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Dear Head of Sustainable Finance,

The sustainability-linked loans market - two years on

The FCA's Strategy 2025-2030 sets out our role in deepening trust in financial services and supporting economic growth. A crucial aspect of this is unlocking the sector's potential to channel capital into managing the risks and opportunities of the transition to net zero. The Government's Financial Services Growth and Competitiveness Strategy suggested the transition could present opportunities of up to £200bn for the UK's financial services sector by 2030. The Government-commissioned Transition Finance Market Review (TFMR) also noted there would need to be an additional capital investment of approximately £50–60bn annually to deliver the UK's net zero target by 2050. The TFMR noted our role in ensuring the market for transition finance scales with integrity.

In 2023, we reviewed the sustainability-linked loans (SLL) market[1], where we identified weaknesses in market integrity, credibility, incentives and conflicts of interest. Since then, we have welcomed constructive engagement with banks active in this market. Two years on, as part of being a smarter regulator, we want to share insights from those ongoing engagements. This is intended to help a wider group of firms in the SLL market learn from both the experience of others and our observations.

Since 2023, we have seen the market for SLLs mature, with better practice and more robust product structures, despite apparent headwinds faced by the market. There are still barriers to scaling the SLL market and concerns about incentives, but the improvements we observed are important steps in the development of a credible transition finance ecosystem.

Raising standards can help establish SLLs as a viable instrument to support borrowers' sustainability objectives, even if it may reduce

[1] In the UK, SLLs are typically used for general corporate purpose financing and often take the form of revolving credit facilities. Many are syndicated loans across a number of participating banks.

volumes in the near term by filtering out poorly structured SLLs. We consider SLLs to be an important part of a bank's transition finance toolkit. They are increasingly used to complement other instruments, whether sustainability-linked or use-of-proceeds. They can play an important role in supporting clients to improve their overall sustainability performance, including those operating in high-emitting or hard-to-abate sectors.

Market integrity and credibility

Developments observed since 2023

We had previously observed weaknesses in the structuring of SLLs, with some key performance indicators (KPIs) and sustainability performance targets (SPTs) being poorly designed and of low ambition. Our ongoing monitoring indicates KPIs are now generally of greater relevance and alignment to a borrower's business model. The market has shifted from numerous, disjointed SPTs to two or three core SPTs that are material and strategically significant to a borrower's business model.

We also note an increasing prevalence of multiple sustainability coordinators across syndicated SLLs. Where the roles and responsibilities of each coordinator are clearly defined, stakeholders have seen greater scrutiny of KPIs and SPTs at the structuring stage. Active debate within a larger forum appears to provide opportunities to more robustly challenge the ambition of a borrower's SPTs. Stakeholders have suggested this contributes to more stretching SPTs and greater coherence with a borrower's business model.

Even where a lender is not a structuring agent, we are aware of banks engaging bilaterally to support a borrower in setting more stretching targets, both through engagement on existing loans and at the point of refinancing. This can help shape and support a borrower in setting, monitoring and conveying their own transition journey. Banks appear to value the role SLLs can play as an important strategic tool, facilitating deeper engagement between borrower and lender on long-term investment plans.

However, where a borrower may breach the sustainability-linked terms of the loan agreement, or the loan itself no longer meets banks' criteria of an SLL, we have also observed banks using declassification as a sanction, albeit infrequently. The fact that banks are now prepared to declassify SLLs tells us that standards have been raised, and banks are willing to exert the full range of measures to maintain higher standards.

Many banks cite the Loan Market Association's (LMA) Sustainability-Linked Loan Principles (SLLPs) as having raised baseline standards in the market.

Regular updates to these principles, notably those published in March 2025, provide clarity on SLL criteria as the market continues to evolve. We also welcome industry efforts since 2023 to build on existing standards and guidance, including the recently published Financial Markets Standards Board's (FMSB) [Governance of Sustainability-Linked Products Statement of Good Practice].

Emerging developments

We are encouraged by the positive action to raise standards within the SLL market. However, a lack of clarity in banks' articulation of how they account for SLLs in their sustainable financing targets can leave them exposed to reputational risks and reduce trust in the SLLs they offer.

Although we do not prescribe how SLLs should be classified within banks' sustainable financing targets, we have observed different approaches in the way banks explain if and how they count SLLs within those targets. We have observed some banks including SLLs in their targets by default. By contrast, some have eligibility criteria based on features of a borrower, while others apply exclusions based on a list of predetermined activities, sectors or other characteristics. A small number of the banks we have engaged with do not include SLLs as part of their financing targets at all. Typically, these banks tend to have narrower, more specific 'climate' or 'green' financing targets. While we do not dictate how banks set sustainable financing targets, it is important that they can clearly articulate and demonstrate how and why SLLs feature within those targets.

The banks we have engaged with could point to a clear framework governing what counts towards their sustainable financing targets and where SLLs may be eligible. Some banks have public documents articulating how and where SLLs qualify as part of their sustainable financing targets. We have observed an increase in the number of banks that have developed or are developing a transition finance framework, to more clearly distinguish transition financing from green, climate or sustainable financing. Some evolution of these targets is expected as the market develops.

Incentives and conflicts of interest

Developments observed since 2023

Clarity around frameworks and targets is important. We had previously noted that banks seemed keen to promote SLLs, incentivised by achieving sustainable financing targets. This approach of prioritising the product over client readiness had appeared to threaten the integrity of the market.

We have analysed a sample of banks' current lending frameworks and origination processes. We have seen that banks typically take steps to assess a client's suitability for an SLL based on their overall sustainability profile. This suggests a shift towards a more client-focused approach, promoting SLLs when a client is deemed ready.

We know that some banks have declined to support clients in structuring SLLs. This tends to occur when banks consider the proposed targets unambitious or immaterial to a borrower's business model. We also know that some banks subsequently work with those clients to ensure that future financing can meet the bank's or syndicate's criteria for SLLs. We have also observed that deals teams and relationship managers are typically not involved in assessing eligibility of an SLL towards a bank's financing target. Nevertheless, given the significance of syndicated credit facilities in relationship lending, and the potential for client relationships to disproportionately drive a bank's decision to provide an SLL to a client, we would encourage banks to remain alert to potential conflicts of interest.

In 2023, we had also observed that the incentives for a borrower to use an SLL may be low. This was attributed to the marginal benefits on borrowing costs for meeting SPTs being outweighed by the costs of developing and complying with a reporting framework. Pricing ambitiousness also remains a challenge, as the margins for meeting or missing SPTs continue to be de minimis. Borrowers were also concerned about potential reputational risks, particularly the heightened scrutiny that comes with the disclosure of missed SPTs.

Since 2023, we know there have been borrowers who, despite having missed their SPTs, have sought to retain their SLL structure upon refinancing. This tends to be more prevalent among frequent issuers of sustainability-linked products, as they are more likely to have integrated these instruments into their wider sustainability strategy. As we suggested in 2023, more missed targets may indicate that the market is maturing, with SLLs serving their purpose of tying borrowers to ambitious targets. Where SPTs are ambitious, we would expect to observe some instances of borrowers not meeting them and this should not unequivocally be regarded as failure. Where SPTs are not sufficiently ambitious, however, this has the potential to undermine the credibility of the SLL market.

Emerging developments

There are still barriers preventing some borrowers from using SLLs. The costs of developing an internal reporting framework, acquiring mandatory external assurance and the large loan sizes required, have all been cited as persistent factors preventing small to medium enterprises (SMEs) from financing through SLLs. We encourage banks to continue to support clients in developing the capacity, should they seek to commit to sustainability improvements through an SLL.

It is important that banks maintain high standards in how they govern their provision of SLLs. As expected, we have observed different frameworks, policies and processes within different banks. Broadly, we have observed clear understanding and practical application of these, with strong collaboration between teams across business lines. Some banks use internal toolkits and scorecards to ensure teams adhere to frameworks, policies and processes consistently. Some banks have also been able to show us systems and processes for monitoring KPIs. This supports the structuring of SLLs, providing the first line with insights to inform and support client engagement, particularly around the ambitiousness of SPTs. This also allows for portfolio and sector level analyses so that the second line can determine whether sufficiently robust challenge is taking place. Post-transaction monitoring can be used to inform self-assessments of existing approaches, ensuring internal frameworks, policies and processes evolve to account for best practice.

It is important that banks have clear governance and escalation processes in place for sustainability-linked instruments. There appears to be appropriate levels of specialist support in discussions over sustainability-linked financing. Some banks have end-to-end systems that consolidate information across their sustainability-linked exposures to a borrower, supported by robust governance forums with clear channels for escalation. This is helpful for ensuring consistency in decision-making, which we recognise is important as sustainability characteristics may be idiosyncratic and often require judgement.

Next steps

We will work closely with the Transition Finance Council (TFC) as it drives forward the TFMR's recommendations to promote the competitive position of the UK as a transition finance hub. Likewise, we encourage banks to engage collaboratively with the TFC's and LMA's work, to build alignment in approaches to transition finance and deepen trust in the instruments used. We will continue to monitor the market, and welcome feedback and engagement on the matters raised in this letter.

Yours sincerely,

Sacha Sadan
Director of Sustainable Finance
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