment will be positive 0.05% and the Sustainability Commitment Fee Adjustment will be positive 0.01%, commencing on the last day such Pricing Certificate could have been delivered pursuant to such Section and continuing until the Company delivers a Pricing Certificate to the Administrative Agent for the applicable fiscal year." Section 5.1(c): "[F]or any fiscal year the Company may elect not to deliver a Pricing Certificate, such election shall not constitute a Default or Event of Default (but such failure to so deliver a Pricing Certificate by the end of such 240-day period shall result in the Sustainability Rate Adjustment and the Sustainability Commitment Fee Adjustment being applied as set forth in Section 2.24(c))" - Hewlett Packard Enterprise Co.
original rate	31	"[I]f . . . the Parent shall have elected in its sole discretion to not report an Applicable Sustainability Adjustment in the applicable Compliance Certificate, then the Applicable Sustainability Adjustment for such Sustainability Adjustment Period shall be zero and there shall be No Applicable Sustainability Adjustment to the Applicable Margin for Revolving Loans" - SL Green Realty Corp "Notwithstanding the foregoing, to the extent that the Borrower does not exercise its right to apply the Sustainability Adjustment Amount prior to December 31, 2021 (or any later date as agreed by the Required Revolving Lenders), with respect to the Revolving Credit Facility, the Applicable Rate shall be determined as set for in clause (b) of the definition thereof." - Evoqua Water Technologies Corp.
Redacted	7	
N/A	1	